BANKRUPTCY UPDATE
Cumulative, through July 2013

Compilation of Recent Developments in Bankruptcy Law

(Covering cases reported through 491 B.R. 306 and 712 F.3d 924)

CRAVATH, SWAINE & MOORE LLP

Richard B. Levin
Cravath, Swaine & Moore LLP
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
(212) 474-1978
rlevin@cravath.com

This update relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.

1. AUTOMATIC STAY 1
1.1 Covered Activities 1
1.2 Effect of Stay 27
1.3 Remedies 29

2. AVOIDING POWERS 34
2.1 Fraudulent Transfers 34
2.2 Preferences 68
2.3 Postpetition Transfers 107
2.4 Setoff 114
2.5 Statutory Liens 121
2.6 Strong-arm Power 122
2.7 Recovery 132

3. BANKRUPTCY RULES 149

4. CASE COMMENCEMENT AND ELIGIBILITY 166
4.1 Eligibility 166
4.2 Involuntary Petitions 176
4.3 Dismissal 184

5. CHAPTER 11 PLANS 190
5.1 Officers and Administration 190
5.2 Exclusivity 213
5.3 Classification 213
5.4 Disclosure Statements and Voting 215
5.5 Confirmation, Absolute Priority 221

6. CLAIMS AND PRIORITIES 251
6.1 Claims 251
6.2 Priorities 290

7. CRIMES 323

8. DISCHARGE 324
8.1 General 324
8.2 Third Party Releases 335
8.3 Environmental and Mass Tort Liabilities 340

9. EXECUTORY CONTRACTS 342

10. INDIVIDUAL DEBTORS 376
10.1 Chapter 13 376
10.2 Dischargeability 382
10.3 Exemptions 395
10.4 Reaffirmation and Redemption 399

11. JURISDICTION AND POWERS OF THE COURT 400
11.1 Jurisdiction 400
11.2 Sanctions 445
11.3 Appeals 448
11.4 Sovereign Immunity 472

12. PROPERTY OF THE ESTATE 481
12.1 Property of the Estate 481
12.2 Turnover 518
12.3 Sales 520

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS 534
13.1 Trustees 534
13.2 Attorneys 546
13.3 Committees 574
13.4 Other Professionals 579
13.5 United States Trustees 590

14. TAXES 591

15. CHAPTER 15—CROSS-BORDER PROCEEDINGS 600

Recent Developments in Bankruptcy Law

Cumulative, through July 2013
by Richard B. Levin, Esq.
© 2007–2013 Cravath, Swaine & Moore LLP

1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a. Automatic stay may apply to nondebtor. The debtor in possession moved for an order that the automatic stay applied to a creditor's action against the debtor's parent and affiliates. The court denied the motion as a matter of law, without factual findings on the proceeding's effect on the estate. The automatic stay applies to "the commencement or continuation … of a judicial … proceeding against the debtor" and to any "act to obtain possession of property from the estate or to exercise control over property of the estate." It therefore normally does not apply to a proceeding against a nondebtor. However, the stay may apply to a proceeding against a nondebtor if the claim asserted in the proceeding will have an immediate adverse economic consequence for the estate. The Court of Appeals therefore remands to the district court to determine the proceeding's effect. *In re Residential Capital, LLC*, ___ Fed. Appx. ___, 2013 U.S. App. LEXIS 1418 (2d Cir. July 15, 2013).

1.1.b. Automatic stay may apply to nondebtor. Before bankruptcy, a bond insurer brought an action against the debtor and the bond underwriter for fraud in issuing the bonds and obtaining the insurance. A second insurer brought an action related to another bond issue but named only the underwriter, alleging the same material facts. In the second action, the underwriter filed a third-party claim against the debtor for indemnification under the underwriting agreement. The automatic stay applies to "the commencement or continuation … of a judicial … proceeding against the debtor." The stay's purpose is to provide the debtor a breathing spell. Courts look to this purpose when applying the stay to nondebtors, so that an action against a nondebtor is subject to the stay where there is such a close identity of interest with the debtor, or the claims against each as so inextricably linked, that a judgment would effectively be against the debtor. An uncontested or absolute indemnification right is sufficient but not necessary to make the link. Here, the debtor's indemnification obligation, the identical nature of the two actions and the underwriter's third-party claim against the debtor show that the claims against the underwriter and the debtor are completely linked so that a judgment in the second action would in effect be a judgment against the debtor. In addition, the stay applies to any "act to obtain possession of property from the estate or to exercise control over property of the estate." An action that has an adverse effect on property of the estate is an attempt to obtain property of the estate indirectly and is therefore subject to the stay. The second action effectively seeks a determination of the debtor's liability and so would have an adverse effect on property of the estate. For these reasons, the automatic stay applies to the second action against the underwriter, even though the plaintiff did not name the debtor as a defendant in the action. *In re Jefferson County, Ala.*, 491 B.R. 277 (Bankr. N.D. Ala. 2013).

1.1.c. Automatic stay does not prevent enforcement of trial subpoena against the debtor. The debtor was a co-defendant in state court litigation. Before bankruptcy, the plaintiff served a trial subpoena on him. When the debtor filed his bankruptcy petition, the plaintiff severed him from the state court case but still insisted that he testify. Section 362(a)(1) stays "the commencement or continuation, including the issuance or employment of process … to recover a claim against the debtor …." Enforcement of a trial subpoena against a debtor who has been severed from the action runs the risk of requiring the debtor to employ counsel to represent him to ensure that the testimony does not adversely affect him in a later proceeding, for example, to determine dischargeability. However, where the plaintiff seeks the debtor's testimony to pursue the case against the other defendants and not primarily to build a case against the debtor, the automatic stay does not by its terms apply. A bankruptcy court may enjoin enforcement of a subpoena, but the burden rests on the debtor to seek an injunction, not on the other party to seek stay

relief to enforce the subpoena. *Kenoyer v. Cardinale (In re Kenoyer)*, 489 B.R. 103 (Bankr. N.D. Cal. 2013).

1.1.d. The automatic stay does not protect property that has been fraudulently transferred. The debtor contracted with an investor to develop wind power projects. The contract required the investor, upon commercial operation, to pay 75% of the projects' purchase price to the debtor and 25% to an advisor. The debtor transferred the development contract to an affiliate without consideration. It later filed bankruptcy. The debtor's bankruptcy trustee sued the affiliate and the advisor to avoid as a fraudulent transfer and recover the transfer of the contract and therefore the right to the purchase price. After commercial operation, the affiliate and the advisor sued the investor in state court for the purchase price. The state court issued judgment against the investor but, based on the trustee's notice of bankruptcy, ordered the payment to be deposited with the bankruptcy court. The state court then transferred the issue of whether the judgment was part of the bankruptcy estate to the bankruptcy court. The affiliate and the advisor successfully removed the action to the district court, where the trustee's fraudulent transfer action was pending. The district court consolidated the two actions. Over the trustee's opposition that the payment was property of the estate to which the automatic stay applied, the affiliate and the advisor obtained an order from the district court requiring distribution to them of the investor's payment. Section 541(a)(1) includes as property of the estate "all legal or equitable interests of the debtor in property as of the commencement of the case", and section 541(a)(3) includes "Any interest in property that the trustee recovers under section … 550 … of this title." Section 541(a)(3) includes property only once the trustee has recovered it. Section 541(a)(1) does not include fraudulently transferred property in which the debtor has divested itself of any interest unless the debtor retains an equitable interest to protect creditors. An equitable interest in property is a beneficial interest that gives the holder the right to acquire legal title. A trustee cannot acquire equitable title to property, which the automatic stay would protect, merely by alleging that the property was fraudulently transferred. Such a rule would infringe the transferee's title without due process. The statute does not suggest such a broad reading of section 541(a)(1). Therefore, the investor's payment was not property of the estate. *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013).

1.1.e. Right to enforce automatic stay may be lost by laches. The debtor operated a Ponzi scheme. Investors in the scheme included various investment funds. The state attorney general sued an investment manager of one of those funds on behalf of fund investors, for violation of state laws. The trustee sued the manager and the funds to avoid and recover voidable transfers. Six months after learning of the attorney general's suit, the trustee informed the attorney general that he would seek to enjoin the action on the ground that the manager's funds derived from property of the debtor, that the manager's funds were therefore property of the estate and that the settlement therefore violated the automatic stay as an attempt to exercise control over property of the estate, unless the attorney general agreed to turn over any recovery to the bankruptcy estate. After some preliminary correspondence, the attorney general invited the trustee to negotiate a resolution of the stay dispute, but the trustee failed to respond for a year, after which the trustee again threatened to sue but did not sue. During the three years after the trustee's initial contact, the attorney general's litigation proceeded, with extensive discovery and summary judgment motions, and the trustee separately negotiated with the investment manager and the funds over settling his own action. In those negotiations, the manager told the trustee that it would not settle with the attorney general without a settlement with the trustee, but ultimately did. When the attorney general finally agreed to a settlement with the investment manager under which the manager would make a substantial payment to the attorney general, the trustee sued to enjoin the settlement. A defendant may assert laches as a defense if the plaintiff has inexcusably delayed bringing the action, to the defendant's prejudice. The trustee waited over three and a half years to seek to enjoin the attorney general's litigation, periodically threatening to sue but never doing so until the end. During that time, the attorney general incurred substantial expense and devoted substantial resources to prosecuting the action against the manager. The trustee is guilty of laches, which warrants dismissal of the action to enforce the automatic stay. *Secs. Investor Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 55670 (S.D.N.Y. Apr. 15, 2013).

1.1.f. 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.g. 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 for 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.h. 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.i. 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.j. 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.*, 484 B.R. 427 (Bankr. N.D. Ala. 2012).

1.1.k. Automatic stay does not apply to contempt injunction. The debtor operated a restaurant in violation of trademark rights. The trademark owner sued to enjoin the infringement. The court granted an injunction against use of the mark. The debtor violated it. Upon a civil contempt motion, the court issued a further injunction against operation of a restaurant as a contempt sanction. The debtor filed bankruptcy. The automatic stay applies to commencement or continuation of a judicial proceeding against the debtor that was commenced before the bankruptcy case. It does not, however, protect a debtor's tortious uses of property of the estate nor from violating a nonbankruptcy court's order (other than for the payment of money). Because application of the automatic stay would not permit the debtor to continue his tortious infringement of the trademark owner's mark, it does not apply to the nonbankruptcy court's injunction against operating the restaurant. *Dominic's Restaurant of Dayton, Inc. v. Mantia*, 683 F.3d 757 (6th Cir. 2012).

1.1.l. Action against debtor's property improvement district is not subject to the automatic stay. The debtor owned undeveloped real property, subject to a mortgage in favor of the bank. Before bankruptcy, the debtor had formed a property improvement district, which is a separate municipal entity that state law authorizes to borrow money secured by tax revenues on the real property, to construct infrastructure, such as roads, utilities and sewers. After bankruptcy, the bank sought to sue the improvement district in state court to challenge the validity of its formation and sought an order from the bankruptcy court that the action did not violate the automatic stay in the debtor's case. The existence of an improvement district and its ability to finance infrastructure development can enhance property's value. The automatic stay prohibits an act to obtain possession of property of the estate or to exercise control

over property of the debtor or estate. Here, the improvement district, as a separate legal entity that the debtor does not control, is not property of the debtor, so the bank's action against the district is not an act to obtain possession of or exercise control over property of the debtor. Although an invalidation of the improvement district would adversely affect the value of the estate's real property, merely having a possible effect on value is insufficient to bring the act within the automatic stay's scope. Rather, the judgment against the third party must be in effect a judgment against the debtor for the stay to apply. Here, the incidental effect on value that the action might have is insufficient. Therefore, the stay does not apply. *Nat'l Bank of Ark. v. In re Panther Mtn. Land Devel., LLC (In re Panther Mtn. Land Devel., LLC)*, 686 F.3d 916 (8th Cir. 2012).

1.1.m. Police and regulatory exception applies to action that private party commences. The debtor operated wireless service under a wireless license granted by the FCC. Several wireline carriers initiated actions before various state PUCs complaining that the debtor was in fact operating a wireline service and, in doing so, violating either state regulatory law or an interconnection agreement with the wireline carrier. In most of the PUC proceedings, the PUC staff becomes a party to the proceedings, and some of the actions are similar to those that the PUC itself might initiate. Section 362(b)(4) excepts from the automatic stay, "the commencement or continuation of an action or proceeding by a governmental unit … to enforce such governmental unit's police and regulatory power". This exception includes a proceeding that is not commenced by a governmental unit but is continued by a governmental unit, such as the participation in the proceedings by the PUC staffs. Therefore, the proceedings may be excepted from the automatic stay, even though not "commenced" by a governmental unit. *Halo Wireless, Inc. v. Alenco Comm'ns Inc. (In re Halo Wireless, Inc.)*, 684 F.3d 583 (5th Cir. 2012).

1.1.n. State PUC proceeding to enforce interconnection agreement is within the police and regulatory power exception to the automatic stay. The debtor operated wireless service under a wireless license granted by the FCC. Several wireline carriers initiated actions before various state PUCs complaining that the debtor was in fact operating a wireline service and, in doing so, violating either state regulatory law or an interconnection agreement (ICA) with the wireline carrier. In most of the PUC proceedings, the PUC staff becomes a party to the proceedings, and some of the actions are similar to those that the PUC itself might initiate. Section 362(b)(4) excepts from the automatic stay "the commencement or continuation of an action or proceeding by a governmental unit … to enforce such governmental unit's police and regulatory power". A proceeding comes within the exception if it does not primarily seek to protect a pecuniary governmental interest, as opposed to the public safety and health and attempts to effectuate public policy rather than adjudicate private rights. The PUCs' role in ensuring that ICA rates are just and reasonable and that there is nondiscriminatory access to telecommunications services are public purposes and meet the public policy test. By limiting the PUCs' ability to enforce any monetary judgment, the bankruptcy court ensures that the proceedings meet the pecuniary purpose test. Therefore, the police and regulatory exception to the automatic stay applies. *Halo Wireless, Inc. v. Alenco Comm'ns Inc. (In re Halo Wireless, Inc.)*, 684 F.3d 583 (5th Cir. 2012).

1.1.o. Automatic stay applies to creditor's unjust enrichment action against debtor's bank to prevent double recovery. The debtor ran a fraudulent scheme that involved moving money between bank accounts. The trustee sued the bank as a fraudulent transferee. One investor claimed that it could trace its investment through the debtor's accounts. The investment was the subject of the trustee's fraudulent transfer action. The investor sued the bank on an unjust enrichment theory. Fearing double liability for the same transfer, the lender asked the bankruptcy court to apply the automatic stay against the investor to prohibit the investor from proceeding with the unjust enrichment action. The bank, because of the double liability risk, has a sufficient personal stake in the matter to have standing to seek to enforce the automatic stay. The automatic stay applies only to actions that belong to the estate, not to actions that only a creditor may bring. The stay applies to "any act … to recover a claim against the debtor". A creditor's fraudulent transfer action seeks to recover a claim against the debtor and is therefore stayed. An unjust enrichment action, as well as a constructive trust action, shares this quality with a creditor's fraudulent transfer action. It is an effort to recover a claim against the debtor, rather than to redress harm the bank caused the investor. The stay therefore applies. *Meoli v. The Huntington Nat'l Bank (In re Teleservices Group, Inc.)*, 463 B.R. 28 (Bankr. S.D. Mich. 2012).

1.1.p. Automatic stay applies to, and court may properly enjoin, creditor's common law action that duplicates estate's fraudulent transfer action. The trustee sued a Ponzi scheme transferee in bankruptcy court to recover a fraudulent transfer. Investors brought tort claims against the same transferee in state court, asserting damages to them from the transferee's participation in the Ponzi scheme. The investors' action alleged the same operative facts as in the trustee's complaint, although they sought different damages from the defendant. The harm for which the investors sought damages was harm that all of the debtor's creditors had been suffered in the same way. Any creditor could have brought the action. The automatic stay enjoins any act to exercise control over property of the estate or to collect or recover on a claim against the debtor. The trustee's fraudulent transfer claims were property of the estate, and the investors' action against the transferee was to collect on their claims against the debtor. In essence, the state court claims duplicate the trustee's fraudulent transfer claims and therefore violate the stay. Finally, the investors' action also harms the trustee more directly by creating a double liability risk for the transferee, thereby impeding the trustee's efforts to reach a settlement on the fraudulent transfer claim. An injunction enforcing the stay is appropriate. *Fox v. Picard (In re Bernard L. Madoff Inv. Secs. LLC)*, 848 F. Supp. 2d 469 (S.D.N.Y. 2012).

1.1.q. Enforcement of a condominium association by-law provision that denies voting rights to a delinquent debtor violates the automatic stay. The debtor real estate developer owned about 20% of the units in a condominium development. The condominium association asserted assessment claims against the debtor with respect to only one of the debtor's units. The debtor disputed the assessment. After a state court judgment against the debtor for the assessment, the debtor filed a chapter 11 case. An association by-law denies a delinquent unit holder the right to vote at a unit-holders meeting. Through canceling several annual unit-holder meetings, the association board effectively denied the debtor the ability to vote at the annual meeting. The court construes the denial as an attempt to enforce the by-law provision. The automatic stay prohibits any act to collect a prepetition debt. Denial of the vote may be designed to pressure a delinquent unit-holder to pay a delinquent assessment. Based on the debtor's voting power and the history between the debtor and the board, the court concludes that the meeting cancellation is an attempt to enforce the by-law provision and therefore violates the stay. *Gordon Props., LLC v. First Owners Assoc. of Forty Six Hundred (In re Gordon Props., LLC)*, 460 B.R. 681 (Bankr. E.D. Va. 2011).

1.1.r. Declaratory action against the trustee to determine avoidability of a transfer violates the automatic stay. The trustee brought an action to recover voidable transfers from the initial transferee and from its related subsequent transferee. The subsequent transferee then brought an action in the Grand Court of the Cayman Islands for a declaration that it was not liable to the trustee. The automatic stay applies to "any act to obtain possession of … or to exercise control over property of the estate". Property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case" "wherever located and by whomever held". It includes any cause of action the debtor had on the petition date as well as avoidance actions. By bringing the Cayman action, the subsequent transferee sought to control the avoiding power action by interfering with the trustee's ability to choose the forum in which to litigate it. The foreign action "seeking declaratory relief from a debtor's claim" therefore violates the automatic stay. *Picard v. Maxam Absolute Return Fund, L.P. (In re Bernard L. Madoff Inv. Secs., LLC)*, 460 B.R. 106 (Bankr. S.D.N.Y. 2011).

1.1.s. Court enjoins pension trustee's participation in U.K. pension funding proceeding against U.S. debtor. U.S. debtors were part of a multinational, Canadian-based corporation that also had significant subsidiaries and operations in the United Kingdom. The Canadian parent and the U.S. and U.K. subsidiaries all commenced insolvency proceedings in their respective jurisdictions on the same day, and all three courts granted recognition to the other proceedings. After the bankruptcy and insolvency proceedings were commenced, the U.K. pension regulator determined that the U.K. debtors' pension plans were substantially underfunded as of a date approximately six months before bankruptcy and insolvency proceedings and issued a "Warning Notice" of intent to issue a "financial support directive" (FSD) against the U.S. and Canadian affiliates to contribute to the U.K. pension trust fund. The pension trustees and the U.K. Pension Protection Fund filed proofs of claim in the U.S. chapter 11 cases for a portion of the underfunding deficiency. The automatic stay enjoins any act to assess a claim that could have been brought before bankruptcy. Courts use two tests to determine whether section 362(b)(4)'s exception for a proceeding by a governmental unit to enforce its police or regulatory power applies: whether the proceeding

has a public health and safety, rather than a pecuniary, purpose and whether it is taken in furtherance of a public policy and not to adjudicate private rights. The exception should not be construed broadly where the governmental unit is a foreign regulator, because the bankruptcy court cannot easily enjoin foreign proceedings. Although the pension regulator that conducts the proceeding is a foreign governmental unit, the pension trustee and the Pension Protection Fund, which insures workers' pensions, are private parties seeking adjudication of their rights against the debtor and do not qualify for the exception. The FSD proceeding addresses only a financial shortfall in pension funding, not any public health or safety issues, and its purpose is not to protect safety or welfare but only to adjudicate the private rights of the pension trust and the Pension Protection Fund. It is unnecessary in this case to decide whether both tests must be met for the exception to apply, because the proceeding fails both tests. Therefore, it does not meet any of the police or regulatory exception requirements, and the court enjoins the pension trustee and the Pension Protection Fund from participating in the FSD proceeding. *Trustees of Nortel Networks U.K. Pension Plan v. Nortel Networks Inc. (In re Nortel Networks Inc.)*, 669 F.3d 128 (3d Cir. 2011).

1.1.t. Section 362(b)(4) does not protect a collection action receiver. The municipal debtor had issued revenue bonds, secured by a pledge of the net revenues of the debtor's sewer system. The debtor defaulted in payments. The indenture trustee sought and obtained the appointment of a state court receiver, as provided in the indenture, to take possession of and operate the system, collect revenues, set rates and pay net revenues to the indenture trustee for distribution to bondholders. Upon the debtor's filing its chapter 9 case, the receiver moved for the bankruptcy court to abstain from taking any action to interfere with the receivership. Section 362(b)(4) excepts from the automatic stay an action by a governmental unit to enforce its police or regulatory power. Property that is subject to a receivership is in the custody of the receivership court, and a receiver takes possession only as an officer of the appointing court. Although the receivership court might be considered a governmental unit, the receiver, which holds the property only for the receivership court, is not. 28 U.S.C. § 1334(e) gives the bankruptcy court exclusive in rem jurisdiction over all property of the debtor as of the commencement of the case. The bankruptcy court's exclusive jurisdiction places the property in the custody of the bankruptcy court, ousting the receivership court of control and the receiver of possession. When the bankruptcy filing dispossesses the receivership court (and therefore the receiver), no property of the debtor remains within that court's jurisdiction for purposes of enforcing the police or regulatory power. *In re Jefferson County, Ala.*, 474 B.R. 228 (Bankr. N.D. Ala. 2012).

1.1.u. Automatic stay prohibits attachment of a lien for unpaid municipal utility expenses. The Wisconsin municipal utility statute provides that, through a procedure initiated each year on October 15, an unpaid municipal utility bill "will be levied as a tax" on November 15 against the real property to which utility services were provided, and the amount will appear on the next property tax bill as a "special charge". The debtor owed substantial sums to its municipal utility when it filed chapter 11 on June 30. On October 15, the utility sent the debtor in possession a letter advising it that the unpaid amounts would become a lien against the debtor's real property if they remained unpaid after October 30. The automatic stay prohibits "any act to create, perfect or enforce any lien against property of the estate" or "any act to collect, assess, or recover a claim". Section 362(b) provides exceptions to the automatic stay, but courts must construe them narrowly to further the stay's protective purposes. Section 362(b)(3) excepts from the stay "any act to perfect … an interest in property to the extent that", under section 546(b)(1), the perfection would relate back so as "to be effective against an entity that acquires rights in such property before the date of perfection". The exception applies only where the creditor, as of the petition date, has an unperfected interest in the property, not merely the right to obtain an interest. Here, the utility did not have such an interest at the petition date, because the lien would arise only on November 15 and only if the debtor did not pay the utility bill by then. Section 362(b)(9) excepts from the stay "the issuance to the debtor by a governmental unit of a notice of tax deficiency [and] the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment". A tax is a governmental levy to support the functions of government, not a fee or reimbursement for services rendered. The Wisconsin statute's treatment of the collection of the bill "as a tax" does not bring it within the meaning of "tax" in section 362(b)(9). Section 362(b)(18) excepts from the stay "the creation or perfection of a statutory lien for … a special tax or special assessment on real property … imposed by a governmental unit" after the petition date. A special tax or special assessment is limited to one imposed for payment for a local improvement or to enhance local property values. The utility charge does not qualify. Therefore, none of the automatic stay

exceptions apply, and the utility's notice to the debtor in possession violated the stay. *Reedsburg Util. Comm'n v. Grede Foundries, Inc. (In re Grede Foundries, Inc.)*, 651 F.3d 786 (7th Cir. 2011).

1.1.v. Automatic stay applies to action for equitable subordination of another debtor in possession's claim. A debtor in possession filed a proof of secured claim in another debtor's case. The debtor in possession in the second case moved to equitably subordinate the creditor-debtor in possession's secured claim. The automatic stay prohibits the commencement or continuation of any judicial proceeding against a debtor that could have been brought before the commencement of the case and any act to obtain possession of property of or from the estate or to exercise control over property of the estate. These provisions do not prevent a party from defending an action that the debtor or debtor in possession has brought. A successful defense does not take property (the estate's claim) of or from the estate or exercise control over property of the estate but only determines that there was no such property. A debtor in possession's motion to subordinate a secured claim owned by another estate, by contrast, acknowledges the existence of the other estate's claim and seeks to transfer the lien securing the claim to the objecting estate. Therefore, the action violates the automatic stay in the creditor-debtor's case. *Palmdale Hills Prop., LLC v. Lehman Comm'l Paper Inc. (In re Palmdale Hills Prop, LLC)*, 654 F.3d 868 (9th Cir. 2011).

1.1.w. Tenth Circuit signals change in rule on automatic stay applicability to appeals. A creditor obtained a prepetition judgment against the debtor, who appealed. After bankruptcy, the creditor argued that the automatic stay applied to the debtor's appeal. Section 362(a)(1) stays a judicial proceeding against the debtor that was commenced before the commencement of the bankruptcy case. All courts of appeals except the Tenth Circuit determine whether the proceeding is against the debtor by looking at the alignment of the parties in the original trial court proceeding. The Tenth Circuit's precedents do not apply the stay to a debtor's appeal of a judgment against the debtor, reasoning that the appeal is not a proceeding against the debtor. In this case, the Tenth Circuit follows its precedent, because the state appeals court had resolved the appeal before the Tenth Circuit issued its decision, and no purpose would be served by retroactively applying the stay to the appeal. However, it invites bankruptcy courts in the circuit "to rule in the alternative when the issue arises in future cases". *Chizzali v. Gindi (In re Gindi)*, 642 F.3d 865 (10th Cir. 2011).

1.1.x. Action against property improvement district is subject to the automatic stay. The debtor owned undeveloped real property, subject to a mortgage in favor of the bank. Before bankruptcy, the debtor had formed a property improvement district, which is a separate municipal entity that state law authorizes to borrow money secured by tax revenues on the real property, to construct infrastructure, such as roads, utilities and sewers. After bankruptcy, the bank sought to sue the improvement district in state court to challenge the validity of its formation and sought a comfort order from the bankruptcy court that the action did not violate the automatic stay in the debtor's case. The existence of an improvement district and its ability to finance infrastructure development can enhance property's value. The automatic stay prohibits an act to exercise control over property of the estate. An invalidation of the improvement district would adversely affect the value of the estate's real property, so the proposed state court action would violate the automatic stay. The court notes that the improvement district, though a distinct legal entity, had no practical or effective existence independent of the debtor and that the treatment of the real estate, including the district's ability to finance and impose taxes on the property that would result in placing liens on the property, is subject to the bankruptcy court's control. *In re Panther Mtn. Land Devel., LLC*, 446 B.R. 282 (8th Cir. B.A.P. 2011).

1.1.y. Action seeking civil penalties or disgorgement may qualify for the police power exception to the automatic stay. The debtor operated in the securities industry but had ceased operations long before bankruptcy. The State sued the debtor before bankruptcy for violations of the securities laws, seeking disgorgement and civil penalties. After bankruptcy, the debtor sought to stay the State's action. Section 362(b)(4) excepts from the automatic stay an action by a governmental unit to enforce its police or regulatory policy. In determining whether the exception applies, the court should not examine the merits or legitimacy of the underlying action, nor whether the governmental unit can show an urgent need to prevent imminent harm, and an action may qualify for an exception from the stay even if it does not seek only an injunction. The court should consider only whether the action satisfies either the pecuniary purpose test or the public policy test. The action meets the pecuniary purpose test if the purpose of the

action is not to recover damages, but to vindicate a public policy. A civil penalty provides deterrence, which is a public policy, so seeking a penalty or disgorgement does not cause the action to fail the pecuniary purpose test. An action meets the public purpose test if its purpose is not to vindicate private rights. *People v. Villalobos,* 453 B.R. 404 (D. Nev. 2011).

1.1.z. Court enjoins U.K. pension funding proceeding against U.S. debtor. U.S. debtors were part of a multinational, Canadian-based corporation that also had significant subsidiaries and operations in the United Kingdom. The Canadian parent and the U.S. and U.K. subsidiaries all commenced insolvency proceedings in their respective jurisdictions on the same day, and all three courts granted recognition to the other proceedings. After the bankruptcy and insolvency proceedings, the U.K. pension regulator determined that the U.K. debtors' pension plans were substantially underfunded as of a date approximately six months before bankruptcy and insolvency proceedings and issued a "Warning Notice" of intent to issue a "financial support directive" (FSD) against the U.S. and Canadian affiliates to contribute to the pension trust fund. The pension trustees and the U.K. Pension Protection Fund filed proofs of claim in the U.S. chapter 11 cases for a portion of the underfunding deficiency. The automatic stay enjoins any act to assess a claim that could have been brought before bankruptcy. The police or regulatory power exception in section 362(b)(4) applies only to an action by a governmental unit that has a public health and safety, rather than a pecuniary, purpose and is taken in furtherance of a public policy and not to adjudicate private rights. The exception should be construed narrowly where the governmental unit is a foreign regulator. The FSD proceeding addresses only a financial shortfall in pension funding, not any public health or safety issues, and its purpose is not to protect safety or welfare but only to adjudicate the private rights of the pension trust and the Pension Protection Fund. Therefore, it does not meet any of the police or regulatory exception requirements, and the court enjoins the FSD proceeding. *Trustees of Nortel Networks U.K. Pension Plan v. Nortel Networks Inc. (In re Nortel Networks Inc.)*, 2011 U.S. Dist. LEXIS 32786 (D. Del. Mar. 29, 2011).

1.1.aa. Dismissal of debtor's action for failure to prosecute does not violate the stay. The debtor corporation consented to its counsel's withdrawal from representation in the debtor's prepetition antitrust action. The court warned the corporate debtor that it could not proceed without counsel and would suffer dismissal for failure to prosecute if it did not obtain replacement counsel. The debtor was unable to obtain replacement counsel, and after the debtor's bankruptcy filing, the court dismissed the action for failure to prosecute. The automatic stay bars continuation of an action against the debtor and any act to obtain possession of property from the estate or to exercise control over property of the estate. The dismissal does not violate the automatic stay, because the action is not against the debtor and because an attempt to dismiss or defeat a debtor's actions is not an act to obtain possession or exercise control. Otherwise, those that a debtor sues could not defend themselves. *Riviera Drilling & Exploration Co. v. Gunnison Energy Corp.*, 2011 U.S. App. LEXIS 255 (10th Cir. Jan. 5, 2011).

1.1.bb. Setoff of special purpose account against derivative contract liability violates the automatic stay. The debtor made numerous daily deposits and withdrawals from its accounts with a bank, often resulting in large intraday overdrafts, which were regularly cleared by the end of each day. Shortly before bankruptcy, the bank demanded collateral to secure intraday overdrafts. The debtor and the bank entered into a security agreement that provided for a large deposit account specifically to secure such intraday overdrafts. The bank also had numerous open derivative contracts with the debtor. When the debtor filed bankruptcy, it had no intraday overdrafts with the bank. After bankruptcy, the bank offset the entire deposit account against the debtor's obligations on the derivative contracts. Section 553(a) recognizes but does not grant a setoff right, which is governed by applicable nonbankruptcy (here, New York) law. New York law permits a bank to offset a depositor's indebtedness to the bank against the depositor's general bank account, but not against a special purpose account or against pledged collateral. Because the parties specifically negotiated the security agreement to secure only indebtedness arising from intraday overdrafts and the deposit was posted as collateral solely for that purpose, the debtor's account was a special purpose account and was pledged collateral that could not be used to offset against other indebtedness. Section 362(b)(17), which provides an automatic stay safe harbor for setoff relating to a derivative contract, does not protect the bank. It applies only to a contractual setoff right, which includes a right provided in a rule or bylaw of a derivatives clearing organization or by common law, "under any security agreement or arrangement or other credit enhancement forming a part of or related to

any swap agreement". The setoff that the bank attempted here was not based on an agreement that was related to any swap agreement and therefore violated the automatic stay. *Bank of America, N.A. v. Lehman Bros. Holdings Inc. (In re Lehman Bros. Holdings Inc.)*, 439 B.R. 811 (Bankr. S.D.N.Y. 2010).

1.1.cc. 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).

1.1.dd. Automatic stay applies to a creditor's action that belongs to the estate. In a Ponzi scheme case, the trustee filed a fraudulent transfer action against an investor. Other investors filed a class action in state court against the fraudulent transfer defendant for conversion, unjust enrichment, conspiracy and RICO violations, claiming lost investment income on their investments. The automatic stay prohibits a creditor from pursuing an action that belongs to the estate. An action belongs to the estate if it does not involve particularized injury to individual creditors and could be brought by any creditor. An action belongs to a particular creditor if the creditor suffered injury significantly different from injury to other creditors. The action here seeks to redress harm to the debtor resulting from the defendant's receipt of payments in excess of his investments with the debtor, not particularized harm to the plaintiff creditors. The trustee's fraudulent transfer action seeks to recover those payments for the benefit of all creditors. Therefore, the plaintiff creditors' action is property of the estate and is stayed. *Picard v. Fox (In re Bernard L. Madoff Inv. Secs. LLC)*, 429 B.R. 423 (Bankr. S.D.N.Y. 2010).

1.1.ee. Direct action against debtor in possession's directors for breach of fiduciary duty in connection with plan negotiations violates the automatic stay. The solvent debtor received an offer for its equity. The debtor's board initially resisted a competing offer, but later initiated a process in its chapter 11 case for an auction, with bankruptcy court supervision and subject to bankruptcy court approval of a plan that reflected the auction results. A shareholder brought an action in state court asserting direct claims against the debtor's directors for breach of fiduciary duty for their initial resistance to the competing bid and seeking an order requiring the directors to "obtain a transaction". The Bankruptcy Code entrusts the administration of a chapter 11 case to the debtor in possession, subject to bankruptcy court supervision. Any attempt to assert control over the case's administration in another court violates the automatic stay. In addition, an action against the debtor's directors implicates the *Barton* doctrine (*Barton v. Barbour*, 104 U.S. 126 (1881)), which requires that a party must first obtain leave from the bankruptcy court before bringing an action against a fiduciary responsible for administering the estate. The debtor in possession's directors qualify for *Barton* protection. Therefore, the bankruptcy court enjoins the state court action. *In re Gen. Growth Props., Inc.*, 426 B.R. 71 (Bankr. S.D.N.Y. 2010).

1.1.ff. The police or regulatory power automatic stay exception does not apply to an ITC proceeding. Before bankruptcy, two plaintiffs brought a proceeding before the International Trade Commission against the debtor and numerous other defendants for importing goods into the United States that violated the plaintiffs' patents. 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 promoting the government's pecuniary interest, and if there is public purpose in the action. Although there is a public purpose in preventing importation of goods that violate U.S. patents, the ITC action here was not brought or prosecuted by a governmental unit and sought only monetary recovery in favor of the plaintiffs. Therefore, the automatic stay applies. *In re Qimonda AG*, 425 B.R. 256 (Bankr. E.D. Va. 2010).

1.1.gg. Court enjoins U.K. pension funding proceeding against U.S. debtor. U.S. debtors were part of a multinational, Canadian-based corporation that also had significant subsidiaries and operations in the United Kingdom. The Canadian parent and the U.S. and U.K. subsidiaries all commenced insolvency proceedings in their respective jurisdictions on the same day, and all three courts granted recognition to the other proceedings. After the bankruptcy and insolvency proceedings, the U.K. pension regulator determined that the U.K. debtors' pension plans were substantially underfunded as of a date approximately six months before bankruptcy and insolvency proceedings and issued a "Warning Notice" of intent to issue a "financial support directive" (FSD) against the U.S. and Canadian affiliates to contribute to the pension trust fund. The pension trustees and the U.K. Pension Protection Fund filed proofs of claim in the U.S. chapter 11 cases for a portion of the underfunding deficiency. The automatic stay enjoins any act to assess a claim that could have been brought before bankruptcy. The police or regulatory power exception in section 362(b)(4) applies only to an action by a governmental unit that has a public health and safety, rather than a pecuniary, purpose and is taken in furtherance of a public policy and not to adjudicate private rights. The FSD proceeding addresses only a financial shortfall in pension funding, not any public health or safety issues, and its purpose is not to protect safety or welfare but only to adjudicate the private rights of the pension trust and the Pension Protection Fund. Therefore, it does not meet any of the police or regulatory exception requirements. The court therefore enjoins the FSD proceeding. *In re Nortel Networks Corp.*, 426 B.R. 84 (Bankr. D. Del. 2010).

1.1.hh. Automatic stay applies to state court action against state agency seeking to enforce the agency's obligations concerning the debtor. A hospital filed a chapter 11 case and sought immediate approval of a closure plan. The court granted interim approval and scheduled a final hearing 20 days later. Local citizens brought an action in state court against only the state health department, alleging that it did not comply with state and federal law in authorizing the closure. The action asked the state court to require the health department to do so. It did not seek monetary or equitable relief against the debtor. The automatic stay enjoins any act to exercise control over property of the estate, whether or not the act directly involves the debtor. The plaintiffs' action would have the effect of exercising control over the hospital and therefore is subject to the automatic stay. Section 362(b)(4)'s police and regulatory power exception to the automatic stay does not apply to the action, because it applies only to an action by a governmental unit, not by a private plaintiff. Only a party in interest may seek stay relief. Since the Code's purpose is to provide a forum for creditors and debtors to resolve matters between them, only a creditor or the debtor is a party in interest for purposes of seeking stay relief. The plaintiffs are not creditors of the debtor and therefore may not seek stay relief. They also do not have standing as a party in interest under section 1109(b) to object to the debtor in possession's motion to approve the closure. *In re Saint Vincents Catholic Med. Ctr.*, 429 B.R. 139 (Bankr. S.D.N.Y. 2010).

1.1.ii. Equitable subordination adversary proceeding against creditor who is a debtor in another case violates the stay. A creditor filed a proof of secured claim. The debtor in possession objected to the claim and filed an adversary proceeding for equitable subordination of the claim and of the lien and for transfer, under section 510(c)(2), of the lien to the estate. The creditor was a debtor in possession in its own bankruptcy case. The automatic stay prevents an action to obtain property from the estate. An objection to claim, whether or not secured, determines whether the creditor has a claim. An action to subordinate a claim under section 510(c) applies only if the creditor has an allowable claim. By seeking transfer of the lien to the estate, the action attempts to remove property from the creditor's estate. Such an action violates the automatic stay in the creditor's case. Although the debtor's bankruptcy court may determine whether the stay applies, only the creditor's court may grant relief from the stay to permit the debtor in possession to seek equitable subordination of the claim and lien and transfer of the lien to the estate. The creditor does not waive the automatic stay in its own case by filing and pursuing the proof of

claim in the debtor's case, and the debtor in possession is not handicapped by being unable to seek equitable subordination, as might be the case if the debtor in possession were stayed from objecting to the claim. The debtor in possession may still object to allowance and may seek stay relief in the creditor's case to pursue equitable subordination. *Lehman Comm'l Paper, Inc. v. Palmdale Hills Prop., LLC (In re Palmdale Hills Prop., LLC)*, 423 B.R. 655 (9th Cir. B.A.P. 2010).

1.1.jj. Refusing to service machines that the trustee proposes to sell violates the stay. Before bankruptcy, the debtor purchased from the creditor large, complex machines that only the creditor could service. The creditor failed to perfect its retained security interest in the machines. After bankruptcy, the trustee attempted to sell the machines, which were worth $2,000,000. The creditor advised potential purchasers that it would refuse to service the machines. The creditor then offered to purchase the machines from the trustee for $100,000, intending to resell them at market value to recover its claim. Section 362(a)(6) enjoins "any act to collect, assess, or recover" a prepetition debt. The automatic stay protects not only the debtor but also creditors from other creditors' collection actions. In this case, the debtor did not benefit from any protection, because it was liquidating. An action violates a creditor-protection stay if the action "could reasonably be expected to have a significant impact on the creditor's ability to collect, assess, or recover" a prepetition debt and is unfair under the circumstances. The creditor's conduct here admittedly was designed to discourage any other buyers from buying the machines from the estate so that the creditor could recover its prepetition claim. Although outside of bankruptcy, a machine manufacturer may choose its service customers, such a choice may become unfair in bankruptcy if it otherwise violates the automatic stay by attempting to recover a prepetition claim, such as was the case here. Therefore, the creditor violated the automatic stay, and the bankruptcy court properly enjoined the creditor to provide service on the machines to any purchaser. *Lewis. v. Negri Bossi USA, Inc. (In re Mathson Indus., Inc.)*, 423 B.R. 643 (E.D. Mich. 2010).

1.1.kk. Automatic stay may apply to action for continuing postpetition patent infringement. Samsung had sued the debtor before bankruptcy for patent infringement. After bankruptcy, it withdrew a portion of its infringement claims and brought an action before the U.S. International Trade Commission (ITC) based on the debtor in possession's post-petition importation into the United States of goods that allegedly infringed the same patents. The automatic stay applies to any "action or proceeding against the debtor that was or could have been commenced before the commencement of the case". An action for a violation arising from continuation during bankruptcy of prepetition conduct is one that was or could have been commenced before bankruptcy and therefore is stayed. The ITC proceeding might be permitted under the police or regulatory power exception to the automatic stay if it does not relate primarily to protecting the government's pecuniary interest and effectuates a public policy. Here, however, the ITC action is initiated by a private litigant against another private litigant, and the ITC plays a judicial role. Therefore, the action is to enforce private rights, not public policy, so the exception does not apply. Finally, section 959(a) permits an action against a debtor in possession for postpetition acts or transactions, but the court may enjoin such an action where necessary for the orderly administration of the estate. Because Samsung attempted to split the prepetition action by dismissing some of the infringement claims and bringing them instead in the ITC, Samsung appeared to be attempting an end run around the automatic stay, so the court enjoins the ITC action. *In re Spansion, Inc.*, 418 B.R. 84 (Bankr. D. Del. 2009).

1.1.ll. Automatic stay requires creditor to undo violations arising from state court order. Before bankruptcy, the debtor violated a spousal support obligation. The debtor's ex-spouse filed a motion in the state court to hold the debtor in contempt. After bankruptcy, the state court ordered the debtor to pay the arrearages by a deadline or be jailed until payment. The order did not follow or track the domestic support payment exceptions to the automatic stay. The debtor sought relief in the state appellate court, which the ex-spouse opposed in full. Ultimately, the bankruptcy court voided the state court order before the payment deadline. The automatic stay prohibits the commencement and the continuation of an action to collect a prepetition debt. It imposes on a creditor that has commenced such an action an affirmative duty of compliance, including to ensure that the action is not continued and to relieve the violation, and does not require action only if the debtor so requests. Thus, in opposing the debtor's state court appeal, the ex-spouse should have argued for affirmance only to the extent that the order fell within the domestic support automatic stay exceptions and could not rely on the ordinary adversary process in that court to reach the right result. The violation is wilful to the extent the creditor knew of the stay and acted intentionally,

whether or not the creditor believed in good faith that the actions did not violate the stay. *Sternberg v. Johnston*, 582 F.3d 1114 (9th Cir. 2009).

1.1.mm. Automatic stay prohibits contract termination upon adoption of the resolution authorizing a bankruptcy. The debtors operated ocean going shipping vessels. They were members of an insurance "club". The club's English law governed insurance policies contained a "cesser" clause, under which the policies terminated not only upon the filing of a bankruptcy petition but also upon the adoption of a winding up resolution by a club member's board. The automatic stay prohibits a contract counterparty from terminating a contract with a debtor after the debtor's bankruptcy, and section 541(c) invalidates any contractual provision that prevents a debtor's property interest from becoming property of the estate. The counterparty may not evade these provision's application by triggering the termination upon the adoption of the resolution authorizing the bankruptcy filing. Therefore, the policies remain property of the estates, and the club may not terminate them without relief from the stay. *LaMonica v. N. of England Protecting and Indem. Assoc. Ltd. (In re Probulk Inc.)*, 407 B.R. 56 (Bankr. S.D.N.Y. 2009).

1.1.nn. Creditor's withholding possession of property of the estate violates the automatic stay. Before the debtor's chapter 13 case, the creditor repossessed the debtor's car. The creditor refused turnover without the debtor's obtaining an adequate protection order. Section 362(a)(3) stays "exercise of control over property of the estate". Merely retaining possession exercises control over an asset. Additional action, such as selling the asset, is not required. Therefore, the creditor violated the stay. Section 542(a) requires turnover to the trustee of property of the estate that the trustee may use, sell or lease. Section 363(e) requires the court to provide adequate protection "upon request of an entity with an interest in property". Thus, the creditor must return possession of the car to the estate (the court refers to the "debtor", not the trustee) and seek adequate protection. The creditor may not place the burden of seeking an adequate protection order on the debtor or the estate. In reaching this ruling, the Seventh Circuits joins the majority of courts in the Sixth, Eighth, Ninth and Tenth Circuits. *Thompson v. Gen. Motors Acceptance Corp.*, 566 F. 3d 699 (7th Cir. 2009).

1.1.oo. Bankruptcy court may extend stay to nondebtors if it has jurisdiction and the preliminary injunction standards are met. The debtor and various nondebtors, including the debtor's CEO, were defendants in prepetition litigation. Continuation of the action would have taken a substantial portion of the CEO's time and prevented him from attending to the chapter 11 case. After bankruptcy, the debtor sought a 60-day preliminary injunction against continuation of the action against the nondebtors. Issuance of a preliminary injunction requires three distinct elements. The bankruptcy court must have jurisdiction over the injunction proceeding, there must be grounds to extend the automatic stay and the plaintiff must meet the traditional grounds for a preliminary injunction. Section 105(a) analysis alone is not adequate, as section 105(a) is not an independent source of subject matter jurisdiction or substantive rights and permits only enforcement of other provisions of the Bankruptcy Code. A proceeding is "related to" a title 11 case and therefore within the bankruptcy court's jurisdiction if its outcome could conceivably have any effect on the estate. Here, the potential distraction of the CEO and other key reorganization personnel, among other things, provides the jurisdictional link. A court may extend the automatic stay to nondebtors in unusual circumstances, such as where there is an identity of interest between the debtor and nondebtor or where the third-party action will have an adverse impact on the debtor's ability to reorganize. The facts here constitute unusual circumstances, because of the effect on the reorganization and the debtor's possible indemnification obligations to the nondebtors. Because the standards for issuance of a preliminary injunction were present, the court enjoins the third party action for 60 days. *In re Phila. Newspapers, LLC*, 407 B.R. 606 (E.D. Pa. 2009).

1.1.pp. Federal civil forfeiture action is excepted from the automatic stay. After the trustee sold the debtor's real property, the U.S. Attorney brought a civil forfeiture action against the trustee to seize the sale proceeds on the ground that the real property, and therefore its proceeds, were the product of criminal activity. Section 362(b)(4) excepts from the automatic stay an action to enforce police or regulatory powers, including an action to enforce a judgment other than a money judgment. An action comes within the exception if the action is to further public policy and not for a pecuniary purpose. A forfeiture action is punishment and therefore comes within the exception. The recognition of the action as within the exception does not conflict with the subordination of forfeiture claims under section 726(a)(5), because a forfeiture relates back to the time of the criminal activity and therefore prevents the property

from becoming property of the estate and subject to the Code's distribution scheme. *Jahn v. U.S. (In re Winpar Hospitality Chattanooga, LLC)*, 401 B.R. 289 (Bankr. E.D. Tenn. 2009).

1.1.qq. Adversary proceeding to collect WARN Act payments for prepetition termination violates the automatic stay. The debtor terminated most of its employees before bankruptcy. After bankruptcy, a terminated employee brought a class action adversary proceeding in the bankruptcy court against the debtor and its sole shareholder. The automatic stay prohibits any attempt to collect a prepetition debt, even in the bankruptcy court. The WARN Act claims for a prepetition termination arose prepetition. Therefore, the adversary proceeding violates the automatic stay. *Bridges v. Continentalafa Disp. Co. (In re Continentalafa Disp. Co.)*, 403 B.R. 653 (Bankr. E.D. Mo. 2009).

1.1.rr. Action in the bankruptcy court does not violate the automatic stay. The debtor's mortgage lender filed a proof of claim in the debtor's chapter 13 case for principal and interest owing under the mortgage and for missed prepetition tax and insurance escrow payments, with a notation on the proof of claim that the debtor's monthly mortgage payments would increase to a specified amount to make up the missed escrow payments. The debtor objected to the claim and sought to hold the lender in contempt for violating the automatic stay by an act to collect or recover a prepetition claim. The automatic stay does not apply to any actions expressly permitted under the Bankruptcy Code. It applies only to actions outside the bankruptcy court forum. An action taken in the case does not violate the stay's purposes of protecting the debtor from litigation and centralizing administration of disputes in the bankruptcy court and can be addressed immediately by the bankruptcy court. Therefore, the lender's filing of its proof of claim, even if wrong, does not violate the stay. *Campbell v. Countrywide Home Loans, Inc.*, 545 F.3d 348 (5th Cir. 2008).

1.1.ss. An action to enforce a perfected judicial lien is not excepted from the automatic stay. The creditors sued the debtor before bankruptcy, obtained an order for attachment of real and personal property and levied the attachments on real property and intangible personal property. Before the creditor obtained a judgment, the debtor filed bankruptcy. Applicable nonbankruptcy law in this state grants priority to a creditor levying on real property against later purchasers, but the judicial lien on the real property is not enforceable unless the creditor obtains a judgment in the underlying action. The state law does not similarly grant retroactive priority to an attachment of intangible personal property. The trustee's strong-arm power under section 544(a) permits the trustee to avoid an interest in real property that is not perfected against a bona fide purchaser of the real property as of the petition date. Section 362(b)(3) excepts from the automatic stay any act to perfect an interest in property under a statute authorizing perfection in accordance with section 546(b). Section 546(b) applies to any generally applicable law, not only a purchase money security interest and a mechanics lien, that permits perfection that takes priority over an interest acquired later. The real property lien was already perfected, and any act to obtain a judgment would be an act to enforce, not to perfect, the judgment. The state law here does not, once a judgment is obtained, grant the judicial lien on the intangible personal property priority over intervening interests. Therefore, the judicial lien on the real property and on the intangible personal property both fail the tests of section 362(b)(3), and continuation of the state court action is not excepted from the automatic stay. The bankruptcy court does not abuse its discretion in denying stay relief in the case, as to the personal property lien because it does not satisfy section 546(b)'s relation back test and as to the real property lien because stay relief could prevent orderly administration of property of the estate. *Ivester v. Miller*, 398 B.R. 408 (M.D.N.C. 2008).

1.1.tt. Police or regulatory power exception applies to state court action for money damages. Shortly before bankruptcy, New York sued the debtor in state court for money damages associated with environmental contamination that the debtor, in part, had caused. The state court entered a default judgment against the debtor after bankruptcy and after New York had filed a proof of claim in the bankruptcy case for the damages. The police or regulatory power exception to the automatic stay itself contains an exception for any act to enforce a money judgment. Obtaining a judgment, even for past environmental response costs, does not amount to enforcement of a judgment. Therefore, the default judgment did not violate the automatic stay. Jurisdiction over civil proceedings in a bankruptcy case is nonexclusive. Therefore, New York's filing of a proof of claim does not give the bankruptcy court exclusive jurisdiction over New York's claim against the debtor such as would oust the state court of jurisdiction to enter the default judgment against the debtor after the filing of the proof of claim. *In re Mystic Tank Lines Corp.*, 544 F.3d 524 (3d Cir. 2008).

1.1.uu. Application of the automatic stay to a prepetition action for estate causes of action against a third parties requires the trustee to take "official action". A bondholder brought an action in district court against the issuer before its bankruptcy, its sole shareholder and its president for tortious interference, fraudulent conveyance, breach of fiduciary duty and alter ego liability. The issuer's bankruptcy trustee sought a stay. Standing to bring an action is determined when it is commenced. The later bankruptcy filing, which may have divested the plaintiff bondholder of the claims, did not affect the plaintiff's standing. The trustee did not take any "official action" to raise the automatic stay and was not yet pursuing any of the plaintiff's claims on behalf of the estate. Therefore, the district court refused to apply the automatic stay to the action, noting, however, that the plaintiff assumed the risk that the action might be in violation of the stay and therefore void. *Taberna Capital Mgmt., LLC v. Dunmore*, 392 B.R. 559 (S.D.N.Y. 2008).

1.1.vv. Safe harbor applies to secured subordinated notes issued by a mortgage conduit. The debtor originated mortgage loans. It sold them to a commercial paper conduit, which issued senior and subordinated notes secured by a security interest in the mortgage loans to fund the mortgage loans' purchase price. The debtor purchased the subordinated notes from the conduit and financed the purchase by reselling them to the conduit sponsor under a repurchase agreement. After bankruptcy, the conduit sponsor terminated the repurchase agreements and foreclosed on the subordinated notes. Section 101(47) defines repurchase agreement to include an agreement to transfer "interests in … mortgage loans". Section 101(51) defines security interest as a consensual lien, and section 101(37) defines lien as "a charge against or interest in property". Therefore, the secured subordinated notes are an interest in the mortgage loans that the conduit owns, and the repurchase agreement here qualifies as a safe harbor repurchase agreement under section 101(47). *Am. Home Mortgage Inv. Corp. v. Lehman Bros. Inc. (In re Am. Home Mortgage Holdings, Inc.)*, 388 B.R. 69 (Bankr. D. Del. 2008).

1.1.ww. Automatic stay safe harbor applies to mortgage loan repurchase agreements but not mortgage servicing agreements. The debtor originated mortgages. It entered into a contract with a financial institution to transfer the mortgages to the financial institution in exchange for cash and an agreement to transfer the mortgages back to the debtor within 180 days for the same amount of cash plus a "Pricing Differential" that was based on the number of days between the transfer and the re-transfer. The contract also provided that the debtor retain the right to designate the mortgage servicer. The financial institution paid less for the mortgages purchased on this "servicing retained" basis than it would for those purchased on a "servicing released" basis. The contracts are repurchase agreements, as defined in section 101(47), as they meet all the definition's essential terms. Accordingly, the section 559 repurchase agreement safe harbor from the automatic stay applies, and the financial institution may close out or terminate the repurchase agreements without leave of or interference from the court. As a repurchase agreement, the contract is also a "securities contract" subject to the safe harbor of section 555. The servicing rights, however, are severable from the contract's repurchase agreement portion. The mortgage purchase price depends in part on whether the buyer also acquires servicing rights. In addition, the right to service is separate from the mortgage itself, so the servicing agreement is not a repurchase agreement that benefits from the safe harbor. *Calyon New York Branch v. Am. Home Mortgage Corp. (In re Am. Home Mortgage Corp.)*, 379 B.R. 503 (Bankr. D. Del. 2008).

1.1.xx. Stay violation may be willful despite creditor's reasonable belief the debtor had not filed bankruptcy. The creditor repossessed the debtor's asset after the debtor filed bankruptcy. The debtor's counsel telephoned the creditor to advise of the bankruptcy filing and demand return of the asset but did not send documentation to show the filing. The creditor doubted that the debtor had filed, because counsel did not send documentation, counsel's telephone demeanor suggested to the creditor that the debtor was trying to scam the creditor into returning the asset, and because the creditor believed the debtor had recently filed a previous case and was ineligible to refile. The creditor did not, however, independently investigate whether the debtor had filed, and it retained the repossessed asset. The creditor's stay violation was willful, despite its doubts. A stay violation is willful if the creditor knew of the stay and intended the actions that constituted the violation. Specific intent to violate the stay is not required, nor does any reasonable doubt or belief excuse a willful violation. Willfulness is to be liberally construed to encourage stay compliance. Finally the debtor need prove willfulness only by a

preponderance of the evidence and need not meet a clear and convincing standard of proof. *Johnson v. Smith (In re Johnson)*, 501 F.3d 1163 (10th Cir. 2007).

1.1.yy. NLRB's filing notice of successor back pay liability violates the stay. The court approved sale procedures for a sale of substantially all of the estate's assets as a going concern. The NLRB had previously asserted unfair labor practice claims against the debtor. It filed a "Notice of Pendency of Unfair Labor Practice Charges" with the bankruptcy court, in which it asserted that a purchaser of the debtor's assets may be required to remedy the unfair labor practices by, *inter alia*, making employees whole, and that potential purchasers may wish to reflect the potential liability in their bids. The NLRB withdrew the notice shortly after it was filed. The court could not determine whether the notice chilled the bidding. The notice does not fall under the police or regulatory stay exception, which exempts only proceedings by a governmental unit to prevent or stop violations or to determine damages, not a proceeding to collect a prepetition claim such as a back pay award for a prepetition period. The notice therefore violates the stay. The NLRB argued that the automatic stay does not apply to a filing in the bankruptcy court, but the court does not address this issue. *In re Pan Am. Hosp. Corp.*, 364 B.R. 832 (Bankr. S.D. Fla. 2007).

1.1.zz. "Police or regulatory" exception does not permit a state to retain assets to conduct a state liquidation procedure. The state Director of Insurance obtained a state court order of conservation and injunctive relief against an automobile service contract provider and also requested an order to wind down and terminate the provider's business. Before the state court ruled on that request, the provider filed bankruptcy. Although the provider was in a regulated business that permitted the Director to bring an enforcement action to wind down its business, the automatic stay's police or regulatory exception does not permit the state, under the guise of a regulatory proceeding, to conduct a parallel liquidation case process. The exception is designed to permit the state "to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws", not to protect creditors of a regulated business that is otherwise eligible for bankruptcy. Here, because the debtor has stopped conducting business, application of the exception would not further the state's legitimate consumer protection interest that the exception protects. *In re Automotive Profs. Inc.*, 370 B.R. 161 (Bankr. N.D. Ill. 2007).

1.1.aaa. Action against nondebtor subsidiary's assets does not violate the automatic stay. A lessor brought an ejectment action against the debtor's nondebtor subsidiary. The debtor does not have an identity of interest with the subsidiary, which is a separate legal entity. The subsidiary's property is not property of the debtor's estate. Finally, the potential loss of value to the subsidiary resulting from the ejectment action does not affect the debtor's interest in the subsidiary, which remains the same; it affects only the value of that interest, which the automatic stay does not protect. Therefore, the action does not violate the automatic stay. The bankruptcy court might, however, enjoin the ejectment action under section 105 in appropriate circumstances. *Kreisler v. Goldberg*, 478 F.3d 209 (4th Cir. 2007).

1.1.bbb. False Claims Act action is excepted from automatic stay. A relator brought a *qui tam* action against a hospital under the False Claims Act for fraudulent Medicare payment requests; the government intervened as to some but not all of the claims. The hospital later filed chapter 11. Some courts have adopted a "pecuniary purpose" test to gauge the reach of section 362(b)(4)'s police or regulatory power exception to the automatic stay. Under this test, the exception applies if the action relates to the public safety or welfare but does not apply if the government is pursuing its pecuniary interest in the debtor's property. Other courts have adopted the broader "pecuniary advantage" test, under which the automatic stay applies to the government's action only if the action would give the government a pecuniary advantage over other creditors, whatever interest the government is pursuing. The exception to the exception—the enforcement of a money judgment—supports the use of the pecuniary advantage test. Thus, an action to fix damages would not be stayed, although enforcement would be. False Claims Act cases have a pecuniary purpose (restitution) but also permit treble damages, which evidence a police or regulatory purpose of deterring fraud. The government's action is therefore not stayed. The relator's action on the remaining claims is stayed, however, because the police or regulatory power exception applies only to an action by a governmental unit. *U.S. ex rel. Fullington v. Parkway Hosp., Inc.*, 351 B.R. 280 (E.D.N.Y. 2006).

1.1.ccc. Reallocation of LLC ownership interests violates the automatic stay. The debtor and his partner owned interests in an LLC. Before bankruptcy, the debtor agreed to allow the partner to control the

debtor's interest, to make capital contributions, and to have a lien on the debtor's interest to secure repayment of the debtor's obligation to make comparable capital contributions. Before and after bankruptcy, the partner, but not the debtor, made capital contributions, and after bankruptcy the partner reallocated the ownership percentages in the LLC, purportedly to reflect his contributions. Doing so violates the automatic stay. There was no evidence that the reallocation properly reflected the differing capital contributions; the partner should have sought relief from the stay or a bankruptcy court ruling that the reallocation did not infringe the debtor's interest in the LLC. In addition, to the extent the reallocation depended on enforcement of the lien the debtor had granted to the partner, the lien enforcement violated the stay. *Braunstein v. Panagiotou (In re McCabe)*, 345 B.R. 1 (D. Mass. 2006).

1.1.ddd. Private antitrust litigation to enjoin estate asset purchase violates the automatic stay. The bankruptcy court approved a sale under section 363, which all parties in interest in the case supported, of the debtor's cable television networks. A cable channel whose signal the debtor and the buyer had refused to carry sued the buyer, but not the debtor or the estate, in the federal district court in another state on private antitrust grounds to enjoin the buyer from purchasing, but not the estate from selling, the estate's assets. Despite the exclusions, the action still violates the automatic stay. The action is an "act to … exercise control over property of the estate," stayed under section 362(a)(3), because it would interfere with the disposition of the estate's assets. The automatic stay does not except private antitrust actions. A governmental unit might pursue its police or regulatory powers under the section 362(b)(4) stay exception, but a private party has no such protection under the statute, and there is no "unwritten" automatic stay exception for private antitrust actions. The bankruptcy court has broad "related to" jurisdiction under section 1334(b), so it may hear the plaintiff's antitrust complaint in connection with the motion to approve the sale; alternatively, the plaintiff may seek stay relief to pursue a damage claim against the buyer or other relief that does not interfere with the asset sale. But it may not seek to enjoin the buyer in another court. *Adelphia Communications Corp. v. The America Channel, LLC (In re Adelphia Communications Corp.)*, 345 B.R. 69 (Bankr. S.D.N.Y. 2006).

1.1.eee. Automatic stay protects property in which estate has only a disputed interest. During marriage, the debtor's wife bought real property in a community property state. The debtor filed bankruptcy on the eve of foreclosure on the property and notified the lender of the bankruptcy and of his claim of a community property interest in the property. The creditor foreclosed anyway, and the debtor sued for a stay violation. The district court later determined that the debtor did not have an interest in the property. Despite the later determination, the foreclosure violated the stay. The stay's purpose is to protect the debtor and other creditors from potential dismemberment of the estate by a creditors' race to the courthouse and asset seizures. If the automatic stay did not apply to property whose ownership was in dispute, creditors could often resolve the dispute as a practical matter by seizing the property, and the estate would often be hard pressed to contest the ownership issue later. Therefore, the automatic stay applies equally to property where the debtor's interest is disputed but at least colorable. *Brown v. Chesnut (In re Chesnut)*, 422 F.3d 298 (5th Cir. 2005).

1.1.fff. Automatic stay may apply to an action against third party who holds estate property. Shortly before bankruptcy, the debtor directed its bank to transfer funds to the creditor. The bank failed to do so. After bankruptcy, the creditor sued the bank but not the debtor in state court for breaching its obligations to the creditor. The action violates the automatic stay. Even though the debtor was not named in the action, recovery against the bank would affect property of the estate, as the bank claimed no interest in the funds in the bank account. The creditor may not circumvent the automatic stay by action against the bank and not the debtor. *Amedisys v. Nat'l Century Fin. Enters,. Inc. (In re Nat. Century Fin. Enters., Inc.)*, 423 F.3d 567 (6th Cir. 2005).

1.1.ggg. Case dismissal annuls automatic stay. The debtor filed two cases, both of which were dismissed. While the cases were pending, an unscheduled creditor, who did not have notice or knowledge of the cases, filed a state court action against the debtor and obtained a default judgment and writ of execution. In the debtor's third case, the court allowed the creditor's secured claim. Although the writ of execution was obtained in violation of the automatic stay in the first two cases, section 349 has the effect of annulling the stay. Although section 349 does not expressly so provide, it reinstates any transfer avoided under the avoiding powers (including section 549) and revests property of the estate in the entity

in whom it was vested immediately before the commencement of the case. Its purpose, therefore, is to restore matters to how they were before the bankruptcy, and its effect is therefore to annul the automatic stay. Although annulment would prejudice creditors in the third case, section 349(b) does not permit the court to exercise equitable discretion. *Industrial Bank N.A. v. Brown (In re Brown)*, 330 B.R. 549 (N.D. Tex. 2005).

1.1.hhh. Reinstatement of dismissed chapter 13 case does not retroactively reinstate automatic stay. The bankruptcy court dismissed the debtor's chapter 13 case. The debtor did not obtain a stay pending appeal, so the secured lender foreclosed. The B.A.P. determined that the dismissal was improper because the bankruptcy court did not give the debtor adequate notice of the grounds for dismissal and an opportunity to defend and reinstated the case. The reinstatement did not give the debtor the right to set aside the foreclosure sale as held in violation of the automatic stay, because the case reinstatement did not retroactively reinstate the stay, which terminated upon the dismissal under section 362(c) when the foreclosed property was no longer property of the estate. The court distinguishes *In re Krueger*, 88 B.R. 238 (Bankr. 9th Cir. 1988), in which the bankruptcy court's due process violation resulted in the debtor not even having notice of the dismissal until after the foreclosure sale. *Lomagno v. Salomon Bros. Realty Corp. (In re Lomagno)*, 429 F.3d 16 (1st Cir. 2005).

1.1.iii. Stock sales that may impair NOL's do not violate the automatic stay. If the debtor's shareholders sold enough stock, it could result in a change of control that would substantially limit the reorganized debtor's ability to use its net operating loss carryforwards under the Internal Revenue Code. The stock sale might not, however, violate the automatic stay. Although the NOL's may be property of the estate, the stock sale is not an "act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." Any effect on the property of the estate would not occur because of any property of the estate that the shareholder possessed or controlled. Accordingly, section 362 does not apply. Since section 105 permits only implementation of other Code provisions, it cannot be used to enjoin a stock sale that is not subject to the stay. However, the analysis is only dicta, because the appeal was dismissed as moot on other grounds. *In re UAL Corp.*, 412 F.3d 775 (7th Cir. 2005).

1.1.jjj. Stay applies to claims asserted in one bankruptcy court in "dueling" bankruptcies. A creditor filed a proof of claim in the debtor's bankruptcy case. The debtor counterclaimed. Shortly before the bankruptcy court awarded attorney's fees to the debtor on his counterclaim, the creditor filed its own bankruptcy case in a different bankruptcy court. The first bankruptcy court's attorney's fee award against the creditor violated the automatic stay in the creditor's bankruptcy case. Although the creditor initiated the proceeding in the first debtor's bankruptcy case by filing a proof of claim, the debtor's counterclaim is an analytically distinct proceeding for purposes of applying the automatic stay. Therefore, the counterclaim was an action or proceeding against the creditor that was stayed upon the creditor's bankruptcy filing. *Snavely v. Miller (In re Miller)*, 397 F.3d 726 (9th Cir. 2005).

1.1.kkk. Presentment of postdated checks does not violate the stay. Days before bankruptcy, the debtor gave a payday lender four postdated checks in repayment of a loan taken out that day. The lender's presentment of the checks did not violate the automatic stay, because section 362(b)(11) contains an express exception for "presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument." The exception is not limited to situations in which the holder expects dishonor as a prerequisite to an action against a third party. The court does not address whether the honor of the check, transferring funds out of the bank account, might violate the stay, but the lender concedes that the transfer is a voidable postpetition transfer that the trustee may recover under section 549(a). *Thomas v. Money Mart Fin. Servs., Inc. (In re Thomas)*, 317 B.R. 776 (B.A.P. 8th Cir. 2004).

1.1.lll. Police or regulatory power exception applies to action by a different governmental unit. The State Attorney General brought a prepetition action against the debtor for violation of the federal Clayton Act, which may be enforced by the U.S. Attorney, a state attorney general, or a private party. Section 362(b)(4) excepts an action by a governmental unit "to enforce such governmental unit's police and regulatory power." This should not be read to require that the governmental unit enforce only its own laws. It may be enforcing its police powers even though it is relying on the laws of a different jurisdiction. It also does not matter that the law might be enforced by a private party, because when the government is acting,

it is enforcing its police powers, not private powers, assuming that the other requirements of the exception (public, nonpecuniary purpose) are met. *Lockyer v. Mirant Corp.*, 398 F.3d 1098 (9th Cir. 2005).

1.1.mmm. Creditor's complaint to real estate licensing board does not violate stay. The creditor claimed that the debtor real estate broker had misappropriated a deposit. After bankruptcy, the creditor filed a licensing complaint before the state licensing board, which has authority only to suspend or revoke a license, not to order restitution. Filing a complaint before a licensing board comes within the governmental police or regulatory power exception to the stay. The exception is not limited to proceedings that the government initiates. *McMullen v. Sevigny*, 386 F.3d 321 (1st Cir. 2004).

1.1.nnn. Refusal to return repossessed car violates the stay. Under Georgia law, prepetition repossession of a car does not prevent the car from becoming property of the estate. The debtor retains title until the lender takes the necessary disposition or retention steps under the U.C.C. Therefore, the creditor's postpetition refusal to turn over the car violated the stay. *Motors Acceptance Corp. v. Rozier (In re Rozier)*, 376 F.3d 1323 (11th Cir. 2004).

1.1.ooo. Section 549(c) is not an exception to the automatic stay. Whether or not the foreclosing creditor knew of the filing of the bankruptcy petition, the foreclosure sale conducted after the commencement of the case was void as a violation of the automatic stay. Section 549(c), which protects a good faith purchaser of real estate in a postpetition transaction, may be used only as a defense to an action by the trustee to avoid the postpetition transfer of estate property. It is not an exception to the automatic stay and therefore may not be pleaded to validate a sale that is void because it was conducted in violation of the stay. *Bustamante v. Cueva (In re Cueva)*, 371 F.3d 232 (5th Cir. 2004). *Accord 40235 Washington St. Corp. v. Lusardi*, 329 F.3d 1076 (9th Cir. 2003).

1.1.ppp. Creditor does not violate automatic stay by retaining possession to protect possessory lien. The creditor had towed the debtor's car before bankruptcy and claimed a statutory possessory lien for towing and storage charges under state law. After bankruptcy, the debtor demanded turnover, which the creditor refused, so as not to lose its possessory lien. After the bankruptcy court ordered turnover conditioned upon the grant of a lien on title to secure towing and storage charges, the creditor complied, and the debtor sued for violation of the automatic stay. The retention of possession was an action to maintain or continue perfection of a lien under section 362(b)(3) and therefore did not violate the stay. The possessory lien was senior to subsequent liens, so section 546(b)(1)(B) (protecting retroactive postpetition perfection) applied and exempted the action from the stay under section 362(b)(3). The court notes that the debtor did not seek sanctions for failure to turnover, but fails to address whether the creditor retention of possession constituted an unsatisfied demand for adequate protection that might have excused turnover under sections 542(a) and 363. *Hayden v. Wells (In re Hayden)*, 308 B.R. 428 (B.A.P. 9th Cir. 2004).

1.1.qqq. Automatic stay has extraterritorial reach. After bankruptcy, a creditor brought an arbitration proceeding in Switzerland against the debtor, obtained an award, domesticated the award in an Italian court, and registered a lien on the debtor's real property in Italy. The court declared the lien registration void ab initio because the registration violated the automatic stay. The court's jurisdiction under section 1334(e) includes property, "wherever located," even outside the territorial jurisdiction of the United States. Comity does not require abstention or deference to the Italian judgment, because section 1334(e) explicitly grants jurisdiction over the foreign property. Still, the jurisdictional grant does not preclude foreign courts from exercising jurisdiction over property located within their countries, and because the property is located in Italy, the Italian courts must determine its ultimate fate, thereby rendering somewhat uncertain the effect of the court's decision that the Italian registration was void ab initio. In this sense, the extraterritorial reach of the automatic stay is only in personam, not in rem. *Sinatra v. Gucci (In re Gucci)*, 309 B.R. 679 (S.D.N.Y. 2004).

1.1.rrr. Automatic stay does not prevent objection to debtor in possession-creditor's proof of claim. The creditor was a debtor in possession in an unrelated chapter 11 case. The debtor in possession in this case objected to the creditor's proof of claim. The creditor argued that the debtor in possession required stay relief in the creditor's own chapter 11 case. The court rejects the argument, holding that the

automatic stay in the creditor's case does not apply where the debtor in possession in that case is acting as the claimant. *Hi-Tech Comm. Corp. v. Poughkeepsie Business Park, LLC (In re Wheatfield Business Park, LLC)*, 308 B.R. 463 (B.A.P. 9th Cir. 2004).

1.1.sss. Action to reduce maintenance payments to debtor may violate automatic stay. The debtor and her husband divorced before bankruptcy. The divorce court had ordered the husband to pay her maintenance payments and had ordered the debtor to pay the mortgage on their house. She missed payments, and the lender foreclosed. After bankruptcy, the husband sought reduction of his maintenance payments to the debtor to compensate for the losses he sustained by the debtor's failure to pay the mortgage. The husband's divorce court action violated the automatic stay. Courts have generally construed the alimony and maintenance exception to the automatic stay in section 362(b)(2)(A) ("the establishment or modification of an order for alimony, maintenance, or support") to apply to an action against the debtor, not to apply to an action that would reduce payments to the debtor. Moreover, in the case, the husband's action was effectively to recover through reduction of maintenance payments a dischargeable claim against the debtor. *In re Harris*, 310 B.R. 395 (Bankr. E.D. Wis. 2004).

1.1.ttt. Coercive discharge settlement negotiations may violate the automatic stay. The creditor had filed a complaint objecting to the discharge of the debtor, a real estate broker. In the course of settlement negotiations between counsel, the creditor's counsel threatened to seek revocation of the debtor's license from the state real estate commission if the matter did not settle. The debtor sued the creditor for violating the automatic stay by making a coercive threat in the negotiations. The First Circuit concludes that settlement negotiations over discharge are permissible, but that, as in reaffirmation negotiations, a coercive or harassing threat violates the automatic stay. The court remands to the bankruptcy court to determine whether this particular threat was coercive. *Diamond v. Premier Capital, Inc. (In re Diamond)*, 346 F.3d 224 (1st Cir. 2003).

1.1.uuu. Contract may not expand scope of automatic stay exceptions. The debtor's power purchase agreement stated that it was a "forward contract," with the intention that forward contract safe harbor provisions would apply and the automatic stay would not prevent termination. However, the counterparty was the Bonneville Power Administration. The Bankruptcy Code limits the definition of "forward contract" to a contract with a "forward contract merchant." "Forward contract merchant" is defined as "a person whose business" consists of forward contract trading. Because the debtor's counterparty was a governmental unit and therefore not a "person," the Code's forward contract safe harbor provisions do not apply. What's more, the parties cannot make them applicable by contract. Only Congress may define the scope of the automatic stay. *In re Mirant Corp.*, 303 B.R. 319 (Bankr. N.D. Tex. 2003).

1.1.vvv. Wisconsin wage lien statute is not subject to the automatic stay. A Wisconsin statute grants a lien against all of the assets of an employer to secure any unpaid wages. The statute provides, "the lien shall take precedence over all other debts, judgments, decrees, liens or mortgages … ." The employee perfected its lien after bankruptcy, relying on the retroactive perfection provision of section 546(b)(1) and the related exception to the automatic stay in section 362(b)(3). Although the statute does not specifically provide that the wage lien relates back to prime any intervening liens, such specific language is not required to come within the protection of section 546(b)(1). The statute's language was broad enough to prime any liens, whenever they attach and whenever perfected. The language of section 546(b)(1) looks only to whether the state lien primes preexisting liens. *In re AR Accessories Group, Inc.*, 345 F.3d 454 (7th Cir. 2003).

1.1.www. Improper chapter 13 petition does not create automatic stay. Upon dismissing the debtor's second chapter 13 case, the bankruptcy court issued a 180-day bar to refiling another bankruptcy case. The debtor moved for reconsideration of the 180-day bar. While that motion, which was ultimately granted, was pending, the debtor filed a third chapter 13 case in a different judicial district. The new judge held that the petition filed in violation of the other court's bar order did not trigger the automatic stay. The Ninth Circuit affirms, but later withdraws its opinion. *Umali v. Dhanani (In re Umali)*, 345 F.3d 818 (9th Cir. 2003); opinion withdrawn, 382 F.3d 1158 (9th Cir. 2004).

1.1.xxx. Section 549(c) is not an exception to the automatic stay. The Ninth Circuit brushes aside dicta in several prior decisions to rule that section 549(c), which protects a good faith purchaser of real estate in a post-petition transaction, is not an exception to the automatic stay. The court rules that section 549(c) applies only to transfers by the debtor, not to a foreclosure sale that violates the automatic stay, because a transfer in violation of the automatic stay is void, not merely voidable. The effect is that the property interests remain the same as if no transfer had been attempted. The court follows the recent decision of the Ninth Circuit Bankruptcy Appellate Panel reaching the same conclusion. *In re Mitchell*, 279 B.R. 839 (9th Cir. B.A.P. 2002). *40235 Washington Street*, *Corporation v. Lusardi*, 329 F.3d 1076 (9th Cir. 2003).

1.1.yyy. Aircraft financiers' section 1110 protection is absolute. The lender failed to perfect an aircraft security interest that would otherwise be subject to the protections of section 1110. The failure to perfect does not affect the lender's right to protection, and section 1110 trumps even the trustee's power to avoid the unperfected security interest under section 544(a). *Vanguard Airlines, Inc. v. International Aero Components, Inc.* (*In re Vanguard Airlines, Inc.*), 295 B.R. 908 (Bankr. W.D. Mo. 2003).

1.1.zzz. Automatic stay does not apply to collection of debt declared to be non-dischargeable. The creditor obtained a nondischargeability judgment against the debtor. The creditor promptly recorded an abstract of judgment in the County Recorder's office, so as to obtain a lien on the debtor's real property. However, the bankruptcy case was still open and the trustee had not yet abandoned the property. Accordingly, the debtor had no interest in real property at the time the abstract was recorded. The Ninth Circuit rules that the recordation of the abstract did not violate the automatic stay, because the debt had been held nondischargeable and also because the debtor did not have any interest in the real property and the abstract of judgment did not affect the estate's interest in the property. *Palm v. Cady (In re Cady)*, 315 F.3d 1121 (9th Cir. 2003).

1.1.aaaa. Creditor's internal record keeping did not violate stay. During the chapter 13 case, the bank continued to accrue post-petition attorney's fees incurred in prosecuting its claim against the debtor and recorded those fees in the debtor's file at the bank. The bank did not, however, assert those fees in the chapter 13 case or against the debtor in any other way. Such internal bookkeeping entries do not violate the automatic stay. *Mann v. Chase Manhattan Mortgage Corp.*, 316 F.3d 1 (1st Cir. 2003).

1.1.bbbb. Automatic stay does not stay appeal that may set precedent against the debtor. The debtor, his wholly owned corporation, and two other defendants were found liable in tort litigation. All four defendants appealed. While the appeal was pending, the debtor filed his chapter 11 case. The Second Circuit rules that the automatic stay applies to stay any further proceedings on the appeal by the debtor and to the appeal by his wholly owned corporation, because determination of the claim against the corporation would effectively determine the claim against the debtor. The stay does not apply to the appeal by the other two defendants, however, even though the appellate decision might have precedential affect against the debtor or might be used through offensive collateral estoppel against the debtor. *Queenie, Ltd. v. Nygard Intl.*, 321 F.3d 282 (2d Cir. 2003).

1.1.cccc. Automatic stay prevents enforcement of bankruptcy court order. The chapter 11 debtor's landlord obtained an order from the bankruptcy court requiring the payment of post-petition rent. When the debtor-in-possession did not pay, the landlord obtained a writ of execution from the clerk of the bankruptcy court and levied on the debtor-in-possession's bank account. The Ninth Circuit rules that the levy of the writ of execution violated the automatic stay of section 362(a)(3), even though the order that the writ sought to enforce was issued by the bankruptcy court against the debtor-in-possession for the payment of a post-petition obligation. *Kir Temecula v. LPM Corp. (In re LPM Corp.)*, 300 F.3d 1134 (9th Cir. 2002).

1.1.dddd. Automatic stay imposes affirmative duty to dismiss collection action. A creditor filed a collection action against the debtor shortly after the bankruptcy filing. The debtor's lawyer advised the creditor's lawyer by telephone and fax of the bankruptcy petition and demanded that the creditor dismiss the action within 14 days. The creditor did not dismiss for 23 days. The Ninth Circuit holds that the failure to dismiss promptly constituted a continuation of the action that violated the automatic stay, subjecting

the creditor and its counsel to sanctions. The Ninth Circuit rules that the automatic stay imposes an affirmative duty to dismiss an action promptly, because the mere pendency of the action creates a threat to the debtor *of a default judgment, which the automatic stay is designed to prevent. Eskanos & Adler, P.C. v. Leetien*, 309 F.3d 1210 (9th Cir. 2002).

1.1.eeee. Stay relief required for litigation over D&O insurance policies. The debtor in possession owned a D&O policy that insured not only the D's & O's, but also the debtor, for its own potential liability for securities law violations. The insurer sought to rescind the policy and had brought a declaratory judgment action before bankruptcy to do so. Because the policy itself (as contrasted to its proceeds) is property of the estate, the insurer may not proceed with the declaratory judgment action without relief from the stay. Similarly, because the debtor had a right to some of the policy proceeds, relief from the stay is required before any of the policy proceeds may be used to pay defense costs of directors and officers. *Adelphia Communications Corp. v. Associated Elec. and Gas Ins. Servs., Ltd. (In re Adelphia Communications Corp.)*, 285 B.R. 580 (Bankr. S.D.N.Y. 2002).

1.1.ffff. Automatic stay motion does not violate sovereign immunity. The state initiated proceedings against the debtor and its officers for non-payment of pre-petition vacation pay. The debtor brought a motion before the bankruptcy court to determine the scope and applicability of the automatic stay. On appeal, the district court rules that the motion does not violate the state's sovereign immunity. First, the proceeding is not a suit against the state, because the state is not named as a defendant, is not served with process, and is not compelled to appear in federal court. Second, the motion asks the bankruptcy court to exercise its power to determine the scope of a provision based on its jurisdiction over the debtor and its estate, not jurisdiction over the state or other creditors. It is the bankruptcy law, not the court's order, that operates to stay the state's action. *In re Midway Airlines Corp.*, 283 B.R. 846 (E.D.N.C. 2002).

1.1.gggg. Stay relief stipulation does not govern plan terms. The debtor and secured creditor entered into a stipulation for relief from the stay, effective some months later, if the debtor did not make certain payments during the chapter 11 case. Before that deadline, the debtor proposed and confirmed a chapter 11 plan that was inconsistent with the stay relief stipulation. The Ninth Circuit rules that the stay relief stipulation does not restrict the terms of a subsequent chapter 11 plan, unless the stipulation expressly so provides. *Atalanta Corp. v. Allen (In re Allen)*, 300 F.3d 1055 (9th Cir. 2002).

1.1.hhhh. Ordinary commodity contracts are subject to the safe harbor of section 546(e). Morgan Stanley Capital Group had entered into a contract for the purchase and sale of natural gas to the debtor. Morgan Stanley received four payments in the ninety days before bankruptcy. The trustee sought to avoid the payments as preferences. The Fifth Circuit rules that the contract for the delivery of natural gas is a "forward contract" within the meaning of section 101(25), because a "forward contract" encompasses all off-exchange forward contracts, even those for actual delivery of a commodity. The court then rules, without analysis, that Morgan Stanley is a "forward contract merchant," as required to qualify under section 546(e). Finally, the court concludes that the payments were "settlement payments" within the meaning of section 101(51A), because that term includes any payments commonly made in the forward contract trade. Section 546(e) therefore prohibits avoidance of the transfers. *Williams v. Morgan Stanley Capital Group, Inc. (In re Olympic Natural Gas Co.)*, 294 F.3d 737 (5th Cir. 2002).

1.1.iiii. A bankruptcy court's exclusive jurisdiction is coextensive with the automatic stay. The bankruptcy court has very broad jurisdiction. Where the automatic stay prohibits an action in another court, the bankruptcy court's jurisdiction is exclusive. Where an exception to the automatic stay applies, or where the bankruptcy court grants relief from the stay, its jurisdiction is concurrent. The non-bankruptcy court in which an action is pending may make a determination about the applicability of the automatic stay, but if it erroneously determines that the stay does not apply, the entire action may later be declared void. If the non-bankruptcy court is correct, it may issue orders that will later be enforced. Here, the Sixth Circuit reviews this question of exclusive and concurrent jurisdiction in the context of an action pending in a different district court from the district where the bankruptcy case was pending. *Chao v. Hospital Staffing Services, Inc.*, 270 F.3d 374 (6th Cir. 2001).

1.1.jjjj. An FLSA "hot goods" action relating to billing records is subject to the automatic stay. The debtor health care provider failed during its chapter 11 case. It did not pay wages to employees who prepared billing records to bill patients for the last several weeks of operations. The Secretary of Labor brought an action under the Fair Labor Standards Act to enjoin the transportation of the billing records in interstate commerce as "hot goods." The Sixth Circuit concludes that because the Secretary's action was solely to collect wages owing to employees and because the goods would not compete in commerce with any other goods produced by an other manufacturers, the Secretary's action did not meet the "public purpose" test of the police or regulatory power exception to the automatic stay in section 362(b)(4). Accordingly, the Secretary's action was stayed. *Chao v. Hospital Staffing Servs., Inc.*, 270 F.3d 374 (6th Cir. 2001).

1.1.kkkk. Automatic stay strictly enforced during involuntary gap. During the involuntary gap period, the debtor paid proceeds of collateral to its lender. The lender applied the proceeds to the loan. The lender's application of the proceeds violated the automatic stay, which applies during the involuntary gap. Although the debtor is authorized under section 303(f) to use or dispose of property as though a petition had not been filed, it does not authorize the lender to apply proceeds received from the debtor during the gap to the loan. *Bankvest Capital Corp. v. Fleet Boston (In re Bankvest Capital Corp.)*, 276 B.R. 12 (Bankr. D. Mass. 2002).

1.1.llll. Italian automatic stay recognized in the United States. The Italian bankruptcy law, as the U.S. bankruptcy law does, includes as property of the estate all of the debtor's property, wherever located. The Italian automatic stay also purports to have extraterritorial reach. The bankruptcy court here recognizes the extraterritorial reach of the Italian automatic stay in an ancillary case under section 304, on the ground that the United States cannot expect foreign courts to do the same if its courts do not equally recognize the impact in the United States of a foreign automatic stay. *In re Aartimm*, S.r.l., 278 B.R. 832 (Bankr. C.D. Cal. 2002).

1.1.mmmm. Discovery against a debtor does not violate the automatic stay. The Rhode Island individual debtor was an officer of a corporate Pennsylvania debtor. An attorney in the Pennsylvania case sought an examination under Rule 2004 of the Rhode Island debtor. The 2004 examination request did not violate the automatic stay in the individual debtor's Rhode Island case. *In re Carlson*, 265 B.R. 346 (Bankr. D. R.I. 2001).

1.1.nnnn. Automatic stay does not prohibit post-bankruptcy creation and perfection of environmental super-lien. Under Massachusetts law, the Commonwealth may create, by recording in the land records office, a lien to secure all clean-up costs that the Commonwealth expended on the real property. The lien is superior to all previously perfected liens. Section 362(a)(4) of the automatic stay prohibits "any act to create, perfect, or enforce any lien," but the exception of section 362(b)(3) exempts "any act to perfect ... an interest in property" to the extent that the perfection primes prior liens. Because the Commonwealth's environmental super-lien is not created until the recording of the notice, the debtor argued that the Commonwealth's postpetition recording violated the automatic stay and did not come within the postpetition perfection exemption. The First Circuit rules otherwise, concluding that the prepetition right of the Commonwealth to file and thereby create and perfect the lien constitutes "an interest in property" that gets the benefit of the exception of section 362(b)(3). *229 Main St. Ltd. P'ship v. Mass. Dept. of Environmental Protection (In re 229 Main St. Ltd. P'ship)*, 262 F.3d 1 (1st Cir. 2001).

1.1.oooo. Bankruptcy trumps district court receivership. In the secured creditors' receivership proceeding in the district court, the district court enjoined all persons from commencing any action that affects the receivership estate. Nevertheless, several employees filed an involuntary bankruptcy case against the debtor. The district court held them in contempt of its prior order, despite their argument that the automatic stay prohibited the district court from acting any further with respect to this debtor. On appeal, the Fourth Circuit rules that the automatic stay applies to the district court and the receivership proceeding, that the district court's injunction could not determine or limit the jurisdiction of the bankruptcy court as authorized under section 1334, and that in any event, a bankruptcy case was a far preferable means of liquidating the assets of a large corporation. *Gilchrist v. General Electric Capital Corp.*, 262 F.3d 295 (4th Cir. 2001).

1.1.pppp. Bankruptcy court has exclusive jurisdiction over automatic stay issues. After bankruptcy, an unscheduled creditor brought an action against the debtor before a state agency. The debtor responded with a letter asserting the applicability of the automatic stay, but the state agency determined that the stay did not apply and proceeded to issue an order against the debtor. The debtor turned to the bankruptcy court for an injunction against the agency and the creditor. Relying on its decision in *Gruntz v. County of Los Angeles (In re Gruntz)*, 202 F.3d 1074 (9th Cir. 2000) (en banc), the Ninth Circuit affirms the jurisdiction of the bankruptcy court to re-examine the automatic stay issue, despite the prior ruling of the state agency. The Ninth Circuit reasons that "Congress vested the federal courts with 'the final authority to determine the scope and applicability of the automatic stay,'" and that actions in violation of the automatic stay are void. *Contractors' State Lic. Board v. Dunbar (In re Dunbar)*, 245 F.3d 1058 (9th Cir. 2001).

1.1.qqqq. State court may determine applicability of automatic stay. Disagreeing with the Ninth Circuit's decision in *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000), a New York bankruptcy court holds that a state court determination that its own order and actions did not violate the automatic stay binds the bankruptcy court under the Rooker-Feldman doctrine. In this case, the debtor was incarcerated post-petition under a pre-petition arrest warrant for contempt of the state court in a debt collection proceeding. The debtor unsuccessfully sought a state court order that the arrest violated the automatic stay. The state court's determination was binding, and the bankruptcy court would not revisit it. *Siskin v. Complete Aircraft Servs., Inc. (In re Siskin)*, 258 B.R. 554 (Bankr. E.D.N.Y. 2001).

1.1.rrrr. Discovery against a debtor does not violate the automatic stay. The debtor was a co-defendant in an action pending in state court at the time the debtor filed her petition. The state court plaintiff sought discovery against the debtor to pursue the plaintiff's claim against the other defendant. On the debtor's motion for sanctions for violation of the automatic stay, the B.A.P. rules, in a matter of first impression that the stay does not prevent discovery against a debtor, even where the debtor is a co-defendant in the action. *Groner v. Miller (In re Miller)*, 262 B.R. 499 (9th Cir. B.A.P. 2001).

1.1.ssss. Government forfeiture action is excepted from the automatic stay. Section 362(b)(4), which excepts from the automatic stay an action by a governmental unit to enforce its police or regulatory power, was amended in 1998 to except the action from paragraphs (1) (2) (3), and (6) of section 362(a). Formerly, it excepted actions only from the stay under paragraph (1) or (2). The broadening of the language permits a governmental action for forfeiture of property used to commit a crime to proceed, despite the automatic stay. Such an action is not an action to enforce a money judgment and meets both the public purpose and nonpecuniary motive tests of the police or regulatory power exception to the automatic stay. *United States v. Klein (In re Chapman)*, 264 B.R. 565 (9th Cir. B.A.P. 2001).

1.1.tttt. Government action against sub-prime lender is excepted from the automatic stay. A sub-prime lender filed a chapter 11 case, ceased business operations, agreed not to write any further loan originations, and began to liquidate under chapter 11. It sought to enjoin several states and the FTC under the automatic stay or by a preliminary injunction from pursuing regulatory actions that would enjoin further loan originations and would assess rescission and restitution amounts and civil penalties. The district court, on appeal, first determined that the actions were excepted from the automatic stay under section 362(b)(4), because the police and regulatory power exception is not limited to situations intended to prevent future harm and the pecuniary aspect of the restitution claim does not take it outside of the police or regulatory power exception. It then ruled that the bankruptcy court should not enjoin the action without a substantially greater showing than the risk of a potential increase in legal fees, inconsistent rulings, and diversion of the debtor's time, energy, and resources, because the exception to the automatic stay evidences a congressional policy favoring police or regulatory power litigation without a strong showing of serious adverse consequences to the estate. *Federal Trade Commission v. First Alliance Mortgage Co. (In re First Alliance Mortgage Co.)*, 264 B.R. 634 (C.D. Cal. 2001).

1.1.uuuu. Repatriation order violates automatic stay. The SEC obtained a judgment for securities fraud shortly before the debtor's bankruptcy. Between trial and entry of the judgment, the debtor transferred substantial assets to an asset protection trust. The SEC sought repatriation of the assets as a remedy for the debtors contempt for violating the judgment. The Second Circuit rules that the efforts to

obtain repatriation constituted enforcement of the underlying money judgment and as such was prohibited by the exception to the exception for actions by a governmental unit in section 364(b)(4). More importantly, the Second Circuit rules that the 1998 amendments to section 362(b)(4) did nothing to affect the scope of the governmental unit exception to the automatic stay. *SEC v. Brennan*, 230 F.3d 65 (2d Cir. 2000).

1.1.vvvv. Court award of sanctions is not subject to the automatic stay. The debtor was sanctioned before bankruptcy. The determination of the amount of the award was not stayed, based on both the pecuniary purpose test (is the government pursuing a pecuniary interest or a matter of public safety and welfare?) and the public policy test (is the government action to effectuate public policy or to adjudicate private rights?). *Berg v. Good Samaritan Hospital (In re Berg)*, 230 F.3d 1165 (9th Cir. 2000).

1.1.wwww. Criminal prosecution with debt collection motive is not automatically stayed. The exception "of the commencement or continuation of a criminal action or proceeding against the debtor" contained in section 362(b)(1) of the automatic stay is absolute and does not admit of any exceptions, even if the prosecutor brings the criminal proceeding with a debt collection motive. A bankruptcy court may, however, enjoin a criminal proceeding under section 105 in appropriate circumstances. *Gruntz v. County of Los Angeles (In re Gruntz)*, 202 F.3d 1074 (9th Cir. 2000) (overruling *Hucke v. Oregon*, 992 F.2d 950 (9th Cir. 1993)).

1.1.xxxx. Qui tam (False Claims Act) action is excepted from the automatic stay. A private party relator brought a False Claims Act action against the debtor before bankruptcy. Even though the government had not substituted in as the plaintiff, the action was excepted from the automatic stay as a police or regulatory action brought by a governmental unit, because the action was brought in the name of the government and the government was the real party in interest. The fact that the action sought monetary damages did not affect the exception from the stay, although collection of any judgment would be stayed. *United States ex rel. Doe v. X, Inc.*, 246 B.R. 817 (E.D. Va. 2000).

1.1.yyyy. Any intentional act constitutes a willful stay violation. Although the creditor knew of the automatic stay, it mistakenly sent the debtor's file to a law firm to initiate foreclosure proceedings. The resulting stay violation was "willful" under section 362(h). Once the creditor received notice, the burden is on the creditor to prevent violations of the automatic stay. *Fleet Mortgage Group, Inc. v. Kanev*, 196 F.3d 265 (1st Cir. 1999).

1.1.zzzz. IRS statutory lien does not attach to post-petition after acquired property. The debtor received an inheritance post-petition which became property of the estate under section 541(a)(5). The IRS had perfected its tax lien against the debtor before bankruptcy and claimed that the lien attached to the after acquired property. In a case of first impression, the Third Circuit holds that section 362(a)(5) stays the attachment of the lien as "an act" to create a lien on property. *United States v. Gold (In re Avis)*, 178 F.3d 718 (4th Cir. 1999).

1.1.aaaaa. Criminal proceedings exception to automatic stay does not encompass recording of criminal restitution lien. 18 U.S.C. § 3613 grants the United States a lien to secure a criminal restitution debt and provides that the lien is perfected against third parties when recorded. The criminal proceedings exception to the automatic stay of section 362(b)(1) does not apply to permit postpetition recording, because the purpose of the lien is compensatory, not punitive. *Mayer v. United States (In re Reasonover)*, 236 B.R. 219 (Bankr. E.D. Va. 1999).

1.1.bbbbb. "Hot goods" manufactured in violation of FLSA wage standards may not be sold after bankruptcy. Under the Fair Labor Standards Act, the Secretary of Labor may enjoin the sale in interstate commerce of goods manufactured by employees who are paid less than the minimum wage. The district court holds that the Secretary's action to enjoin the sale comes within the police or regulatory power exception to the automatic stay. *Herman v. Hospital Staffing Services, Inc.*, 236 B.R. 377 (W.D. Tenn. 1999).

1.1.ccccc. Actions in the bankruptcy court may violate the automatic stay. Before bankruptcy, GM attempted to terminate the debtor's franchise. The debtor brought a proceeding before a state agency to challenge the termination notice. Under state law, the termination was not effective until resolution of that proceeding, during which the debtor filed chapter 11. The debtor attempted to sell the franchise during the chapter 11 case. GM objected, arguing that the franchise agreement had been terminated prepetition and was not an asset of the estate. The Third Circuit rules that GM's actions in the bankruptcy court constituted acts to take possession or control of property of the estate and thus violated the automatic stay. *Krystal Cadillac Oldsmobile GMC Truck, Inc. v. General Motors Corporation (In re Krystal Cadillac Oldsmobile GMC Truck, Inc.)*, 142 F.3d 631 (3d Cir. 1998).

1.1.ddddd. Margin calls on broker loan are not subject to the automatic stay. In a straight loan transaction, the debtor borrowed money from a stock broker and pledged securities to secure repayment, under the broker's standard margin account agreement. As the stock moved downward, the broker made unanswered margin calls after the debtor's bankruptcy and ultimately sold the debtor's position. The stock later recovered, and the trustee sued for violation of the automatic stay. In a case of apparent first impression, the Ninth Circuit holds that the exception to the automatic stay of section 362(b)(6) for margin calls applies even to straight loan transactions that do not implicate the securities' markets generally. *Wolkowitz v. Shearson Lehman Bros., Inc. (In re Weisberg)*, 136 F.3d 655 (9th Cir. 1998).

1.1.eeeee. Administrative hold may still constitute a violation of the stay. In *Citizens Bank v. Strumpf*, 516 U.S. 16 (1995), the Supreme Court held that an administrative freeze on a bank account did not violate the stay. In this case, however, the credit union waited four months before seeking relief from stay to effect the set-off. The District Court holds that the wait was too long and that the credit union therefore violated the automatic stay. *Town of Hempstead Employees' Federal Credit Union v. Wicks (In re Wicks)*, 215 B.R. 316 (E.D.N.Y. 1997).

1.1.fffff. PUC revocation of a debtor's taxi licenses is not subject to the automatic stay. The PUC sought to revoke the debtor's taxi licenses for non-use. The bankruptcy court enjoined the PUC for a violation of the automatic stay. The Tenth Circuit reverses, holding that the governmental police and regulatory power exception of section 362(b)(4) applies to the stay of an act "to exercise control over property of the estate" in section 362(a)(3). *Yellow Cab Co-op. Assoc. v. Metro Taxi, Inc. (In re Yellow Cab Co-op Assoc.)*, 132 F.3d 591 (10th Cir. 1997).

1.1.ggggg. Town ordinance may violate the automatic stay. After agreeing to process the debtor's application for a landfill, the town council adopted an ordinance prohibiting further landfills within the town. The trustee sued for a violation of the automatic stay, arguing that the town attempted to "exercise control over property of the estate." "Exercise control" requires a direct connection between the conduct stayed and the property at issue. The trustee had leased the site and assigned the application to a third party. As a result, the application was no longer property of the estate, even though there was a contingent payout right to the estate. However, the debtor's actions in reliance on the town's representation created an estoppel right that was property of the estate, over which the ordinance exercised control. Accordingly, the automatic stay litigation could proceed. *Slater v. Town of Albion (In re Albion Disposal, Inc.)*, 217 B.R. 394 (W.D.N.Y. 1997).

1.1.hhhhh. Directors and officer's liability insurance coverage litigation allowed to proceed in non-bankruptcy court. The debtor-in-possession sued its former officers and directors in the bankruptcy court. The directors and officers' liability insurer sued in state court for a declaration that the directors and officers were not covered by the liability portion of the policy. The debtor-in-possession obtained an injunction from the bankruptcy court against the insurer proceeding further in state court, arguing that the defendants' insurance coverage was like property of the estate and should be protected by the bankruptcy court. The Ninth Circuit vacated the injunction, ruling that the estate's difficulty in collecting damages from the defendants did not warrant the injunction. *Pintlar Corporation v. Fidelity and Casualty Company of New York (In re Pintlar Corporation)*, 124 F.3d 1310 (9th Cir. 1997).

1.1.iiiii. Retention of amounts owed by a State violates the automatic stay. The bankruptcy court ordered a State taxing agency to pay over to the trustee disputed taxes that had been paid under protest.

Pending an appeal from the bankruptcy court's order, the State did not pay the trustee. The State's refusal to pay was held a violation of the automatic stay and of the section 542(a) turnover provision, which, the court holds, is automatic and does require either a demand or an action to enforce. *Employment Development Department v. Taxel (In re Del Mission Ltd.)*, 98 F.3d 1147 (9th Cir. 1996).

1.1.jjjjj. Insurer's lawsuit against debtor's shareholders does not violate automatic stay. An insurance company had issued environmental response cost policies to the debtor and to each of its two corporate shareholders. After the filing of the debtor's chapter 11 case, the insurance company sought declaratory relief against the shareholders in state court. Because the lawsuit was carefully circumscribed, it did not implicate property of the estate and did not violate the automatic stay. *Liberty Mutual Insurance Co. v. Official Unsecured Creditors' Committee of Spaulding Composites Co. (In re Spaulding Composites Company, Inc.)*, 207 B.R. 899 (9th Cir. B.A.P. 1997).

1.1.kkkkk. Prohibited bankruptcy filing did not create automatic stay. An order of dismissal was made "with prejudice to the filing of a petition under any chapter of the Bankruptcy Code for a period of twelve months." The debtor colluded in the filing of an involuntary petition against herself two months later. While the second petition was pending, she was sued. Because of the prohibition in the prior bankruptcy case, the second filing did not trigger the automatic stay of Section 362(a), and the judgment in the lawsuit was affirmed. *Federal Deposit Insurance Corporation v. Cortez*, 96 F.3d 50 (2d Cir. 1996).

1.2 Effect of Stay

1.2.a. Section 108(c) extends a creditor's time to act under nonbankruptcy law, even where the automatic stay does not prohibit alternative action to preserve the creditor's rights. The debtor's mortgage obligation had matured. State law terminated the lien of the mortgage if the mortgagee did not commence a judicial foreclosure action or file a notice of extension within five years after the mortgage's maturity date. Before the five-year period expired, the debtor filed bankruptcy. The mortgagee did not commence foreclosure or file an extension statement. The automatic stay prohibits the commencement of a judicial foreclosure proceeding. Section 362(b)(3), however, excepts from the automatic stay an act "to perfect, or to maintain or continue the perfection of, an interest in property", such as recording the extension statement. Section 108(c) provides that if applicable nonbankruptcy law "fixes a period for commencing or continuing a civil action in a court other than the bankruptcy court on a claim against the debtor, … and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of (1) the end of such period … or (2) 30 days after notice of the termination or expiration" of the automatic stay. The state statute gives only the mortgagee the option to commence a judicial proceeding or record the extension statement. The automatic stay stayed the mortgagee's right to commence the proceeding. Accordingly, section 108(c) extended the time for the mortgagee to commence the proceeding, whether or not section 362(b)(3) permitted the mortgagee to record the extension statement. Because bankruptcy occurred before the expiration of the five-year period and the automatic stay prevented the commencement of foreclosure proceedings, the state law did not terminate the lien of the mortgage unless the mortgagee did not act within 30 days after notice of termination of the automatic stay. *Shamus Holdings, LLC v. LBM Fin., LLC (In re Shamus Holdings, LLC)*, 642 F.3d 263 (1st Cir. 2011).

1.2.b. Mortgagee need not record an extension statement to prevent operation of an obsolete mortgage discharge statute. State law discharges a mortgage five years after its due date unless the mortgagee records an extension affidavit or commences a civil action to enforce the mortgage. In this case, the five-year period expired during the debtor's bankruptcy case. The automatic stay prohibits any action to enforce a lien, but an exception in section 362(b)(3) permits an act "to maintain or continue the perfection" in certain circumstances, which are present here. Section 108(c) extends applicable nonbankruptcy statutes of limitation for commencing a civil action that has not expired as of the petition date until 30 days after termination of the stay with respect to the action. Although the automatic stay exception permits the mortgagee here to extend the mortgage by recording the extension affidavit before the five-year period expires, the Bankruptcy Code does not require the mortgagee to elect that remedy rather than rely on the extension contained in section 108(c) to bring a civil action. Therefore, the

obsolete mortgage statute did not discharge the mortgage. *LBM Fin., LLC v. 201 Forest St., LLC (In re 201 Forest St., LLC)*, 422 B.R. 888 (1st Cir. B.A.P. 2010).

1.2.c. Stay relief does not divest the estate of its property interest. With the debtor in possession's consent, the bankruptcy court granted stay relief to permit foreclosure. An entity that the DIP's principals secretly controlled purchased the property at the foreclosure sale. Despite the stay relief, the property remained estate property, because stay relief only terminates an injunction; it does not dispose of any property or interest in property. The DIP's principals owed the fiduciary duty of loyalty to the estate not to deal with estate property for their own benefit, which they breached by their role at the foreclosure sale. Therefore, the court properly imposed a constructive trust on the property for the benefit of the estate. *Lange v. Schropp (In re Brook Valley IV, Joint Venture)*, 496 F.3d 893 (9th Cir. 2007).

1.2.d. Appellate reversal of dismissal order does not retroactively reinstitute the stay. When the court denied confirmation of the debtors' chapter 13 plan, it dismissed their case. The debtors appealed and sought but were denied stays pending appeal. While the appeal was pending, the secured lender foreclosed on the debtors' real property. The appellate court later reversed the dismissal, and the debtors sought to void the foreclosure sale as violating the stay. The reversal and reinstatement of the chapter 13 case did not retroactively revive the automatic stay, so the creditor's foreclosure sale was valid. Some courts have adopted a "due process" exception to this rule: if the debtor did not receive due process notice of the motion to dismiss and the order is reversed on appeal, then the stay may be retroactively reinstated. This exception does not apply in the First Circuit. Even if it did, the debtors had adequate notice in this case, as the dismissal came at the conclusion of the confirmation hearing, which the debtors attended. *Lomagno v. Salomon Bros. Realty Corp. (In re Lomagno)*, 320 B.R. 473 (B.A.P. 1st Cir. 2005).

1.2.e. Section 108, not section 362, governs the tolling of a period of redemption. Under Vermont and other states' real property foreclosure law, the debtor has a fixed period of time after the judgment of foreclosure to redeem the property. If the debtor files a bankruptcy petition within that time period, the petition tolls a running of the redemption period. However, the tolling is governed by section 108, not section 362. Although the right of redemption is property of the estate, and section 362 stays any act to exercise control over property of the estate, section 362 does not stay the running of time, because the running of time is not an "act." In addition, section 108 would be rendered superfluous if section 362 provided an unlimited tolling. The Second Circuit joins the Sixth, Seventh, and Eighth Circuits in reaching this conclusion. *Canney v. Merchants Bank (In re Canney)*, 284 F.3d 362 (2d Cir. 2002).

1.2.f. Statute of duration of judgment extended beyond discharge by section 108. A state court judgment entitled the judgment creditor to a lien on the debtor's assets. The debtor had received his discharge, but there remained assets in the estate to be distributed. Because the automatic stay continues with respect to property of the estate until it is no longer property of the estate, section 108(c) suspends the operation of the statute of duration (which voids a judgment after ten years) until 30 days after the termination of the automatic stay. *Spirtos v. Moreno (In re Spirtos)*, 221 F.3d 1079 (9th Cir. 2000).

1.2.g. Bankruptcy court may not enjoin shareholders' securities suits against directors. The trustee brought a claim against directors for damage to the corporation. Shareholder sued the directors for violation of section 10(b)(5) of the Securities Act. The bankruptcy court enjoined the prosecution of the shareholder action. The district court reversed, holding that the shareholders action was not property of the estate, that the potential interference between the two actions was unlikely, and that the resolution of the potential conflict in the pursuit of directors and officers insurance policies should await liability and determination of coverage under the policies. *In re Reliance Acceptance Group, Inc.*, 235 B.R. 548 (D. Del. 1998).

1.2.h. Debtor may not stipulate to relief from stay during the involuntary gap period. Because a debtor does not have the powers of a trustee during the involuntary gap period, the debtor may not stipulate to relief from the automatic stay. The creditor may obtain relief only by filing a motion, with service upon the debtor and the petitioning creditors. *In re E.D. Wilkins Gray Co.*, 235 B.R. 647 (Bankr. E.D. Cal. 1999).

1.2.i. Bankruptcy Court has exclusive jurisdiction to determine applicability of automatic stay. The debtor was prosecuted in state court for nonpayment of child support while he was a debtor in a bankruptcy case and over his objection that the prosecution violated the automatic stay. Relying on section 1334(a) of title 28, which grants bankruptcy courts exclusive jurisdiction over bankruptcy cases (as opposed to "proceedings arising in cases" under section 1334(b), the Ninth Circuit holds that the determination of the effect of an exception to such a fundamental bankruptcy tool as the automatic stay must be within the exclusive jurisdiction of the bankruptcy court. *Gruntz v. County of Los Angeles (In re Gruntz)*, 166 F.3d 1020 (9th Cir. 1999).

1.2.j. Court enforces pre-bankruptcy waiver of automatic stay. The court sets forth the following factors as relevant in determining whether a pre-bankruptcy waiver of the automatic stay provides sufficient cause for relief from the stay: (1) the financial and legal sophistication of the borrower; (2) whether the lender gave significant consideration for the waiver; (3) whether the case was primarily a two-party dispute; and (4) whether circumstances substantially changed since the granting of the waiver. Finding all four factors present in this case, the court granted relief from the stay. *Mass. Mut. Life Ins. Co. v. Shady Grove Tech Center Assocs. Ltd. P'ship (In re Shady Grove Tech Center Assocs. Ltd. P'ship)*, 227 B.R. 422 (Bankr. D. Md. 1998).

1.2.k. Automatic stay provides defense to liability. A Pennsylvania statute made the officers of a corporation personally liable to the employees for failure to pay over withheld union dues or vacation or other fringe benefit payments. When the corporation filed chapter 11, the automatic stay prevented the corporation from paying the amounts it owed. Because the corporation was prevented by operation of law from paying the amounts, the Third Circuit rules that the individual officers are not personally liable for non-payment. *Belcufine v. Aloe*, 112 F.3d 633 (3d Cir. 1997).

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).

1.3.c. A receiver is a party in interest for purposes of seeking stay relief or abstention from proceedings that would interfere with the receivership. The municipal debtor had issued revenue bonds, secured by a pledge of the net revenues of the debtor's sewer system. The debtor defaulted in payments. The indenture trustee sought and obtained the appointment of a state court receiver, as provided in the indenture, to take possession of and operate the system, collect revenues, set rates and pay net revenues to the indenture trustee for distribution to bondholders. Upon the debtor's filing its chapter 9 case, the receiver moved for the bankruptcy court to abstain from taking any action to interfere with the receivership. Only a party in interest may request relief from the bankruptcy court. The Code does not define "party in interest", though section 1109(b) contains a nonexclusive list of some parties in interest. An entity is a party in interest if it has a sufficient interest, whether pecuniary or practical, in the particular proceeding to merit representation. Although the receiver is not a creditor but is merely an arm of the appointing court, the receiver has a sufficient practical interest in knowing whether and to what extent the automatic stay and the Code's turnover provisions apply to qualify as a party in interest. *In re Jefferson County, Ala.*, 465 B.R. 243 (Bankr. N.D. Ala. 2012).

1.3.d. Bankruptcy court may sanction for contempt on motion and may order relief to return the parties to the prior status quo. The debtor operated a mine on lease. A creditor filed an involuntary petition against the debtor. The lessor attempted to terminate the lease, commenced a state court action to collect royalties owing under the lease and sued one of the debtor's customers to require it to pay to the lessor amounts that it owed to the debtor. The creditor filed a motion to hold the lessor in contempt for violation of the automatic stay. The lessor did not respond to the motion. The court found the lessor in contempt, declared any acts to terminate the lease void and ordered the lessor to return to the debtor any money it had collected, to dismiss the action to collect from the debtor's customer and to pay the creditor's attorneys' fees and costs for the contempt proceeding. Rule 9020 provides that Rule 9014 governs a motion for a contempt order. Rule 9014 permits a party to obtain relief by motion. Bankruptcy Rule 7001 requires an adversary proceeding to obtain injunctive, equitable or declaratory relief but does not apply to a motion to restore the status quo as it existed before a stay violation. Therefore, the creditor properly requested the relief by motion. A bankruptcy court may find a party in contempt for violating the stay. The court is not limited to ordering monetary sanctions. Therefore, the court may void any action that the contemnor took in violation of the stay to return the parties to the situation that existed before the violation. *Std. Indus., Inc. v. Aquila, Inc. (In re C.W. Mining Co.)*, 625 F.3d 1240 (10th Cir. 2010).

1.3.e. Contempt action for stay violation may be brought by motion. A creditor filed an involuntary petition against the debtor. Before the hearing on the petition, another creditor terminated its contract with the debtor and attempted to collect a prepetition claim, and a third creditor sued the debtor's account party to collect funds that had been garnished by the petitioning creditor. The petitioning creditor filed a motion to hold the other two creditors in contempt for violating the automatic stay, seeking an order declaring the contract termination void, requiring repayment to the estate of any funds that the other two creditors had received, ordering the third creditor to dismiss the state court lawsuit and requiring payment to the petitioning creditor of the cost, including attorneys' fees, of pursuing the contempt action. Bankruptcy Rule 9020 provides that Rule 9014 governs a motion for an order of contempt. Rule 9014 governs contested matters. Thus, a motion suffices; an adversary proceeding is not required, even where the contempt motion seeks monetary damages or injunctive relief. In redressing a stay violation, a bankruptcy court is not limited to monetary relief. Here, the relief requested would only return the parties to the status quo ante and is appropriate. *Std. Indus., Inc. v. Aquila, Inc. (In re C.W. Mining Co.)*, 625 F.3d 1240 (10th Cir. 2010).

1.3.f. Individual creditor may seek damages for stay violation. Shortly after the debtor construction company's chapter 11 filing, the debtor's bonding company advised customers that payments to the debtor in possession of amounts owing on construction contracts would reduce the bonding company's liability on the bond to the customers. Predictably, customers stopped paying the DIP, the DIP ran short of cash, the case converted to chapter 7 and the debtor liquidated. The debtor's individual shareholders had guaranteed the bonding company. They sued the bonding company for damages arising from the company's automatic stay violation. Section 362(k) provides that "an individual injured by any willful

violation of a stay … shall recover actual damages …". Section 362(k) creates a private remedy for automatic stay violations. The term "individual" and the language of section 362(k) are not limited to the debtor. The automatic stay exists to protect creditors as well as the debtor. In addition, section 1109(b) gives a creditor standing to appear and be heard on any issue in a chapter 11 case. Finally, a claim for a stay violation is not solely property of the estate, because it arises only postpetition and is not listed in section 541(a). Therefore, standing is not limited to the debtor or the trustee. The shareholders here may assert a claim for damages, but only in their capacity as creditors. The court rules that they may not assert the claim in their capacity as shareholders but does not explain why. *St. Paul Fire & Marine Ins. Co. v. Labuzan*, 579 F.3d 533 (5th Cir. 2009).

1.3.g. Stay violation actual damages does not include attorneys' fees for seeking damages. A creditor willfully violated the automatic stay. The debtor brought an action in the bankruptcy court for damages arising from the violation. Section 362(k)(1) grants an individual injured by a willful stay violation recovery of "actual damages, including costs and attorneys' fees". The American Rule does not include within the scope of damages for a breach of duty the attorneys' fees incurred in seeking damages. Section 362(k)(1) is unclear on whether Congress intended a departure from the American Rule. However, a departure would require a clearer statement of Congress's intent. The inclusion of the phrase "including costs and attorneys' fees" should therefore be read to include only the costs and attorneys' fees incurred to remedy the stay violation, such as any action to undo the violation or return the parties to their prior position. Consistent with the American Rule, "actual damages" does not include the costs or attorneys' fees incurred to recover the actual damages. *Sternberg v. Johnston*, 582 F.3d 1114 (9th Cir. 2009).

1.3.h. Bankruptcy court may award punitive damages and attorney's fees for willful stay violation; emotional distress damages require specific evidence of harm. While incarcerated for criminal contempt for nonpayment of child support and his ex-wife's attorney's fees, the debtor filed a chapter 13 petition. Despite the automatic stay and clear notice of the stay, the ex-wife's attorney continued efforts to collect her fees, including refusing consent to the debtor's release from prison and refusing to appear in state court to present a stipulation providing for release, until her fees were paid, even though the debtor and ex-wife had settled and agreed to his release. Once released, the debtor sued the attorney for damages for a stay violation under section 362(k), including emotional and punitive damages and attorney's fees for the section 362(k) proceeding itself. Section 362(k) permits "an individual injured by any willful violation of a stay [to] recover actual damages, including costs and attorney's fees, and, in appropriate circumstances, [to]recover punitive damages. The bankruptcy court may award damages for emotional distress only where the debtor presents specific information concerning emotional distress damages, rather than generalized assertions. Where, as here, the debtor asserted that the continued incarceration caused him to miss his father's funeral but only that missing the funeral was "very traumatic", that he still had dreams about it and that he would likely never get over it, the evidence was not sufficiently specific to support an emotional damages award under section 362(k). A court may grant punitive damages if the creditor's conduct is egregious. The attorney here ignored warnings about the automatic stay, ignored her client's wishes that the debtor be released from jail, failed to appear before the bankruptcy court despite an order to do so and persisted in collection efforts despite the bankruptcy court's admonition to stop. Such conduct is sufficiently egregious to warrant punitive damages. Finally, section 362(K) contemplates an attorney's fees award for prosecuting the section 362(k) proceeding itself, not just for attorney's fees incurred as a result of the stay violation. *Young v. Repine (In re Repine)*, 536 F.3d 512 (5th Cir. 2008).

1.3.i. Emotional distress damages are not available for an automatic stay violation. Reversing its prior ruling, 367 F.3d 1174 (9th Cir. 2004), the Ninth Circuit concludes that a debtor may bring a claim under section 362(h) for emotional distress damages, whether or not the debtor suffers economic damages as well. Because section 362(h) provides for actual damages only for individuals, as distinguished from incorporeal entities, Congress must have intended to protect attributes of actual damages that are unique to individuals, such as emotional distress. However, to be entitled to emotional distress damages under section 362(h), the debtor must suffer significant harm, clearly establish it, and demonstrate a causal connection between that harm and the stay violation (as distinct from the emotional harm of bankruptcy or financial distress generally, for example). *Dawson v. Washington Mut. Bank, F.A. (In re Dawson)*, 390 F.3d 1139 (9th Cir. 2004).

1.3.j. Stay relief may not be denied solely to prevent lien perfection. The creditor had obtained a prejudgment attachment in state court before bankruptcy but had not "perfected" the attachment by obtaining judgment on the underlying claim because of the automatic stay. The creditor sought relief from the stay, which the bankruptcy court denied to prevent the creditor from perfecting the attachment and having a valid secured claim. Though there may be other reasons to deny stay relief in these circumstances, such as because the ultimate lien would have been worthless or because the underlying claim was invalid, it was improper to deny relief solely to block perfection of the creditor's lien. *First Fed. Bank v. Robbins (In re Robbins)*, 310 B.R. 626 (B.A.P. 9th Cir. 2004).

1.3.k. Collateral agent has exclusive right to seek stay relief to enforce rights against collateral. The loan agreement and the security agreement irrevocably appointed an administrative agent and a collateral agent, respectively, and granted the agents the exclusive right to pursue claims against the debtor and to enforce rights against the collateral. As a result, the individual members of the bank group, and all members of the group acting together, did not have standing to enforce claims against the debtor or to seek relief from the automatic stay to foreclose on the collateral. The contract among the banks and the debtor was binding even in bankruptcy, and only the agent could bring the actions. *Mizuho Corporate Bank, Ltd. v. Enron Corp. (In re Enron Corp.)*, 302 B.R. 463 (Bankr. S.D.N.Y. 2003).

1.3.l. Emotional distress damages are not available for an automatic stay violation. A debtor may not bring a claim under section 362(h) for emotional distress damages. Section 362(h) is directed to economic damages resulting from a stay violation. Any claim for emotional distress should be brought only under state tort law. *Dawson v. Washington Mut. Bank, F.A.*, 367 F.3d 1174 (9th Cir.), *rev'd* 390 F.3d 1139 (9th Cir. 2004).

1.3.m. Standard for annulling the automatic stay is a "balancing of the equities" test. The Ninth Circuit B.A.P. rejects an "extreme circumstances" test in favor of a "balancing of the equities" test in determining whether the bankruptcy court should retroactively annul the automatic stay. In this case, the debtor filed her second petition twelve days after her first petition had been dismissed and less than one hour before a scheduled foreclosure sale. The auctioneer at the foreclosure sale postponed the sale for two hours but then sold the property to a buyer who was not aware that the bankruptcy had been filed. The court annulled the stay solely on the ground that the purchaser was a good faith purchaser who would have been protected by section 549(c). The B.A.P. concludes that section 549(c) is not an exception to the automatic stay and that reliance on the factor alone does not adequately balance the equities. *Fjeldsted v. Lien (In re Fjeldsted)*, 293 B.R. 12 (9th Cir. B.A.P. 2003).

1.3.n. Judicial estoppel bars debtor from pursuing stay violation claim. The debtor and its franchisor litigated extensively over whether the franchisor properly terminated the franchise agreement, which would have had substantial value in a sale. During the course of the chapter 11 case, the court determined that the franchisor's termination of the agreement violated the automatic stay. Nevertheless, the debtor's disclosure statement did not state that it had a claim against the franchisor for violation of the stay, only for reinstatement of the franchise agreement. Nor did the debtor amend its Schedules to disclose the stay violation claim. As a result, the stay violation claim was barred by judicial estoppel. The non-disclosure of the potentially significant asset appears to have been designed to induce creditors to settle for less. That was an inconsistent prior position that the debtor took in bad faith. *Krystal Cadillac-Oldsmobile GMC Truck, Inc. v. General Motors Corp.*, 337 F.3d 314 (3d Cir. 2003).

1.3.o. Trustee may not get punitive damages for stay violation. After bankruptcy, the creditor recorded a deed of trust, but it was unclear whether the creditor directly knew of the automatic stay. After the creditor was informed that the recordation violated the automatic stay, he refused to reconvey the deed of trust to undo the violation. The trustee then sought and received compensatory (attorney's fees) and punitive damages. The Ninth Circuit reverses. The Ninth Circuit rules that the trustee is not an "individual" protected by section 362(h). The bankruptcy court may sanction for civil contempt under section 105(a) for a violation of the stay. Section 105 provides civil contempt authority, even though it does not provide a vehicle generally for enforcing provisions of the Bankruptcy Code. Sanctions for civil contempt under section 105(a) and for violation of section 362(h) both require willfulness, but in the context of section 362(h), willfulness requires only a finding that the defendant knew of the automatic stay

and that its actions were intentional. For this purpose, knowledge of the bankruptcy petition imputes knowledge of the automatic stay. For civil contempt purposes, however, because the contemnor must actually know of the order being violated to be subject to sanctions, the contemnor must have actual knowledge of the automatic stay. Here, because the defendant did not remedy the violation after he learned of the automatic stay, sanctions were proper. Punitive sanctions, however, are not proper under the Bankruptcy Code's civil contempt authority or under its inherent authority to sanction improper conduct. Civil contempt sanctions may be only compensatory or coercive, not punitive. Imposition of punitive sanctions requires compliance with criminal procedural protections. Sanctions under the court's inherent authority may be imposed only for bad faith or willful misconduct, which requires something more egregious than mere negligence or recklessness. By contrast, punitive sanctions are available under section 362(h) only because Congress expressly authorized them as a civil remedy. *Knupfer v. Lindblade (In re Dyer)*, 322 F.3d 1178 (9th Cir. 2003).

1.3.p. Stay relief should be granted to pursue proceeds of embezzled funds. The debtor purchased goods using embezzled funds. Although the debtor had legal title to the goods, he did not have any equitable interest. The automatic stay should be lifted to permit pursuit of the victim's pre-petition state court action to recover the goods. The court distinguishes an action to impose a constructive trust on the grounds that with respect to proceeds of stolen property, the debtor never obtained equitable title, which the state court may determine. In the typical constructive trust, the debtor engaged in improper conduct after receiving the property, giving rise to the equitable remedy of a constructive trust, distinguishing *In re Omegas Group, Inc.*, 16 F.3d 1443 (6th Cir. 1994). *Kitchen v. Boyd (In re Newpower)*, 233 F.3d 922 (6th Cir. 2000).

1.3.q. Bankruptcy Court has exclusive jurisdiction over modification of the automatic stay. A proceeding to modify the automatic stay is part of the "case" for purposes of jurisdiction under section 1334(a). As a result, the bankruptcy court has exclusive jurisdiction to modify the stay, and any state court judgment regarding the stay is void. The Ninth Circuit also suggests that any core proceeding is part of the "case" rather than a "proceeding" under section 1334(b). The court also vests the automatic stay with the qualities of "an injunction arising from the authority of the Bankruptcy Court." *Gruntz v. County of Los Angeles (In re Gruntz)*, 202 F.3d 1074 (9th Cir. 2000).

1.3.r. Bankruptcy court has exclusive jurisdiction over sanctions for stay violation. The debtor sought sanctions under section 362(h) in the state court for opposing counsel's violation of the stay in the state court action. The state court denied sanctions. The debtor later sought sanctions from the bankruptcy court for the same action of opposing counsel The bankruptcy court denied sanctions on *res judicata* grounds, but the District Court reversed, holding that the bankruptcy court had exclusive jurisdiction over sanctions under section 362(h) and was therefore not bound by the state court's prior ruling. *Halas v. Platek*, 239 B.R. 784 (N.D. Ill. 1999).

1.3.s. Debtor may not enforce automatic stay to protect estate. The debtor's landlord sued the debtor for damage to the building and obtained relief from the stay on the grounds that the debtor's liability was insured. After conversion of the debtor's case to chapter 7 and the appointment of a trustee, the landlord obtained judgment in excess of the policy limits. The trustee settled with the landlord for the excess amount by assigning the debtor's insurance bad faith claim to the landlord in exchange for 5% of the landlord's recovery. The lawyer who defended the debtor in the underlying action at the expense of the insurance company brought a motion in the bankruptcy court on behalf of the debtor to "enforce the automatic stay," that is, to enjoin the landlord from proceeding against the insurer on the assigned claim. The court of appeals holds that in a chapter 7 case, the debtor does not have standing to enforce the automatic stay for the protection of the estate. *In re New Era, Inc.*, 135 F.3d 1206 (7th Cir. 1998).

1.3.t. Equitable servitude granted as protection against automatic stay. The debtor filed a bankruptcy petition under questionable circumstances, listing a house as his only asset. On a motion for relief from stay and for further relief, the bankruptcy court granted relief and an *in rem* order, which operated as an equitable servitude on the property to bind all subsequent purchasers for 180 days so that any subsequent bankruptcy filing would not result in the triggering of the automatic stay against

foreclosure on the real property. *Great Western Bank v. Snow (In re Snow)*, 210 B.R. 968 (Bankr. C.D. Cal. 1996).

1.3.u. Contempt sanctions for violation of automatic stay. The Eleventh Circuit joins the Second and Ninth Circuits in holding that "individual" in section 362(h) does not include a corporation, but that the bankruptcy court has contempt power under section 105(a) to award monetary and other forms of relief for automatic stay violations. Because this case involved a stay violation by the IRS, the court further ruled that "section 106(a) unequivocally waives sovereign immunity for court-ordered monetary damages under section 105," but that any attorney's fees awarded against the IRS must be consistent with the Equal Access to Justice Act, 28 U.S.C.§ 2412(d)(2)(A) and section 7430 of the Internal Revenue Code. The court also prohibited any punitive sanction for the civil contempt violation of the automatic stay. *Jove Engineering, Inc. v. Internal Revenue Service*, 92 F.3d 1539 (11th Cir. 1996).

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a. Subchapter S corporation's dividend is not a fraudulent transfer. The debtor corporation agreed with a shareholder in 1991 that if the shareholder became liable for the corporation's taxes, the corporation would declare a dividend in the amount of the shareholder's resulting tax liability. In 2005, the debtor made a Subchapter S election and in 2006 issued a dividend to the shareholder in the amount of his resulting tax liability. The debtor was insolvent at the time and filed bankruptcy within two years. The trustee may avoid a transfer made while the debtor was insolvent within two years before bankruptcy if the debtor did not receive reasonably equivalent value in exchange. The shareholder's agreement to pay the corporation's taxes provided reasonably equivalent value to the debtor. Therefore, the dividend is not an avoidable transfer. *Crumpton v. Stephens (In re Northlake Foods, Inc.)*, 715 F.3d 1251 (11th Cir. 2013).

2.1.b. Section 546(g) preempts state law fraudulent transfer claims. The debtor transferred a large commodities derivatives portfolio shortly before bankruptcy. The debtor's chapter 11 plan established a litigation trust, to which certain creditors transferred all of their claims, including claims under nonbankruptcy fraudulent transfer law to avoid the debtor's prebankruptcy transfers. More than two years after bankruptcy, the litigation trustee, as the creditors' assignee, brought an action against the portfolio transferee to avoid and recover the portfolio under nonbankruptcy constructive fraudulent transfer law, relying on the creditors' claims, not the estate's claims under section 544(b). Section 546(g) provides that a trustee may not avoid "a transfer, made by or to … a swap participant under or in connection with any swap agreement." A federal law impliedly preempts a state law if, among other things, there is a conflict so that the application of the state law would be an obstacle to accomplishing Congress's purposes and objectives. Section 546(g)'s purpose is to protect financial markets from the disruptive effects of unwinding settled transactions. Permitting creditors to assign their nonbankruptcy law avoiding power claims to a trustee would undercut section 546(g) and render it a nullity. Therefore, section 546(g) preempts the nonbankruptcy law fraudulent transfer claim. *Whyte v. Barclays Bank plc*, ___ B.R. ___ (S.D.N.Y. June 11, 2013).

2.1.c. Incurrence and payment of a tax penalty is not a fraudulent transfer. The debtor failed to pay withholding and employment taxes. The IRS assessed penalties. The debtor paid some of the taxes and some of the penalties. The debtor later filed a chapter 11 case and confirmed a plan that provided for the debtor to retain avoiding power claims. The reorganized debtor sued the IRS to recover the penalty payments as fraudulent transfers. A transfer or obligation may be avoidable under section 548 or under the UFTA if made or incurred for less than reasonably equivalent value while the debtor was insolvent. "Value" includes satisfaction or securing of an antecedent debt. Payment of an antecedent debt is voidable as a fraudulent transfer only if the debt is avoidable as a fraudulent obligation. A debtor might not receive reasonably equivalent value in exchange for the imposition of a noncompensatory tax penalty obligation. However, nothing in section 548 or UFTA suggests that they were intended to permit avoidance of such obligations, and their purpose to discourage creditors from gaining unfair advantage during the debtor's slide into insolvency would not be served by permitting avoidance of tax penalty obligations. Moreover, the impact of a decision to permit avoidance would be enormous, spawning litigation reaching

to all kinds of penalties. Therefore, neither the obligations nor their payment is avoidable. *Southeast Waffles, LLC v. U.S. (In re Southeast Waffles, LLC)*, 702 F.3d 850 (6th Cir. 2012).

2.1.d. Dissolving law firm partners' *Jewel v. Boxer* waiver is a transfer of property of the debtor. Under *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1994), a partner in a law firm undergoing dissolution owes a fiduciary duty to the partnership and the other partners to account for profits on any unfinished business that the partner completes after leaving the firm. Here, law firm partners entered into an agreement to dissolve the firm. The agreement contained a waiver of the partnership's *Jewel* rights to facilitate the movement of partners and unfinished business to new law firms, which in turn facilitated movement of associates and staff, reduction of WARN Act and malpractice liability and an increase in the firm's ability to collect receivables from its former clients. The law firm filed bankruptcy within a few months. Before it filed bankruptcy, it continued to incur debts, which it was able to pay from current cash flow, but it had substantial prior unliquidated liabilities that it was no longer able to pay. A trustee may avoid as a fraudulent transfer a transfer of an interest of the debtor in property if made within two years before the bankruptcy for less than reasonably equivalent value when the debtor was insolvent or was incurring debts beyond its ability to repay. Unfinished business was property of the law firm as of the dissolution date. Therefore, the partners' waiver of a right to claim the profits from completion of the unfinished business was a transfer of property of the law firm. In the absence of proof by the defendants of the value that the law firm received in exchange for the *Jewel* waiver, the court may conclude that the law firm did not receive reasonably equivalent value in exchange for the waiver. A debtor incurs debts beyond its ability to pay as they become due even when it can pay new obligations if as a result of paying the new obligations, it is unable to pay its prior obligations. Therefore, the trustee may avoid the *Jewel* waiver. *Heller Ehrman LLP v. Jones Day (In re Heller Ehrman LLP)*, ___ B.R. ___, 2013 Bankr. LEXIS 889 (Bankr. N.D. Cal. Mar. 11, 2013).

2.1.e. Departing law firm partners are initial transferees of *Jewel v. Boxer* waiver; hiring law firms are subsequent transferees. Under *Jewel v. Boxer*, 156 Cal. App. 3d 171 (1994), a partner in a law firm undergoing dissolution owes a fiduciary duty to the partnership and the other partners to account for profits on any unfinished business that the partner completes after leaving the firm. Here, law firm partners entered into an agreement to dissolve the firm. The agreement contained a waiver of the partnership's *Jewel* rights to facilitate the movement of partners and unfinished business to new law firms, which in turn facilitated movement of associates and staff, reduction of WARN Act and malpractice liability and an increase in the firm's ability to collect receivables from its former clients. New law firms hired departing partners who brought their unfinished business from the old law firm. The new law firms did not compensate the partners for the unfinished business that they brought with them, but some of them knew of the waiver. The law firm filed bankruptcy within a few months. The trustee avoided the *Jewel* waiver as a fraudulent transfer. Section 550(a) allows the trustee to recover the property transferred or its value from the initial transferee or from a subsequent transferee, unless it took for value, in good faith and without knowledge of the voidability of the transfer. The departing partners were the initial transferees of the *Jewel* waiver, because the waiver gave the partners the right to complete the unfinished business free of the duty to account for the profits. The partners were also the initial transferees of the unencumbered unfinished business, and the law firms were the subsequent transferees only because they hired the departing partners. "Takes for value" requires the subsequent transferee to give value to the initial transferee, not necessarily the debtor. Here, the law firms did not provide any value in exchange for the unfinished business, so they lose on the first element of the defense. Courts construe "good faith" to mean the same as lack of knowledge of voidability. An objective standard, what a reasonable person would or should know under the circumstances after inquiry, determines lack of knowledge; actual (subjective) knowledge is not required. A defendant's knowledge of the waiver and that it is potentially avoidable is adequate to defeat the second element of the defense, even though the waiver's legal effect as a fraudulent transfer had not yet been determined. However, lack of knowledge of the waiver satisfies the requirement to sustain the defense. *Heller Ehrman LLP v. Jones Day (In re Heller Ehrman LLP)*, ___ B.R. ___, 2013 Bankr. LEXIS 889 (Bankr. N.D. Cal. Mar. 11, 2013).

2.1.f. Wisconsin law does not permit a creditor with an execution returned unsatisfied to avoid a fraudulent transfer. The debtor transferred funds more than four years before the petition date with actual intent to hinder, delay or defraud creditors. Section 544(a)(2) grants the trustee the rights and powers of a judgment creditor with an execution returned unsatisfied. Under common law, a creditor with an unsatisfied execution could seek equitable remedies under supplemental proceedings in the form of a

creditor's bill, which could permit the creditor to discover and reach property that could not be levied upon at common law, such as property that the debtor had fraudulently transferred. Accordingly, under a creditor's bill, a creditor with an execution returned unsatisfied could discover and recover from a fraudulent transferee. However, here, Wisconsin law had repealed the creditor's bill procedure by a statute that dictated the scope of supplemental proceedings. The statute does not permit discovery against a non-debtor third party or the right to pursue fraudulently transferred property. Therefore, section 544(a)(2), applying Wisconsin law, does not permit the trustee to recover a fraudulent transfer. *In re Archdiocese of Milwaukee*, 483 B.R. 855 (Bankr. E.D. Wis. 2012).

2.1.g. Safe harbor does not protect a stockbroker's transferee who knew of the fraud but does protect subsequent transferees of a protected initial transferee. The stockbroker debtor ran a Ponzi scheme. It accepted deposits into customer accounts, produced false account statements that showed consistently profitable securities trading in the accounts and honored withdrawal requests as they were made, until it ran out of money. Some accounts were held by feeder funds, which had their own investors. The feeder funds withdrew funds from their accounts to satisfy, in part, redemption requests from their investors. The debtor's SIPA trustee sued account holders and feeder fund investors as initial and subsequent (immediate and mediate) transferees to avoid and recover withdrawals as preferences and fraudulent transfers. The section 546(e) safe harbor protects from avoidance a stockbroker's transfer that is a settlement payment or that is made in connection with a securities contract. The court had previously ruled that the customers' account agreements qualified as securities contracts and that withdrawals constituted settlement payments and so exempted the withdrawals from recovery. However, the trustee also alleged that some of the customers knew of the fraud and that they knew that the withdrawals were not settlement payments or made in connection with a securities contract. The safe harbor's purpose is to minimize market displacements that a major bankruptcy might cause, which can be achieved by protecting investors who had reasonable expectations they were signing securities contracts, but not by protecting those who had no such expectations. Therefore, the safe harbor does not shelter those who knew of the fraud. Similarly, a subsequent transferee may raise as a defense that the safe harbor protects the initial transfer, unless the subsequent transferee knew of the fraud. Finally, the safe harbor applies to a settlement payment made by or to a financial institution. The securities contract definition is not limited to a contract with the debtor. Therefore, if the financial institution withdrew funds from the debtor to satisfy its own obligation to its customer "in connection with a securities contract" between the financial institution and the customer, then the safe harbor protects both the financial institution and the customer. *Secs. Investor Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC*, ___ B.R. ___ (S.D.N.Y. Apr. 15, 2013).

2.1.h. Safe harbor permits trustee to bring breach of fiduciary duty claim, but not fraudulent transfer claim, against LBO corporate shareholder-directors. The trustee sued to avoid and recover LBO payments to the shareholder-directors of a closely held corporation as constructive fraudulent transfers. The trustee also alleged that the defendants were unjustly enriched by the receipt of money from the LBO and breached their fiduciary duties to the corporation by saddling it with debt that they knew it could not repay to facilitate the payout for their shares. The trustee sought damages for unjust enrichment and for the breach of fiduciary duty. Section 546(e) precludes the avoidance as a fraudulent transfer of a payment through a financial institution for the purchase of shares, so the court dismisses the trustee's fraudulent transfer claim. It also dismisses the state law unjust enrichment claim as preempted by section 546(e), because allowing recovery would implicate the same concerns as section 546(e) and would frustrate its purpose. However, the fiduciary duty claim seeks damages from the directors rather than avoidance or recovery of payments from the shareholders and thus does not implicate the same concerns. Accordingly, the court denies the motion to dismiss the fiduciary duty claim. *AP Servs. LLP v. Silva*, 483 B.R. 63 (S.D.N.Y. 2012).

2.1.i. 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.j. 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.k. 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).

2.1.l. Ponzi scheme presumption does not apply in the absence of the debtor's actual fraud. The debtor was required by commodity trading regulations to keep customer property segregated from its own assets. Despite this requirement, it used customer-segregated assets to secure its obligations arising from its own proprietary trading activities. After bankruptcy, the trustee sued the secured bank lender, who had accepted customer-segregated assets to secure the debtor's credit line to the bank, to avoid the debtor's

transfer of the assets to the bank as an actual fraudulent transfer. A trustee may prove actual intent to hinder, delay or defraud creditors by showing the badges of fraud, but proof of the badges is not required where other proof is available. However, a debtor's genuine belief that paying one creditor in preference to another might prevent collapse does not by itself constitute actual intent to hinder, delay or defraud other creditors, nor does the illegality of the transaction, even where the transferee negligently did not know of the illegality. Nor, where the debtor is not running a Ponzi or other fraudulent scheme, may the court impose a "Ponzi scheme presumption" that a debtor's knowledge of imminent collapse irrebuttably implies that the debtor made each transfer with actual intent to defraud. Under the circumstances, the debtor did not transfer customer-segregated funds to the bank with actual intent to hinder, delay or defraud, and the bank is not liable for a fraudulent transfer. *In re Sentinel Mgmt Group, Inc.*, 689 F.3d 855 (7th Cir. 2012).

2.1.m. A debtor's payment of interest on notes issued in a fraudulent transfer and then sold does not benefit the initial note recipient. 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, issued 145 million of its shares to the parent and paid the parent $2.4 billion in cash (including $2.0 billion in borrowed cash) by wire transfer from the subsidiary's account to the parent's account at the same bank. 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 interest payments on the new debt and recover them from the parent. Section 548 permits a trustee to avoid a transfer or obligation made within two years before bankruptcy under certain circumstances; section 550(a) permits the trustee to recover an avoided transfer from "the initial transferee of such transfer or the entity for whose benefit such transfer was made." The parent may have benefited by receiving the notes from the subsidiary and using them to retire its own debt and by the subsidiary's undertaking the obligation to pay interest on the notes. However, if the subsidiary did not make the interest payments, the parent would not have been affected. Moreover, whether or not the parent caused the subsidiary to issue the notes, it did not cause the subsidiary to make the interest payments, because the subsidiary was then independent. Therefore, the interest payments were not for the benefit of the parent. *U.S. Bank Nat'l Assoc. v. Verizon Commc'ns Inc.*, ___ B.R. ___, 2012 U.S. Dist. LEXIS 131469 (N.D. Tex. Sept. 14, 2012).

2.1.n. Intra-bank payment for securities is a settlement payment that is subject to section 546(e). 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, issued 145 million of its shares to the parent and paid the parent $2.4 billion in cash (including $2.0 billion in borrowed cash) by wire transfer from the subsidiary's account to the parent's account at the same bank. 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. Section 546(e) prohibits a trustee from avoiding a transfer that is a "settlement payment" made by, to or for the benefit of a "financial institution". A payment to purchase securities is a settlement payment, and a bank is a financial institution. Section 546(e) and the definition of settlement payment are not limited to payments that occur in the securities market settlement process or system. Nor are they limited to payments in which the financial institution is not acting as an intermediary or a conduit. The subsidiary paid cash, debt and stock to the parent to purchase the division, including the stock in the existing subsidiary. Therefore, the cash payment was a settlement payment, even though it did not implicate the securities market settlement process and even though the payment was simply an intra-bank transfer. *U.S. Bank Nat'l Assoc. v. Verizon Commc'ns Inc.*, ___ B.R. ___, 2012 U.S. Dist. LEXIS 131469 (N.D. Tex. Sept. 14, 2012).

2.1.o. Section 546(e) safe harbor prohibits intentional fraudulent transfer avoidance under section 544(b) and applicable state law. The debtor purchased securities and paid the seller through its bank in cash, notes and its own stock. After bankruptcy, the trustee claimed that the transfer of the

consideration to the seller was an intentionally fraudulent transfer that was avoidable under section 544(b) and section 5(a) of the applicable state Uniform Fraudulent Transfer Act. Section 546(e) prohibits a trustee from avoiding a transfer that is a settlement payment made by, to or for the benefit of a financial institution, "except under section 548(a)(1)(A)". Section 548(a)(1)(A), in language essentially identical to UFTA section 5(a), permits the trustee to recover a transfer that is made "with actual intent to hinder, delay, or defraud" any creditor of the debtor. Although Congressional intent was clear to except intentional fraudulent transfers from the section 546(e) settlement payment safe harbor, the exception is limited to avoiding power actions under section 548(a)(1)(A), not to all intentional fraudulent transfers. Therefore, the trustee may not avoid the transfer under section 544(b). However, section 546(e) applies only to transfers, not to the incurrence of obligations. Therefore, it does not bar the unlawful dividend to recover the notes. *U.S. Bank Nat'l Assoc. v. Verizon Commc'ns Inc.*, ___ B.R. ___, 2012 U.S. Dist. LEXIS 131469 (N.D. Tex. Sept. 14, 2012).

2.1.p. Section 546(e) safe harbor applies to a claim to recover an illegal cash dividend that was also a protected fraudulent transfer. The debtor purchased securities from its parent corporation and paid the parent through its bank in cash, notes and its own stock. After bankruptcy, the trustee claimed that the transfer of the consideration to the parent was an avoidable intentionally fraudulent transfer and that the payments constituted an unlawful dividend under state law. Section 546(e) prohibits a trustee from avoiding a transfer that is a settlement payment made by, to or for the benefit of a financial institution and so bars the trustee's fraudulent transfer claim. Permitting the trustee to recover the cash payment under the state's unlawful dividend statute would render section 546(e)'s prohibition meaningless. Therefore, the trustee may not pursue the unlawful dividend claim against the parent for the cash. However, section 546(e) applies only to transfers, not to the incurrence of obligations. Therefore, it does not bar the unlawful dividend to recover the notes. *U.S. Bank Nat'l Assoc. v. Verizon Commc'ns Inc.*, ___ B.R. ___, 2012 U.S. Dist. LEXIS 131469 (N.D. Tex. Sept. 14, 2012).

2.1.q. Granting a lien to secure a borrowing to pay an affiliate's creditor is a fraudulent transfer to the affiliate's creditor. The debtor was a housing developer. Its subsidiary had entered into a joint venture to develop houses. The joint venture borrowed heavily and then failed. The debtor had guaranteed the loans. A default on the loans would have cross-defaulted the debtor's bonds and its bank revolving credit line, both of which were guaranteed by its other subsidiaries, who were not liable on the joint venture's obligations. After the joint venture failed, the debtor and its other subsidiaries borrowed from different lenders to pay the joint venture's lenders. The other subsidiaries granted security interests in substantially all their assets to secure the new loans. The borrowed funds, less fees incurred, were disbursed through another of the debtor's (nondebtor) subsidiaries to the joint venture lenders. The new loans increased the subsidiaries' liabilities above the value of their assets and prevented them from accessing needed additional capital as their markets and businesses continued to decline. But the transaction prevented the cross-default and might have given the debtor and the other subsidiaries the chance to avert a bankruptcy. Despite the momentary respite, the housing market was collapsing both before and after the transaction, and the debtor could not recover. The debtor and the subsidiaries filed bankruptcy seven months after the transaction. A transfer is fraudulent and avoidable if the debtor had unreasonably small capital or was insolvent at the time of or was rendered insolvent by the transfer and did not receive reasonably equivalent value in exchange. A bankruptcy court has wide latitude to determine what constitutes reasonably equivalent value, which is a question of fact. The chance to avert bankruptcy is not an unqualified benefit for which a company may pay any price; its value must be weighed against the alternative. Here, the benefit was not reasonably equivalent to the value the other subsidiaries transferred. The other subsidiaries did not receive any direct or indirect benefit from the transfers because they were not liable on preexisting obligations to the joint venture lenders, they did not receive the borrowed funds and the payments did not preserve value for the corporate group. Therefore, the payments to the old lenders were avoidable as constructive fraudulent transfers. *Sr. Transeastern Lenders v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.)*, 680 F.3d 1298 (11th Cir. 2012).

2.1.r. Proceeds of loan that is transferred directly to third party is a transfer of property of the debtor. As part of an acquisition and leveraged recapitalization, the debtor borrowed enough not only to buy the target corporation but also to pay a dividend to its shareholders. All of the debtor's subsidiaries (as well as the target) guaranteed the loan and granted security interests in their assets to secure the

guarantees. A second tier subsidiary (which became a debtor) declared the dividend to the debtor's first tier subsidiary, which declared a dividend to the debtor, which declared a dividend to its nondebtor parent. The loan agreement provided that a portion of the funds equal to the dividend amount would be paid directly to the nondebtor parent, and at closing, funds were disbursed as provided in the loan agreement. The trustee sought recovery from the nondebtor parent of the dividend payment as a fraudulent transfer. The trustee may recover a transfer of property of the debtor if the transfer is actually or constructively fraudulent. Property of the debtor includes property that would have become property of the estate if it had not been transferred. Despite the lender's direct transfer to the nondebtor parent, the funds were property of the second tier subsidiary, because the funds would have remained with the debtor second tier subsidiary if the transfer had not been made. Therefore, the complaint adequately states a claim that the debtor transferred property of the debtor. *Michaelson v. Farmer (In re Appleseed's Intermediate Holdings, LLC)*, 470 B.R. 289 (D. Del. 2012).

2.1.s. Trustee may recover property that the debtor held in trust only for the benefit of the trust beneficiaries. The debtor operated a Ponzi scheme through a loan servicing business. It maintained an operating account and a servicing account. It paid its operating expenses only from the operating account. It used the servicing account to receive and disburse loan funds and also to fund the Ponzi scheme. A lender transferred funds to the debtor to fund a loan, who, at the lender's direction, deposited the funds directly into a servicing account and later paid the funds to the borrower. The debtor received payments from the borrower, which, at the lender's direction, the debtor also deposited into the servicing account and paid out to the lender. The debtor followed the same procedure for other lenders and borrowers. A trustee may avoid a transfer of property as a fraudulent transfer if, among other things, the property was property of the debtor. Property was property of the debtor if it would have become property of the estate upon the filing of the petition had it not been transferred. The debtor holds only legal title, not an equitable interest, in property that the debtor holds in trust for another. Based on applicable nonbankruptcy law, the debtor held the servicing account funds in trust for the lenders, because, even though the debtor skimmed funds from the servicing account to perpetuate the Ponzi scheme, the parties' expressed their intention that the lender's funds be used solely to fund the specific loan to the borrower and that the borrower's funds be used solely to repay the lender. However, the lender may defend against avoidance only to the extent that the lender can trace its own funds into and out of the servicing account. It may not assert that funds were not property of the debtor on the ground that the debtor held them in trust for another. Where the debtor holds bare legal title to trust funds, a trustee's avoidance action may recover only legal title to, not an equitable interest in, the funds, and any recoveries from lenders would still be held in trust for the benefit of lenders, not for the benefit of the estate or the general creditors. *Notinger v. Migliaccio (In re Fin. Res. Mortgage, Inc.)*, 468 B.R. 487 (Bankr. D.N.H. 2012).

2.1.t. Court applies state limited partnership law to determine fraudulent transfer reach-back period. The Delaware limited partnership debtor agreed with an investor that he could receive a refund of his limited partnership investment if the debtor's president left the debtor's employ. The president left 3-1/2 years before bankruptcy, and the debtor promptly refunded the investment. The debtor conducted business only in California, but the debtor's limited partnership agreement had a Delaware choice of law provision. The trustee sued the investor to recover the payment under section 544(b) as a fraudulent transfer and under the Delaware Revised Uniform Limited Partnership Act as an unlawful distribution. The statute of limitations for a fraudulent transfer action depends on the choice of law. A federal court with exclusive jurisdiction over an action, such as in bankruptcy, should apply federal choice of law rules, which follow the Restatement. Restatement section 6(1) requires a court to apply its own state's statutory choice of law rules. Here, state law points to the law of the partnership's organization. Restatement section 187(1) points to the parties' contract if the matter at issue could have been resolved by an express contract provision. Therefore, Delaware law applies to disputes regarding the transfer. A statute of limitations differs from a statute of repose in that the former is procedural, while the latter is substantive and defeats the cause of action after its expiration. DRULPA section 17-607(c) provides that a limited partner who receives a distribution from the partnership "shall have no liability under this chapter or under applicable law for the amount of the distribution after the expiration of 3 years from the date of the distribution." It is a statute of repose, because it cuts off liability after 3 years. Moreover, because it precludes liability "under other applicable law", it therefore precludes liability under Delaware's fraudulent transfer statute, which otherwise would have a four-year statute of limitations. Because the choice of law rules apply Delaware law to the

action to avoid and recover the transfer, the trustee is barred from recovering it. *Diamond v. Friedman (In re Century City Doctors Hosp., LLC)*, 466 B.R. 1 (Bankr. C.D. Cal. 2012).

2.1.u. Estate representative may pursue avoiding power action even after unsecured claims are paid in full. The debtor in possession brought a fraudulent transfer action against a lender. The debtor confirmed a plan that provided for full payment of unsecured claims and the vesting of avoiding power actions in an asset recovery corporation, which succeeded as plaintiff to the fraudulent transfer action. The estate's right to avoid a transfer vests as of the petition date. Section 550 permits recovery "for the benefit of the estate". The estate is not synonymous with unsecured creditors. Therefore, despite the payment in full of unsecured claims, an avoiding power action persists until it no longer benefits the estate, and the asset protection corporation has standing to pursue the claim. The court does not provide any guidance on when an action will no longer benefit the estate. *MC Asset Recovery LLC v. Commerzbank A.G. (In re Mirant Corp.)*, 675 F.3d 530 (5th Cir. 2012).

2.1.v. Legal title is not required for property to be property of the debtor. A group of related companies conducted a fraudulent investment scheme. All investors deposited their funds into a bank account that was titled in the name of a Curaçao bank that was an affiliate of the debtors and had no business operations of its own. One of the debtors completely controlled all withdrawals from the account; the Curaçao bank had no authority over the account. The debtor directed transfers to its insiders with actual intent to defraud creditors. The trustee may avoid a fraudulent transfer of property of the debtor. Property ownership depends on the individual facts of each case, not merely on legal title to the property. Control may constitute ownership even where the control party does not have legal title. Where evidence of fraud and the debtor's strict control are strong, legal title is a less compelling factor. Based on the facts here, the funds in the account were property of the debtor, and the transfers to insiders from the account were avoidable in the debtor's bankruptcy case. *Stettner v. Smith (In re IFS Fin. Corp.)*, 669 F.3d 255 (5th Cir. 2012).

2.1.w. Federal Debt Collection Procedures Act is not "applicable nonbankruptcy law" for purposes of section 544(b). The estate representative sought to avoid a guarantee under section 544(b), relying on the Federal Debt Collection Procedures Act (FDCPA) as applicable law and the United States' claim as the triggering allowable claim. The FDCPA has a long statute of limitations for recovery of a fraudulent transfer. 28 U.S.C. § 3003(c) provides that the FDCPA "shall not be construed to supersede or modify the operation of title 11". Therefore, it may not be used to apply section 544(b). *MC Asset Recovery LLC v. Commerzbank A.G. (In re Mirant Corp.)*, 675 F.3d 530 (5th Cir. 2012).

2.1.x. Payment of noncompensatory tax penalties is not a fraudulent transfer. Before bankruptcy, the debtor became delinquent on its withholding taxes. The IRS assessed the taxes and penalties. The debtor paid some of the amounts owing. The IRS applied the payments first to the penalties. After bankruptcy, the debtor in possession filed an action to avoid the payments that the IRS applied to penalties as fraudulent transfers. A debtor in possession may avoid a transfer as a constructively fraudulent transfer if the transfer was made for less than reasonably equivalent value while the debtor was insolvent. "Value" includes satisfaction or securing of an antecedent debt. A dollar-for-dollar reduction in debt in exchange for a payment is reasonably equivalent value. Although the penalties were not in compensation for actual pecuniary loss and their payment did not reduce the debtor's tax liability, the IRS gave reasonably equivalent value in exchange for the payments because they reduced the debtor's liability for the penalties, which were valid, pre-existing debts. *Southeast Waffles, LLC v. U.S. (In re Southeast Waffles, LLC)*, 460 B.R. 132 (6th Cir. B.A.P. 2011).

2.1.y. Fraudulent transfer law of state with most significant relationship to transaction applies under section 544(b). In a bankruptcy case pending in Texas, the debtor in possession brought an action under section 544(b), relying on New York fraudulent transfer law, to avoid a prepetition guarantee that was negotiated and executed in New York. The debtor's headquarters were in Georgia. New York's fraudulent transfer law permits the avoidance of a guarantee. Unlike all other states' fraudulent transfer laws, Georgia's law in effect at the time of the action did not, though it later amended its law to permit avoidance. A fraudulent transfer avoidance action sounds in tort. Texas applies the "most significant relationship" test to determine choice of law in a tort action. Sections 6 and 145 of the Restatement

(Second) of Conflicts describe the most significant relationship. Section 145(b) requires that the contacts to be taken into account in applying section 6 include the places where the injury and the conduct causing the injury occurred, the domicile or residence of the parties and the place where their relationship is centered. Where an injury, such as a fraudulent transfer, is intangible, it is difficult to assign a location, and the facts here make it impossible to define what conduct caused the injury or where it occurred. The relevant parties are in both New York and Georgia, and there is no one location where their relationship is centered. Therefore, these contacts are of limited importance in applying section 6. Section 6 looks to the needs of the interstate system, the relevant policies of the interested states and the basic policies underlying the law, among other things. Here, the fraudulent transfer law's basic policy is creditor protection. Applying the approach taken by the overwhelming majority of states best serves the needs of the interstate system. Finally, Georgia does not have a strong interest in applying its now-repealed law, because its citizens would not benefit from it in this case. Therefore, New York law should apply. *MC Asset Recovery LLC v. Commerzbank A.G. (In re Mirant Corp.)*, 675 F.3d 530 (5th Cir. 2012).

2.1.z. Court may collapse bridge and permanent LBO financing to permit a fraudulent transfer action against the permanent lender. A buyer was unable to arrange permanent financing for a leveraged buyout and so acquired the debtor with bridge financing. Within a month after the acquisition, the buyer and debtor replaced the bridge financing with permanent financing. The debtor failed within two years and filed bankruptcy. The trustee may avoid a lien granted to secure a loan used to finance a leveraged buyout if the debtor was rendered insolvent by the transaction. Though the lender gives reasonably equivalent value for the lien by making the loan to the debtor, the debtor uses the loan proceeds to pay its shareholders, who do not give reasonably equivalent value to the debtor in exchange. The fraudulent transfer laws apply to such a transaction because the court collapses the steps in the transaction and views the combined transactions as encumbering the debtor's assets to permit a payment to shareholders. Similarly, where the LBO buyer arranges bridge financing and then permanent financing, the court may collapse those transactions as well to permit an LBO fraudulent transfer action to proceed against the permanent lender. *Official Ctte. Of Unsecured Creditors v. CIT Group/Business Credit Inc. (in re Jevic Holding Corp.)*, 2011 Bankr. LEXIS 3553 (Bankr. D. Del. Sept. 15, 2011).

2.1.aa. Collapsing requires reconveyance of the consideration received from the first transaction and the transferee's knowledge of the fraud. The individual debtor and his law firm, also a debtor, maintained two banking relationships: one of the banks held the account from which the law firm conducted a Ponzi scheme. The law firm borrowed from the other bank and granted it additional collateral. The firm transferred the loan proceeds to the first bank and from there repaid a Ponzi scheme investor. The trustee sues the lending bank to avoid the grant of the security interest in the additional collateral as a fraudulent transfer. To prevail, the trustee must collapse the two transactions—the loan and the payoff of the investor. Multiple transactions may be collapsed for purposes of applying the fraudulent transfer laws if they are steps in an integrated transaction, where none of the transactions would occur unless they all did. In addition, the debtor must transfer the consideration from the first transaction with actual intent to defraud or for less than fair consideration and the initial transferee must have actual or constructive knowledge of the fraudulent scheme. In this case, the Ponzi scheme presumption satisfies the actual fraud alternative of the first of these elements. The trustee does not satisfy the second element, however, because the law firm did not run the Ponzi scheme through accounts at the lending bank. Therefore, the trustee's complaint fails to state a claim on which relief may be granted. *Gowan v. Wachovia Bank, N.A. (In re Dreier LLP)*, 453 B.R. 499 (Bankr. S.D.N.Y. 2011).

2.1.bb. UFCA actual fraudulent transfer action does not require that the transferee intended to defraud. The debtor attorney perpetrated a Ponzi scheme by soliciting investors in interest bearing notes purportedly issued by a client. The investors advanced the money to purchase the notes to an account that the attorney characterized as a client escrow account. In reality, the attorney forged the notes, commingled the money in the escrow account with other client funds and firm operating funds and used the money for his own purposes and to repay interest and principal on earlier investors' notes. After bankruptcy, the trustee sought to recover payments of principal and interest under New York's version of the Uniform Fraudulent Conveyance Act (NY DCL § 276; UFCA § 6), which permits avoidance of a transfer made with actual intent to hinder, delay or defraud creditors. The Ponzi scheme presumption establishes the debtor's actual intent to defraud creditors. Nothing more is required. Prior case law had determined

that a trustee could avoid an actually fraudulent transfer only if the transferee also was guilty of fraudulent intent. Those decisions were based primarily on a decision, later corrected, that had misread pre-UFCA law. However, a careful reading of section 276, which addresses only the transferor's intent, and of section 276-a, which applies only when both the transferor and the transferee both intended to defraud, shows that the trustee need not plead the transferee's intent to survive a motion to dismiss an actual fraudulent transfer complaint under the UFCA. *Gowan v. The Patriot Group, LLC (In re Dreier LLP)*, 452 B.R. 391 (Bankr. S.D.N.Y. 2011).

2.1.cc. Debtor does not receive fair consideration for Ponzi scheme interest payment on notes the debtor did not issue. The debtor attorney perpetrated a Ponzi scheme by soliciting investors in interest bearing notes purportedly issued by a client. The investors advanced the money to purchase the notes to an account that the attorney characterized as a client escrow account. In reality, the attorney forged the notes, commingled the money in the escrow account with other client funds and firm operating funds and used the money for his own purposes and to repay interest and principal on earlier investors' notes. After bankruptcy, the trustee sought to recover payments of principal and interest under New York's version of the Uniform Fraudulent Conveyance Act (NY DCL § 273; UFCA § 3), which permits avoidance of a transfer made without "fair consideration" while the debtor was insolvent or undercapitalized. "Fair consideration" requires an exchange of property or discharge of an antecedent debt for fair equivalent value, given in good faith. Return of principal to a Ponzi scheme victim discharges the debtor's obligation to the victim for restitution arising from the fraud. Unless the transferee is an insider or participated in the fraud, a transferee who takes in discharge of the debt for principal is in good faith. Otherwise, application of the avoiding power would have the effect of a preference statute, contrary to the UFCA's intent not to disturb legitimate payments to satisfy debts. A payment of interest on a note might also be for value, if the debtor is obligated to pay interest (rather than, say, an equity return). Here, however, the debtor did not issue the notes and did not commit to pay interest. The notes were purportedly issued by the debtor's client. Therefore, the debtor's payment of interest to the investors did not discharge the debtor's obligation for interest and was not for fair consideration. *Gowan v. The Patriot Group, LLC (In re Dreier LLP)*, 452 B.R. 391 (Bankr. S.D.N.Y. 2011).

2.1.dd. An equity investor gives value in exchange for return of principal from a Ponzi scheme debtor. Investors bought equity interests in a Ponzi scheme debtor and later received transfers from the debtor, representing returns of principal or purported profits on their investments. Section 548(a)(1)(A) permits the trustee to avoid a transfer made with actual intent to hinder, delay or defraud creditors. Under the Ponzi scheme presumption, any transfer that a Ponzi scheme operator makes is presumed to be made with such intent. Under section 548(c), a transferee "takes for value and in good faith" may retain the transfer. "Value" includes satisfaction of an antecedent debt. Ordinarily, return of an equity investment to a shareholder does not satisfy an antecedent debt and provides no value to the transferor. In a Ponzi scheme, however, where the investor bought the equity interest after the fraud began, the investor has a fraud claim against the debtor in the principal amount of the investment. The debtor's transfer to the investor of the invested principal satisfies that debt and therefore is for value. *Perkins v. Haines*, 661 F.3d 623 (11th Cir. 2011).

2.1.ee. An avoiding power defendant does not have standing to argue that the transferred property was trust property rather than property of the debtor. The debtor attorney perpetrated a Ponzi scheme by soliciting investors in interest bearing notes purportedly issued by a client. The investors advanced the money to purchase the notes to an account that the attorney characterized as a client escrow account. In reality, the attorney forged the notes, commingled the money in the escrow account with other client funds and firm operating funds and used the money for his own purposes and to repay interest and principal on earlier investors' notes. After bankruptcy, the trustee sought to recover payments of principal and interest as actual fraudulent transfers under section 548(a)(1)(A) and New York's version of the Uniform Fraudulent Conveyance Act (NY DCL § 276; UFCA § 6). A trustee may recover a transfer only of property of the debtor. Property that the debtor holds in an express trust is not property of the debtor for this purpose. An express trust requires a designated beneficiary, a designated trustee, a designated trust fund and actual delivery with intent to vest title in the trustee. Only the beneficiary has standing to assert the trust. Here, even if the client trust account were properly maintained, it existed for the benefit of the attorney's clients, not the investors, as there was no express agreement that the

attorney serve as trustee for the investors. Thus, they did not have standing to argue that the funds that they advanced were held in trust and therefore not property of the debtor. Moreover, where the debtor commingles funds in an account, there is a presumption for purposes of applying the avoiding powers that the transfers were made from property of the debtor, and the burden is on the defendant to prove otherwise. Therefore, the court denies a motion to dismiss based on defendants' argument that the transfers were not made from property of the debtor. *Gowan v. The Patriot Group, LLC (In re Dreier LLP)*, 452 B.R. 391 (Bankr. S.D.N.Y. 2011).

2.1.ff. Rooker-Feldman does not prohibit a fraudulent transfer action challenging a consensual divorce property division. The debtor divorced her husband. They agreed on a division of their property, which was approved as a consensual division without evaluation of its fairness. The trustee sued the husband to avoid and recover the property division and the debtor's obligations as a fraudulent transfer and obligations, alleging that the transfer was made and the obligations were incurred for less than reasonably equivalent value in exchange. *Rooker-Feldman* prohibits an action in federal court that challenges a state court judgment, though not an action that raises the same issues on which a state court has already ruled, which might be barred by ordinary claim preclusion rather than by *Rooker-Feldman*. Here, the state court did not rule on fairness or the value of the division of property and obligations, so *Rooker-Feldman* does not bar the trustee's fraudulent transfer suit. *Samson v. Blixseth (In re Blixseth)*, 2011 Bankr. LEXIS 2953 (Bankr. D. Mont. Aug. 1, 2011).

2.1.gg. Section 546(e) safe harbor does not apply to small, local LBO. The debtor's shareholder acquired the debtor in a leveraged buyout for $1,500,000 from its prior shareholders with the cash proceeds of a loan secured by the debtor's assets. The debtor did not receive reasonably equivalent value for undertaking its obligation on the loan or granting a security interest to secure its obligation, was rendered insolvent by the transaction and filed bankruptcy 15 months later. The transfer of the security interest to the lender for the benefit of the former shareholders was a constructively fraudulent transfer under section 548(a)(1)(B). Section 546(e) prohibits the trustee from avoiding a transfer under section 548(a)(1)(B) "that is a … settlement payment as defined in section 101 or 741 of this title, made by or to … [a] financial institution … or in connection with a securities contract, as defined in section 741". The definition of settlement payment is circular and therefore ambiguous, requiring the court to review the legislative history to determine section 546(e)'s scope. The defined terms are used in the stockbroker liquidation subchapter, the "settlement payment" definition refers to "any other payment commonly used in the securities trade", and the legislative history focuses on preserving stability in the securities and financial markets. Therefore, it is reasonable to conclude that the safe harbor should apply only to a transaction that might affect the securities markets. Although line drawing may be difficult, this transaction is clearly far from the line and far removed from Congress' intent in protecting settlement payments. Therefore, the safe harbor does not apply, and the trustee may avoid the transfers to the former shareholders. *Geltzer v. Mooney (In re MacMenamin's Grill Ltd.)*, 450 B.R. 414 (Bankr. S.D.N.Y. 2011).

2.1.hh. Section 546(e) safe harbor does not apply to constructively fraudulent obligation. The debtor's shareholder acquired the debtor in a leveraged buyout for $1,500,000 from its prior shareholders with the cash proceeds of a loan secured by the debtor's assets. The debtor did not receive reasonably equivalent value for undertaking its obligation on the loan or granting a security interest to secure its obligation, was rendered insolvent by the transaction and filed bankruptcy 15 months later. The incurrence of the obligation to the lender for the benefit of the former shareholders was a constructively fraudulent obligation under section 548(a)(1)(B). Section 546(e) prohibits the trustee from avoiding "a transfer [under section 548(a)(1)(B)] that is a … settlement payment as defined in section 101 or 741 of this title, made by or to … [a] financial institution … or in connection with a securities contract, as defined in section 741". The trustee brought an action against the lender to avoid the debtor's obligation to the lender. The safe harbor applies only to transfers, not obligations. Therefore, it does not protect the lender from the trustee's action here. *Geltzer v. Mooney (In re MacMenamin's Grill Ltd.)*, 2011 Bankr. LEXIS 1461 (Bankr. S.D.N.Y. Apr. 21, 2011).

2.1.ii. Preservation of viability and strengthening of a corporate group may constitute reasonably equivalent value for an upstream guarantee. The debtor's subsidiary had entered into a joint venture that borrowed heavily and then failed. The debtor had guaranteed the loans. The debtor's other subsidiaries were not liable on the joint venture's obligations, but were co-borrowers on the debtor's

revolving credit facility and had granted security interests in all their assets to secure their obligations under the facility. If the debtor defaulted on the joint venture loan, it would have cross-defaulted the revolver, which neither the debtor nor the subsidiaries would have been able to pay. After the joint venture failed and the joint venture lenders sued the debtor, the debtor borrowed from different lenders to pay the joint venture's lenders. The debtor's other subsidiaries became co-borrowers on the new loans and granted security interests in substantially all their assets to secure their new obligations. The debtor and the subsidiaries filed bankruptcy seven months after the new loans, due in large part to the collapse of the debtor's markets during the time between the new loans' funding and the bankruptcy. A transfer of the debtor's property is fraudulent and avoidable if the debtor had unreasonably small capital or was insolvent at the time of or rendered insolvent by the transfer and did not receive reasonably equivalent value in exchange. The Code defines "value" to mean "property, or satisfaction or securing of an antecedent debt" but does not define "reasonably equivalent value". "Property" is broadly defined in the Bankruptcy Code, and therefore "value" may include tangible or intangible indirect benefits to a debtor, including the opportunity to receive an economic benefit in the future. The opportunity to avoid default and foreclosure, even if ultimately unavailing, may therefore constitute value for fraudulent transfer purposes, based on the totality of the circumstances, including whether the transaction was at arms' length and in good faith. Here, the subsidiaries' incurrence of the obligation under the new loan and the grant of security interests to the new lenders gave the subsidiaries the opportunity to prevent default under the revolver and preserve their viability. In addition, the strengthening of the corporate group's viability provided value to the subsidiaries. Therefore, the subsidiaries' transfers were not avoidable. *3V Cap. Master Fund Ltd. v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.)*, 444 B.R 613 (S.D. Fla. 2011).

2.1.jj. Co-borrower does not transfer its property where the loan agreement requires direct disbursement, rather than payment by the co-borrower, to pay off an affiliate's prior loan. The debtor's subsidiary had entered into a joint venture that borrowed heavily and then failed. The debtor had guaranteed the loans. The debtor's other subsidiaries were not liable on the joint venture's obligations. After the joint venture failed and the joint venture lenders sued the debtor, the debtor borrowed from different lenders to pay the joint venture's lenders. The debtor's other subsidiaries became co-borrowers on the new loans. The new lenders disbursed the borrowed funds to another subsidiary of the debtor, who was not liable on the joint venture loan or the new loan, and who disbursed the loan proceeds directly to the joint venture lenders in full satisfaction of their claims. The loan documents required this disbursement method. The debtor and the subsidiaries filed bankruptcy seven months after the new loans. A transfer of the debtor's property is fraudulent and avoidable if the debtor had unreasonably small capital or was insolvent at the time of or rendered insolvent by the transfer and did not receive reasonably equivalent value in exchange. The payment of the joint venture lenders was not a fraudulent transfer by the subsidiaries to the joint venture lenders because the new loan proceeds were never the subsidiaries' property. Although the subsidiaries became liable as co-borrowers on the new loans, they never had an interest in the cash because the new loans agreement's requirement for direct disbursement, without the subsidiaries' involvement, deprived the subsidiaries of any control over the cash. *3V Cap. Master Fund Ltd. v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.)*, 444 B.R 613 (S.D. Fla. 2011).

2.1.kk. Court uses tort analysis to determine fraudulent transfer choice of law. The debtor issued a guarantee that rendered it insolvent without receiving reasonably equivalent value. The parties negotiated, documented and closed the transaction in New York, and New York law governed the documents. But the debtor made the decision to issue the guarantee at its headquarters in Georgia. The debtor in possession commenced an action against the guaranteed creditors to avoid the guarantee as a constructively fraudulent obligation. Federal choice of law principles apply. They require the court to apply a most-significant-relationship test, which is reflected in the Second Restatement of Conflict of Laws. Fraudulent transfer actions arise in tort. Therefore, sections 6 and 145 of the Restatement apply. Section 145 looks to where the injury and the injury-causing conduct occurred, the parties' location and where the parties' relationship is centered. In a fraudulent transfer action, the injury is the degradation of the debtor's economic condition. It occurs where the debtor is located. The injury-causing conduct is the debtor's decision to issue the guarantee, which also occurred at headquarters, not where the guarantee was documented. In a business or financial interest case, the parties' place of business is the more important consideration in determining the third factor, although the location of creditors plays a role as well. It would be unusual if the injury, the injury-causing conduct and the location of the parties differed from the center

of their relationship. Section 6 sets forth policy considerations in applying section 145 but should not take precedence over section 145. Importantly, a policy of adding value to a bankruptcy estate should not be the focus of the section 6 analysis. Based on these factors, the court determines that Georgia fraudulent transfer law applies. *MC Asset Recovery, LLC v. Commerzbank AG*, 441 B.R. 791 (N.D. Tex. 2010).

2.1.ll. Section 544(b) does not incorporate the Federal Debt Collection Procedures Act. The debtor issued a guarantee more than one year before bankruptcy that rendered it insolvent without receiving reasonably equivalent value. The debtor in possession commenced an action under section 544(b) against the guaranteed creditors to avoid the guarantee as a constructively fraudulent obligation, relying on the U.S. as a creditor and on the Federal Debt Collection Procedures Act, 28 U.S.C. §§ 3304(a)–(b), 3306(a) ("FDCPA"). FDCPA permits the U.S. to avoid and recover a fraudulent transfer or obligation "as to a debt to the United States". The FDCPA is a remedy for the exclusive use of the United States and is therefore not available to a trustee under section 544(b). *MC Asset Recovery, LLC v. Commerzbank AG*, 441 B.R. 791 (N.D. Tex. 2010).

2.1.mm. Liquidating trustee may pursue avoiding power actions even if creditors have been paid in full. The debtor issued a guarantee before bankruptcy that rendered it insolvent without receiving reasonably equivalent value. The debtor in possession commenced an action under section 544(b) against the guaranteed creditors to avoid the guarantee as a constructively fraudulent obligation. The plan transferred the action to a liquidating trust. The plan provided for satisfaction of creditors' claims in stock, which the bankruptcy court determined was worth enough to satisfy creditors' claims in full. An avoiding power cause of action arises as of the petition date and is to be exercised for the benefit of the estate, which is the injured party. Moreover, section 550(a) permits the trustee to recover "for the benefit of the estate". Therefore, where the recovery will enhance the reorganized debtor's value, the liquidating trustee has standing despite the plan's full satisfaction of claims. The court notes the result might differ if creditors were paid in full in cash. *MC Asset Recovery, LLC v. Commerzbank AG*, 441 B.R. 791 (N.D. Tex. 2010).

2.1.nn. A transfer of property directly from the debtor's customer to the debtor's account is not avoidable. The debtor operated a Ponzi scheme by offering loans to customers against their stock. In a typical transaction, the customer would transfer his or her stock directly to the debtor's account at a stock brokerage. The debtor then sold the stock and misappropriated the proceeds, using proceeds from future stock sales to purchase and return stock to customers when they repaid their loans. After bankruptcy, the trustee sued the broker to recover the transfers of stock from the customers to the broker as fraudulent transfers. Section 548(a)(1)(A) permits a trustee to avoid a transfer of property of the debtor that was made with actual intent to hinder, delay or defraud creditors. Property was property of the debtor if it would have become property of the estate if it had not been transferred, so as to permit recovery of property that would have been available to creditors. Here, if the stock had not been transferred, it would not have become property of the estate. Therefore, the stock was not property of the debtor, and the trustee may not avoid the transfers to the broker. *Grayson Consulting, Inc. v. Wachovia Secs., LLC (In re Derivium Cap., LLC)*, 437 B.R. 798 (Bankr. D.S.C. 2010).

2.1.oo. In determining solvency, a court must include contingent assets as well as contingent liabilities and not discount asset value for its stock's illiquidity or for the debtor's tax shields. The debtor hospital made transfers three years before bankruptcy that the trustee sought to avoid as constructive fraudulent transfers. At the time, the debtor had defrauded Medicare, but though the debtor's conduct was under investigation, the fraud had not yet been discovered. Its later discovery led in part to the debtor's bankruptcy. The debtor's owner was behind the fraud but had sufficient wealth that he ultimately repaid the government the amount that was charged against the debtor. The debtor was a subchapter S corporation and so paid no taxes. A trustee may avoid a constructively fraudulent transfer if the debtor was insolvent when it made the transfer. The court may not use hindsight in valuing the debtor. Thus, the liability to Medicare should be discounted based on the probability, as of the time the debtor made the transfer, that it would be fixed. In addition, the court must also include the contingent asset—the owner's liability either to the government for the fraud or the debtor for the damage the owner caused the corporation—and the owner's ability to pay. Solvency is measured by the fair market value of assets against liabilities. In determining the value of assets, the court may not confuse the value of the corporation's stock with the value of its assets, although in many cases, the stock value may indicate asset value. In this case, the court should not discount the value of the corporation's assets based on the

possibility that a buyer of its stock would be a taxpaying entity and would discount itself the value of the corporation by the expected taxes that it would pay. *Paloian v. LaSalle Nat'l Bank Assoc.*, 619 F.3d 688 (7th Cir. 2010).

2.1.pp. UFCA's good-faith-for-value transferee liability limitation applies in an action under section 544(b). When the California debtor urgently needed funding, its chairman purchased real property from the debtor more than two years before the debtor's bankruptcy. The trustee sued other participants in the transaction, including attorneys and directors, to recover the transfer to the chairman as a constructively fraudulent transfer. The other defendants settled. After trial, the bankruptcy court found that the transfer was a constructively fraudulent transfer because it was not made in exchange for reasonably equivalent value. However, the chairman received the transfer in good faith, and the amount that the chairman underpaid was less than the amount for which the other defendants settled. Section 544(b) permits the trustee to avoid a transfer that is voidable by a creditor holding an allowable unsecured claim, thereby incorporating state fraudulent transfer law. Under California's version of the Uniform Fraudulent Transfer Act, a transferee that takes for value and in good faith is entitled to a credit against fraudulent transfer liability to the extent of value actually given. Although section 544(b) grants the trustee the power to avoid transfers, the good faith limitation is imported into the avoiding power, so that it applies to protect a good faith transferee for two reasons. First, the UFCA's language imports the limitation into the avoiding power itself. Second, this construction makes application of section 544(b) congruent with section 548, which contains a similar good-faith-for-value limitation in section 548(c). California permits a tortfeasor a credit in liability for any amount for which joint tortfeasors have settled with the plaintiff. Construing a fraudulent transfer as a tort, the court permits the chairman a credit for the amount of the other defendants' settlement, reducing the chairman's liability to zero. The court does not address the single satisfaction limitation of section 550(c). *Decker v. Tramiel (In re JTS Corp.)*, 617 F.3d 1102 (9th Cir. 2010).

2.1.qq. Section 546(a) limitation is not jurisdictional. The trustee filed a fraudulent transfer complaint on the two-year anniversary of the order for relief. Section 546(a) provides that an avoiding power action "may not be commenced … after … two years after the order for relief". Two years after the order for relief is the second anniversary of the order for relief. The statute prohibits commencement of an action after, not on, that date. In addition, Rule 9006(a) provides that "in computing any time period specified … in any statute", the day triggering the period is excluded. As a result, the end of the period would be the second anniversary of the filing date. However, Rule 9006(a) applies only where the statutory period is not jurisdictional. Section 546(a) is simply a statute of limitations and is not jurisdictional. Therefore, the complaint was timely. *Myers v. Raynor (In re Raynor)*, 617 F.3d 1066 (8th Cir. 2010).

2.1.rr. 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.ss. 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)*, 439 B.R. 284 (S.D.N.Y. 2010).

2.1.tt. 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.uu. 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).

2.1.vv. Creditor's prepetition fraudulent transfer action becomes property of the estate. Before bankruptcy, a creditor sued the debtor, his wife and two corporations owned by his wife under fraudulent transfer, reverse veil-piercing and constructive trust theories, to recover a judgment against the debtor. After bankruptcy, the creditor, who held 86% of the unsecured claims against the debtor, funded the trustee's continued pursuit of the action. The trustee sought court approval under Rule 9019 of a settlement with the defendants. The creditor objected and offered substantially more to buy the claims from the estate. Section 363(b) permits the trustee to sell only property of the estate. Under Texas law, a debtor may assert alter ego claims against its shareholders. The claims therefore are property of the estate. A reverse veil-piercing claim is the same for this purpose and is also property of the estate. Under section 544(b), the trustee steps into the shoes of a creditor who has brought a prepetition fraudulent transfer action, which thereby becomes property of the estate. The creditor's constructive trust claim is a remedy that follows the underlying actions. Therefore, all the claims are property of the estate, which the trustee may sell. *The Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253 (5th Cir. 2010).

2.1.ww. Severance payment to insider after termination is avoidable as a fraudulent transfer. Six years before bankruptcy, the debtor entered into an employment contract with its CEO that provided for a specified salary and an unspecified severance payment without regard to the cause of termination. Within two years before bankruptcy, the debtor terminated the CEO, although he remained on the debtor's board of directors, and negotiated the severance payment amount. He resigned from the board upon reaching the severance agreement. The debtor made the severance payment four months later, within one year before bankruptcy. Section 548(a)(1)(B)(ii)(IV) permits a trustee to avoid a transfer made or an obligation incurred within two years before the petition date if the debtor received less than reasonably equivalent value for the transfer or obligation and "made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business." Here, the debtor incurred the obligation under the severance agreement when it reached agreement on the severance payment amount, and the former CEO was an insider (as a director) at that time. The debtor received less than reasonably equivalent value for the obligation. The prior employment contract requiring the debtor to pay severance did not provide consideration for the later severance amount agreement, because when the CEO entered into that agreement, he was already under a continuing obligation to serve as CEO, and the salary under that agreement was adequate consideration for his future service. The debtor received nothing at the time in exchange for its agreement to pay severance upon a future termination. Although the debtor's actual severance payment was supported by consideration—the severance amount agreement—the trustee may avoid that agreement under section 548(a)(1)(B)(ii)(IV), voiding the consideration for the payment and thereby making the payment avoidable. *TSIC, Inc. v. Thalheimer (In re TSIC, Inc.)*, 428 B.R. 103 (Bankr. D. Del. 2010).

2.1.xx. A severance payment to the CEO to settle termination under a disputed employment contract is a fraudulent transfer. The debtor's CEO had an employment contract that entitled him to a severance payment of $3 million if he were terminated without cause, $1.5 million if he were terminated with cause and nothing if he resigned. The debtor's counsel advised the board that there were grounds to terminate for cause, but termination would likely lead to litigation, the outcome of which would be uncertain. Ultimately, the board terminated the CEO, and the debtor negotiated a settlement agreement to pay him $3 million in installments in exchange for his resignation. One month later, the debtor obtained a directors' and officers' liability policy that covered the CEO for any "Loss". The debtor filed bankruptcy eight months later, after having paid the CEO $2.2 million. Under section 548(a)(1)(B), a trustee may avoid a transfer made or obligation incurred within two years before bankruptcy if the debtor received less than reasonably equivalent value in exchange and made the transfer or incurred the obligation for the benefit of an insider under an employment contract and not in the ordinary course of business. The CEO was an insider when the debtor incurred the obligation to pay him, so it was irrelevant that he was not an insider when the debtor made the payments. A court must determine reasonably equivalent value by judging the consideration the debtor received from the standpoint of creditors. Because of the possibility that the debtor could have terminated the CEO for cause, the debtor did not receive reasonably equivalent value for the agreement to pay the full amount to which the CEO would have been entitled if he were terminated without cause. Therefore, the trustee may avoid the payments. Under the insurance policy, "Loss" does not include restoration of an ill-gotten gain or restitution. An obligation to repay a fraudulent transfer is both. Therefore, the insurance policy did not cover the judgment against the former CEO. *Stanley v. U.S. Bank N.A. (In re TransTexas Gas Corp.)*, 597 F.3d 298 (5th Cir. 2010).

2.1.yy. Secured borrowing to pay an affiliate's obligation may be a fraudulent transfer to both the new lender and the affiliate's creditor. The debtor's subsidiary had entered into a joint venture that borrowed heavily and then failed. The debtor had guaranteed the loans. After the joint venture failed, the debtor borrowed from different lenders to pay the joint venture's lenders. The debtor's other subsidiaries, who were not liable on the joint venture's obligations, were co-borrowers on the new loans and granted security interests in substantially all their assets to secure their obligations. The borrowed funds, less fees incurred, were disbursed directly to the joint venture lenders. The joint venture lenders and the new lenders were aware or should have been aware of debtor's and the subsidiaries' precarious financial condition before the new loans were made. The new loans increased the subsidiaries' liabilities above the value of their assets and prevented them from accessing needed additional capital as their markets and businesses continued to decline. The debtor and the subsidiaries filed bankruptcy seven months after the new loan. A transfer is fraudulent and avoidable if the debtor had unreasonably small capital or was insolvent at the time of or rendered insolvent by the transfer and did not receive reasonably equivalent

value in exchange. The subsidiaries did not receive any direct or indirect benefit from the transfers because they were not liable on preexisting obligations to the joint venture lenders, they did not receive the borrowed funds and the payments did not preserve value for the corporate group. Therefore, the transfers of security interests to the new lenders were avoidable as constructive fraudulent transfers. A fraudulent transferee that takes for value and in good faith may retain a lien to secure value given. If the transferee knew or should have known that the transfer would be fraudulent, however, the transferee does not take in good faith. Because the new lenders knew of the subsidiaries' precarious financial condition and that the borrowed funds would be used to pay obligations for which the subsidiaries were not liable, the new lenders did not take their security interests in good faith and could not retain a lien to secure any value that they gave. As co-borrowers on the new loans, each of the subsidiaries had an interest in the borrowed funds. Thus, payment of the borrowed funds to the joint venture lenders was a transfer of the subsidiaries' property. The subsidiaries did not receive any direct or indirect benefit from the transfers because they were not liable on obligations to the joint venture lenders, and the payments did not preserve value for the corporate group. Therefore, the payments are avoidable and may be recovered from the joint venture lenders. *Official Comm. of Unsecured Creditors v. Citicorp N. Am., Inc. (In re TOUSA, Inc.)*, 2009 Bankr. LEXIS 3311 (Bankr. S.D. Fla. Oct. 13, 2009).

2.1.zz. Fraudulent transfer savings clause in loan documents is not enforceable. The debtor's subsidiaries were co-borrowers with the debtor and granted security interests in substantially all their assets to secure their obligations. The loans rendered the subsidiaries insolvent, and the subsidiaries did not receive reasonably equivalent value for the obligations and the grant of the security interests. The debtor and its subsidiaries filed bankruptcy seven months after the new loan. The new loan agreement had a fraudulent transfer savings clause, which provided, "if such Borrower's joint and several liability hereunder … would, but for the application of this sentence, be unenforceable under applicable law, such joint and several liability … shall be valid and enforceable to the maximum extent that would not cause such joint and several liability … to be unenforceable under applicable law, and such joint and several liability … shall be deemed to have been automatically amended accordingly at all relevant times". A transfer or obligation is fraudulent and avoidable if the debtor was insolvent at the time of or rendered insolvent by the transfer or the obligation and did not receive reasonably equivalent value in exchange. The savings clause was not effective to shield the lenders from fraudulent transfer liability. An interest in property becomes property of the estate, despite any contractual provision to the contrary conditioned upon the debtor's insolvency or financial condition. The savings clause is conditioned upon insolvency and effects a forfeiture of the estate's cause of action for a fraudulent transfer. In addition, efforts to contract around the Bankruptcy Code are unenforceable. The savings clause would apply only if the transaction were otherwise avoidable, so its purpose is to nullify section 548. Therefore, the savings clause is not enforceable. *Official Comm. of Unsecured Creditors v. Citicorp N. Am., Inc. (In re TOUSA, Inc.)*, 2009 Bankr. LEXIS 3311 (Bankr. S.D. Fla. Oct. 13, 2009).

2.1.aaa. Court collapses and avoids asset sale LBO as fraudulent transfer. The shareholders of old Crown agreed to sell its assets to new Crown for $3.1 million in cash and a $2.9 million junior secured note, with 8% contingent interest. New Crown received a $500 investment from its owner plus a $3.1 million senior secured loan from a bank. Just before closing, old Crown dividended $600,000 to its shareholders. At closing, it received the note and the cash, which it promptly paid to its shareholders. New Crown made two annual interest payments on the junior note, which were transferred to the old Crown shareholders. New Crown failed and filed bankruptcy three and one-half years after the sale, in part due to business mistakes the new owner made. In the bankruptcy, the trustee sued the old Crown shareholders to avoid the transaction as a fraudulent transfer. The trustee may avoid a transfer of the debtor's property made in exchange for less than reasonably equivalent value if the debtor was insolvent or had unreasonably small capital at the time of the transfer. Although the debtor new Crown purchased old Crown's assets rather than its stock, as in a more classic LBO, the transaction form does not save the transaction from fraudulent transfer attack, because the proceeds were distributed to the old Crown shareholders. In effect, although not formally, the court collapses the transaction steps. A company has unreasonably small capital when it has "such meager assets that bankruptcy is a consequence both likely and foreseeable". The transaction overencumbered new Crown's assets and, by the preclosing dividend and new interest payment obligations, voided the company of cash, reducing its ability to borrow on favorable terms or weather financial storms. The new owner's business errors do not provide a defense, because mistakes are part of business, and their possibility creates the need for adequate capital. The

three-and-one-half-year delay before failure also does not provide a defense, although it is relevant evidence of capital adequacy, because the court must determine whether capital is reasonable as of the time of the transaction. Here, the evidence showed that the debtor could not have survived indefinitely, because it was cash-starved from its inception. Therefore, the court avoids the transaction, including the promissory note, the two interest payments and the pre-closing dividend. *Boyer v. Crown Stock Dist., Inc.*, 587 F.3d 787 (7th Cir. 2009).

2.1.bbb. Settlement payments include any payments for the purchase of stock. The debtor acquired several privately-owned corporate businesses in leveraged buyouts. It paid for the shares in the acquired companies by wire transfer from its bank. Its bankruptcy trustee sought to recover the payments from the selling shareholders as fraudulent transfers. Section 546(e) protects against avoidance a "settlement payment … made by or to … a … financial institution". Section 101 defines "settlement payment" to include "a final settlement payment, or any other similar payment commonly used in the securities trade". The definition is not limited to payments made through the public securities trading system of intermediaries and guarantees. Rather, it focuses on the common meaning of the term "settlement payment" in the securities trade, which includes any payment to complete a transfer of securities. Therefore, section 546(e) protects from avoidance the acquisition payments that the debtor made in this case. *Brandt v. B.A. Cap. Co., LP (In re Plassein Int'l Corp.)*, 589 F.2d 605 (3d Cir. 2009).

2.1.ccc. Federal choice of law rules apply to a section 544(b) fraudulent transfer action. A Texas incorporated debtor's Texas bankruptcy trustee sued an Ohio limited partnership whose principal place of business was in Texas under section 544(b) for recovery of the debtor's fraudulent transfer to the limited partnership of Ohio real property. The statute of limitations would have run on the action under Ohio fraudulent transfer law but not under Texas fraudulent transfer law. The court first must determine whether federal or state choice of law rules apply. Bankruptcy jurisdiction is federal question jurisdiction, so the requirement to use the forum's choice of law rules in a diversity case do not apply. Federal choice of law rules should apply if there is a compelling federal bankruptcy interest in the proceeding. An action under section 544(b), even though it incorporates state law as the rule of decision, is part of the administration of the bankruptcy law and implicates the federal interest in a uniform bankruptcy law. That is, the choice of law in determining whether a transfer is avoidable under section 544(b) should not depend on the state in which the bankruptcy case or avoidance action is pending. Therefore, federal choice of law rules apply. Federal choice of law rules require determination of the state with the most significant contacts or most significant relationship, as prescribed by the Restatement (Second) of Conflict of Laws. The Restatement applies different considerations depending on the nature of the underlying action, whether contract, property or tort. Here, the action does not involve the validity of the contract by which the debtor transferred the real property or of the transferee's property interest but whether the transfer was fraudulent as to creditors. Indeed, the trustee need not recover the property transferred but may recover its value under section 550(a). Thus, the central focus of an action under section 544(b) is to redress harm to the estate and to creditors. Therefore, the action sounds in tort, so the court must determine choice of law based on the place where the conduct and the injury occurred and the locations of the parties and their relationship. *Tow v. Rafizadeh (In re Cyrus II P'shp)*, 413 B.R. 609 (Bankr. S.D. Tex. 2008).

2.1.ddd. Partners' waiver of rights to future partnership profits is a fraudulent transfer. State partnership law provides a dissolved law firm partnership owns profits accruing to a partner or his new law firm from the partner's post-dissolution work on the old law firm's unfinished business. Shortly before the law firm's failure, while the law firm was insolvent, the partners amended the partnership agreement to waive the partnership's right to any such profits generated by any partner. The law firm later filed bankruptcy. A trustee may avoid a transfer of property of a debtor that the debtor transferred while the debtor was insolvent for less than reasonably equivalent value within two years before bankruptcy. Nonbankruptcy law determines what is property; bankruptcy law determines whether it is property of the debtor to which the trustee's avoiding powers apply. The rights to profits from unfinished business were property of the debtor when the partners amended the partnership agreement to waive the rights. The waiver effected a transfer of the rights to each partner who took unfinished business to a new firm. The agreement among the partners to waive any rights to the profits may have provided value to each partner who took unfinished business, but it did not provide value to the dissolving partnership. Nor did the partners' agreement to assist in the winding up and the collection of receivables provide value to the partnership, as the partners were already under a duty to do so. Therefore, the waiver is an avoidable fraudulent transfer.

However, the burden remains on the trustee to show the value, if any, in the profits generated by the unfinished business that the partners took. *Greenspan v. Orrick, Herrington & Sutcliffe LLP (In re Brobeck, Phleger & Harrison LLP)*, 409 B.R. 318 (Bankr. N.D. Calif. 2009).

2.1.eee. Trustee may not avoid an LBO payment to a privately held corporation's shareholders. The privately held debtor was the target of a leveraged buyout. The buyer made its payment for the debtor's shares to a bank that served as the buyer's exchange agent. The bank paid the debtor's shareholders. After the debtor filed bankruptcy, the trustee sought to avoid and recover the payment from the former shareholders as a fraudulent transfer. Section 546(e) excepts from the trustee's avoiding powers a "settlement payment … made by or to … a financial institution". The "settlement payment" definition is circular, but its important provision is "payment commonly used in the securities trade". Whether or not Congress intended the settlement payment exception to protect the public financial markets, the settlement payment definition is not limited to payments for the purchase of publicly traded securities. Therefore, the payment to the shareholders qualifies as a settlement payment. The bank was a financial institution, and the payment was made to the bank. The statute does not require that the financial institution receive a beneficial interest in the transfer for the exception to apply. Therefore, even though the bank acted only as an exchange agent, section 546(e) excepts the transfer from the trustee's avoiding powers. *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545 (6th Cir. 2009).

2.1.fff. An ordinary commodity supply contract may be a swap agreement. The debtor was in the business of selling natural gas (a commodity) to end users. Shortly before bankruptcy, the debtor sold at below market prices to defraud its lender. The trustee sued to recover from the buyers the value shortfall as a fraudulent transfer. Sections 546(g) and 548(c) and (d) limit the trustee's ability to avoid transfers under a "commodity contract", a "forward contract" or a "swap agreement". "Commodity contract" includes only a futures contract traded on a contract market or board of trade and related agreements. "Forward contract" includes a contract for the future purchase of a commodity but specifically excludes a "commodity contract". "Swap agreement", however, is defined more broadly to include "a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange, precious metals, or other commodity agreement" and a "a *commodity* swap, option, future, or *forward agreement*" (emphasis added). A "commodity forward agreement" need not be traded (or of a kind traded) on an exchange to qualify for the financial contract protections. Nor does the Code require that a commodity forward agreement be financially settled to qualify. Four principles guide whether a supply contract qualifies for financial contract treatment. First, the agreement's subject must be a commodity, with substantially all performance costs attributable to the commodity cost, as distinguished from other supply contracts that include costs attributable to packaging, marketing, transportation or service. Second, the agreement must be "forward", that is, for delivery more than two days hence. Third, the agreement must fix not only the price, but also the time and quantity of deliveries. Finally, even though financial market trading is not required for an agreement to qualify, there must be some relationship between the agreement and the financial markets, so that the Code's financial contract protection provisions subordinate the Code's overarching equal distribution policy only when necessary to serve Congress's policy, embodied in the financial contract provisions, of protecting financial markets. Although the agreements here were simple supply agreements that were to be physically settled, they also had hedging elements, because they involved prices and quantities specified at the time of contracting and so were similar to forward contracts that are financially settled as hedges. The hedging elements made these contracts sufficiently similar to those financial markets contracts that Congress intended to protect. *Hutson v. E.I. du Pont de Nemours and Co., Inc. (In re Nat'l Gas Distr's, LLC)*, 556 F.3d 247 (4th Cir. 2009).

2.1.ggg. Trustee may recover prejudgment interest in a fraudulent transfer action at the applicable state law rate. The court granted the trustee judgment for recovery of a fraudulent transfer under section 544(b), based on a state law cause of action. The trustee is entitled to interest on the judgment from the time of demand on the defendant. 28 U.S.C. § 1961 provides for the allowance of interest at the federal rate "on any money judgment in a civil action recovered in a district court". Because the bankruptcy court is a unit of the district court, section 1961 governs postjudgment interest. The substantive law under which the trustee brings the claim governs prejudgment interest. Here, section 544(b) gives the trustee the right to sue, and section 550 specifies the parties against whom the trustee may recover. But the claim arises under state fraudulent transfer law. Therefore, the applicable state law

interest rate applies to prejudgment interest. *Lassman v. Keefe (In re Keefe)*, 401 B.R. 520 (1st Cir. B.A.P. 2009).

2.1.hhh. Undercapitalization differs from insolvency and should be characterized instead as excessive leverage. The newly formed debtor purchased an aluminum smelting plant, including an existing contract with the local electric utility to provide the large amounts of electricity the plant needed at a favorable price. Because of an electricity shortage when the debtor acquired the plant, the utility agreed to make a large curtailment payment to the debtor in exchange for the debtor's agreement not to operate the plant for 14 months. The debtor financed the purchase in large part with the payment. At the time, the debtor intended to begin operations at the end of the curtailment period. However, electricity prices rose and aluminum prices fell, making operation uneconomical, so the debtor never began operations and filed bankruptcy. The shutdown fixed various liabilities that were contingent when the debtor purchased the plant, such as termination and severance expenses. As a result, the debtor was insolvent when it filed bankruptcy. The trustee sought to avoid as fraudulent transfers several payments made during the curtailment period. The trustee may avoid a transfer for less than reasonably equivalent value made while the debtor was insolvent (fair value of assets are less than liabilities) or had an unreasonably small capital. In evaluating the debtor's liabilities, the court must discount a contingent liability based on the likelihood of its becoming fixed, not based on the likelihood that the debtor will be able to pay it assuming that it becomes fixed. Similarly, the court may not consider the risk that the debtor's costs would increase and thereby render the debtor insolvent, because all businesses are at risk of future changes that cannot be predicted with adequate certainty. That does not make them insolvent. Finally, analyzing whether a debtor has unreasonably small capital differs from analyzing whether a debtor is insolvent. Undercapitalization should be analyzed as excessive leverage. Here, the curtailment meant that the debtor would not have revenues for at least the curtailment period, requiring that it have sufficient capital to survive that period. Because it had planned for reopening, its balance sheet showed that it was adequately capitalized at the time of the purchase. *Baldi v. Samuel Son & Co., Ltd.*, 548 F.3d 579 (7th Cir. 2008).

2.1.iii. Payments within the fraudulent transfer reachback period on a guarantee given before that period may be avoidable as fraudulent transfers. The debtor's shareholder sold the stock in the debtor to a purchaser and guaranteed the shareholder's note given in payment for the purchase. The debtor (rather than the stockholder) made regular payments on the note until it filed bankruptcy more than four years later. The trustee may avoid a transfer that is avoidable by creditors. The state's Uniform Fraudulent Transfer Act (UFTA) permits a creditor to avoid a transfer made or obligation incurred within four years for less than reasonably equivalent value while the debtor was insolvent. It defines "value" to include satisfaction or securing of an antecedent obligation and defines "transfer" to mean "every direct or indirect … method of disposing of or parting with an asset or an interest in an asset, and includes payment of money …". It therefore includes incurring an obligation as well as payment on the obligation. Therefore, each payment on the note and the guarantee was a transfer that is avoidable under the UFTA. The court does not discuss whether the definition of "value" protects the payments or the potentially limiting effect on whether incurring an obligation is included in the definition of "transfer" of the UFTA's language that permits avoidance of a transfer <u>or</u> an obligation. *Belfance v. Buonpane (In re Omega Door Co., Inc.)*, 399 B.R. 295 (6th Cir. B.A.P. 2008).

2.1.jjj. LBO resulted in a fraudulent conveyance where the debtor overpaid for assets and was unable to keep trade debt reasonably current. The debtor was formed to acquire the assets of three businesses in the same industry in a leveraged buyout. The acquired assets' value was less than the amount paid by about 10%. At the closing of the transaction, the debtor's projections showed sufficient liquidity and capital to pay interest and maturing principal on its long-term debt. However, the debtor did not have enough liquidity or credit facility availability to pay its trade debts on industry standard terms either at closing or for at least 12 months after closing. The debtor filed bankruptcy 29 months after the acquisition. A trustee may avoid a fraudulent transfer under the Uniform Fraudulent Conveyance Act if the debtor received less than "fair consideration" and the transfer was made when the debtor was about to engage in a business for which it had unreasonably small capital. Fair consideration requires that the value the debtor receives is at least the amount paid. The value the debtor received here was not fair consideration. The court suggests that a value deficiency of even 2% would fail as fair consideration. For a business not to have unreasonably small capital, the debtor need not have sufficient capital to ensure that equity holders recover their investments or that long-term debt holders can be paid, as they may agree to extended terms

based on unforeseen circumstances that may compromise the debtor's ability to pay. Rather, a business has unreasonably small capital "whenever it cannot reasonably anticipate resources needed to effect the timely payment of its trade obligations". A business may choose to accelerate receivables and stretch payables as a business strategy, but the business has unreasonably small capital when such practices arise from necessity. It does not matter that the debtor was able to survive for 29 months, as the test is applied only as of the time of the transfer. *CNB Int'l, Inc. v. Kelleher (In re CNB Int'l, Inc.)*, 393 B.R. 306 (Bankr. N.D.N.Y. 2008).

2.1.kkk. Dividend notes payable only out of funds legally available for a dividend are not contingent claims for insolvency determination purposes. The debtor issued dividend notes to its parent corporation which were expressly "payable only out of funds legally available for the payment of dividends". Valued at face, the notes rendered the debtor insolvent. The trustee sought to recover interest payments on the notes as fraudulent transfers made for less than reasonably equivalent value while the debtor was insolvent. To determine insolvency, a bankruptcy must value contingent liabilities at face multiplied by the probability that the contingency will occur. Although payment on the notes might have been contingent on availability of funds, the obligation was absolute, as evidenced by the debtor's regular interest payments on the notes. Therefore, the court must include the notes at their face amount in determining the debtor's solvency. *Freeland v. Enodis Corp.*, 540 F.3d 721 (7th Cir. 2008).

2.1.lll. Margin payments to further a Ponzi scheme are not exempt from avoidance. The debtor operated a Ponzi scheme. It maintained securities accounts with a stockbroker, which issued numerous margin calls in the year before bankruptcy on the debtor's short positions. Section 546(e) exempts from the trustee's avoiding powers any margin payments to a financial institution such as a stockbroker, except a transfer avoidable under section 548(a)(1)(A), because such a transfer is made with actual intent to hinder, delay, or defraud creditors. These margin payments would qualify for the stockbroker exemption, except that any payment made to further a Ponzi scheme is by definition made to hinder, delay, or defraud creditors, because it is made to perpetuate the fraud inherent in a Ponzi scheme. Payments to investors are intended to further the Ponzi scheme by creating an impression of success that attracts new investors. The margin payments, even though not to investors, were required to maintain the debtor's trading position and continue the scheme. Therefore, the margin payments are made with actual intent to defraud and are not exempt from avoidance. *Bear, Stearns Sec. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1 (S.D.N.Y. 2007).

2.1.mmm. Ponzi scheme fraudulent transfer defendant may have "value" defense. The debtor collected limited partnership investments in a Ponzi scheme. The trustee sued one investor for fraudulent transfer liability for return of "principal" and of "interest". A Ponzi scheme operator's payments to investors are made with actual intent to defraud creditors, so an investor has a defense to fraudulent transfer recovery only if the investor took for value in good faith. "Value" includes satisfaction of an antecedent debt. He took the principal return for value because he had a restitution claim for the amount invested for limited partnership interests, which was satisfied by the return of the amount he invested. He did not, however, give value for the interest payment. Because the case is a fraudulent transfer action, the court concludes the probable subordination of the investor's restitution claim under section 510(b) does not negate the "value" argument. *Barclay v. Mackenzie (In re API Holding, Inc.)*, 525 F.3d 700 (9th Cir. 2008).

2.1.nnn. Fraudulent transfer plaintiff must show avoidance will benefit creditors. A postconfirmation creditor recovery trust for the debtor parent corporation sought to avoid bank claims against the debtor's unconsolidated subsidiaries, whose creditors had been paid in full under the plan and retained no interest in the reorganized debtor or the recovery trust. Under *Whiteford Plastics Co. v. Chase Nat'l Bank*, 179 F.2d 582 (2d Cir. 1950), a transfer or obligation may be avoided as fraudulent only when avoidance would benefit creditors, not just the debtor. The *Whiteford* rule remains good law under the Bankruptcy Code. Therefore, the recovery trust lacks standing to bring the fraudulent transfer claims against the banks. *Adelphia Recovery Trust v. Bank of Am., N.A.*, 390 B.R. 80 (S.D.N.Y. 2008).

2.1.ooo. A court may use market value to determine insolvency. Motorola developed the idea of a global satellite telephone system in 1987 and formed a subsidiary, Iridium, to develop, market, and operate the system. Motorola spun off Iridium but continued to provide development and other services, for which Iridium paid Motorola $3.7 billion in the four years before Iridium's bankruptcy. During the same period, Iridium raised billions of dollars in the capital markets to fund its development and operation costs.

Despite Iridium's thoroughness and care in developing financial projections, which were vetted as well by outside consultants and financial underwriters, the projections were overly optimistic. Iridium had completely misjudged the market for a system with the technical limitations that a satellite-based system imposed. Iridium filed bankruptcy nine months after starting commercial operation. In deciding whether the transfers the Motorola could be avoided as constructively fraudulent, the court must use a going-concern or market price valuation to determine whether a going-concern debtor such as Iridium was insolvent. It must determine whether the debtor had adequate capital based on whether the debtor's capital needs projections were reasonable and prudent when made, not in hindsight. The court may consider the market value of the debtor's equity and the willingness of investors to lend or invest in the debtor, even if those indicators were based on projections that, though reasonable when made, were wrong or based on market exuberance or a bubble. Such market indicators are preferable to post-hoc projection revisions, which impermissibly interject hindsight into the valuation. A company's subsequent failure is irrelevant to the analysis absent concealment or later discovery of highly relevant information. Contemporaneous evidence, including market data, carries more weight. *Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

2.1.ppp. Payment to further a Ponzi scheme is made with actual fraudulent intent. When the SEC sued a Ponzi scheme operator in district court, the court froze the operator's assets. The operator asked a business associate to fund the operator's legal fees, which an affiliate of the operator immediately reimbursed. The SEC brought a similar action against the affiliate three years later, and the court determined that the affiliate had simply perpetuated the operator's fraudulent scheme. The affiliate's receiver sought recovery of the reimbursement payment from the business associate under the Uniform Fraudulent Transfer Act as an actual fraudulent transfer. Only the transferor's intent is relevant in determining whether a transfer is made with actual intent to hinder, delay, or defraud creditors. Operating a Ponzi scheme invests actual intent to defraud creditors in every transfer. In addition, reasonably equivalent value must be measured from the perspective of preservation of the debtor's net worth or utility to creditors. Legal services to defend the SEC's action did not benefit creditors and therefore did not provide reasonably equivalent value for the transfer. *SEC v. Res. Dev. Int'l, LLC*, 487 F.3d 295 (5th Cir. 2007).

2.1.qqq. Reduction in working capital may result in unreasonably small capital. A successful company's shareholders sold their shares to a buyer, who financed the purchase with a loan that was secured by the company's assets. After the transaction, the company's working capital decreased from an average over the prior five years of 27% of net sales and 30% of total assets to 2.1% and 1.0%, respectively. The company had to borrow under its line of credit to pay the transaction's closing costs. Under the circumstances, the company was left with unreasonably small capital. Neither the reasonableness of the financial projections at the time of the sale nor the availability of a line of credit to fund the company's working capital needs affects the analysis. In addition, the court may conclude that the shareholder defendants, who were the company's prior management, intended or believed that the company would become unable to pay its debts as they matured. *Official Comm. of Unsecured Creditors v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68 (Bankr. E.D.N.Y. 2007).

2.1.rrr. Direct payment to LBO shareholders is not a safe harbor settlement payment. A company's shareholders sold their shares to a buyer, who financed the purchase with a loan that was secured by the company's assets. The loan proceeds were paid directly from the lender bank to the shareholders. The payment is not a "settlement payment" that section 546(e) protects from avoidance. Section 741(8)'s "settlement payment" definition includes "settlement payment … or any other similar payment commonly used in the securities trade". To give the latter phrase meaning, the definition must be limited to the "securities trade", which refers to the public securities markets, not merely to any transaction in securities. Such a reading is consistent with the safe harbor's purpose "to prevent the ripple effect created by the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected industry". (internal quotes omitted). *Official Comm. of Unsecured Creditors v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68 (Bankr. E.D.N.Y. 2007).

2.1.sss. Section 546(e)'s safe harbor prevents avoidance of a debtor's payments to its principal's stockbroker. The debtor corporation made numerous payments into its president's margin account at Morgan Stanley Dean Witter in the three years before bankruptcy, at times when the margin

account had debit balances. MSDW applied the deposits to reduce margin debt, to purchase securities, and to fund withdrawals from the account. The trustee may not avoid the transfers under section 544(b) or 548. Section 546(e) prohibits avoidance under those sections of "a margin payment … or settlement payment … made by or to … [a] stockbroker". Section 101(38) defines "margin payment" broadly and therefore includes a payment into a margin account. MSDW is a "stockbroker", even though it was not acting as the debtor's stockbroker in these transactions. The "stockbroker" definition is not limited to a situation in which the stockbroker is acting in that capacity for the debtor. *Hays v. Morgan Stanley DW Inc. (In re Stewart Fin. Co.)*, 367 B.R. 909 (Bankr. M.D. Ga. 2007).

2.1.ttt. Bankruptcy petition does not affect fraudulent transfer statute of limitations. The trustee brought a fraudulent transfer action under section 544(b) and applicable state law to avoid an obligation entered into four years and 20 days before the filing of the complaint, but less than a year after the bankruptcy petition filing. The state fraudulent transfer statute of limitations was four years. The court measures the running of the statute of limitations from the complaint's filing date, rather than allowing the trustee two years under section 546(a) to bring the action. *Adv. Telecomm. Network, Inc. v. Allen (In re Adv. Telecomm. Network, Inc.)*, 490 F.3d 1352 (11th Cir. 2007).

2.1.uuu. LBO lender is not a necessary party to a fraudulent transfer action. A successful company's shareholders sold their shares to a buyer, who financed the purchase with a loan that was secured by the company's assets. The company later filed bankruptcy. The committee brought an action on the estate's behalf to recover the payments to the shareholders. Although an LBO may be viewed as an integrated transaction, under which the lender may be liable for any resulting fraudulent transfer, an action to avoid or recover any assets transferred may be brought independently against each possible defendant. Rule 19, which governs joinder of parties, requires joinder only if a complete adjudication among the parties to the action (here, the committee and the former shareholders) is not possible without joinder of a third person, or if a party would be subject to inconsistent adjudications in another action with a nonjoined party. Neither of those possibilities is present in a fraudulent transfer action against fewer than all of the transferees. *Official Comm. of Unsecured Creditors v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68 (Bankr. E.D.N.Y. 2007).

2.1.vvv. Margin payments to further a Ponzi scheme are not exempt from avoidance. The debtor operated a Ponzi scheme. It maintained securities accounts with a stockbroker, which issued numerous margin calls in the year before bankruptcy on short positions that the debtor maintained. Section 546(e) exempts from the trustee's avoiding powers any margin payments to a financial institution such as a stockbroker, except a transfer avoidable under section 548(a)(1)(A) because it is made with actual intent to hinder, delay, or defraud creditors. These margin payments would qualify for the exemption, except that any payment made to further a Ponzi scheme is by definition made to hinder, delay, or defraud creditors, because it is made to perpetuate the fraud inherent in a Ponzi scheme. Therefore, the margin payments are not exempt from avoidance. The trustee may not recover, however, from a mere conduit for the payments, that is, one who does not have dominion or control over the transferred funds. A stockbroker is required under SEC Rule 15c3-3 to maintain customer funds, such as margin, in segregation from the stockbroker's own assets and is limited in how the stockbroker may use or apply the funds. However, the stockbroker takes a security interest in margin funds and may apply them to the customer's obligations in connection with securities transactions, for which the stockbroker would be liable to the customer's counterparty if the customer did not provide adequate funds. The segregation limitation on the stockbroker's use of the funds therefore does not deprive it of sufficient dominion or control to make it a conduit. It is the initial transferee, and the trustee may recover the transfers from the stockbroker. Finally, section 548(c)'s good faith defense does not apply in this case, because the stockbroker had negative financial information about the debtor that should have led it to investigate the debtor's true financial condition. *Gredd v. Bear, Stearns Sec. Corp. (In re Manhattan Inv. Fund Ltd.)*, 359 B.R. 510 (Bankr. S.D.N.Y. 2007).

2.1.www. An ordinary commodity supply contract is not a swap agreement. The debtor was in the business of selling natural gas (a commodity) to end users. Shortly before bankruptcy, the debtor sold at below market prices to defraud its lender. The trustee sued to recover from the buyers the value shortfall as a fraudulent transfer. Sections 546(g) and 548(c) and (d) limit the trustee's ability to avoid transfers

under a "swap agreement," which, under section 101(53B), means, among other things, "a commodity swap, option, future, or forward agreement." Although the debtor's sales agreements provided for future (forward) delivery of a commodity, they are not swap agreements. Section 101(53B)(A)(ii)(I), which includes within the swap agreement definition similar agreements "of a type that has been … the subject of recurrent dealings in the swap or other derivatives markets" suggests that the definition is intended to encompass financial (that is, swap) market transactions, not ordinary commercial supply agreements. Moreover, the legislative history excludes "[t]raditional commercial arrangements, such as supply agreements" from the definition. Otherwise, the swap agreement exception would do more than protect against financial market disruption; it would defeat the Bankruptcy Code's equal distribution principle in a wide range of transactions, which Congress did not appear to intend. *Hutson v. Smithfield Packing Co. (In re Nat'l Gas Distribrs., LLC)*, 369 B.R. 884 (Bankr. E.D.N.C. 2007).

2.1.xxx. A court may use stock market value to determine "reasonably equivalent value." Campbell spun off to its shareholders its Vlasic Foods division, but only after the division borrowed $500 million to pay Campbell for the division's assets. Vlasic failed three years later. The market value of Vlasic's publicly traded stock for at least the first nine months after the spinoff was at least $1 billion. The court may rely on the stock market value to determine the value of the spun-off assets and whether the $500 million Vlasic paid to Campbell was "reasonably equivalent value" for the acquired assets. *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624 (3d Cir. 2007).

2.1.yyy. Payment of secured claims is not a fraudulent transfer. A lender provided a warehouse financing line to a sub-prime mortgage lender, who was found to have engaged in fraudulent sales practices to the detriment of sub-prime borrowers. The warehouse line was secured by the debtor's mortgages. The bankruptcy trustee sought to avoid the debtor's prepetition payments to the warehouse lender as fraudulent transfers, because it provided the line and collected the payments at a time when it knew or reasonably should have known of the debtor's fraud in securing the mortgages. Although the debtor may have attempted to defraud its own borrowers and the warehouse lender was found to have aided and abetted the fraud by providing the warehouse line with knowledge of the debtor's misconduct, the repayments of the lender's secured loans are not fraudulent transfers. The debtor's borrowers were not initially its creditors, and the lender's providing the warehouse line did not defraud the borrowers; the debtor's fraud was direct and independent of its lender's loans. The fraudulent transfer laws address fraud in removing (or hiding) assets from the debtor to prevent paying creditors, not the repayment of secured debt. *Henry v. Lehman Comm'l Paper, Inc. (In re First Alliance Mortgage Co.)*, 471 F.3d 977 (9th Cir. 2006).

2.1.zzz. LBO share purchase through a financial institution insulates the transaction from fraudulent transfer attack. The debtor was acquired through a leveraged buyout. The cash to pay for the shares was obtained from a bank loan that was secured by the debtor's assets. The cash was paid to another bank as a disbursing agent. The payments to the selling shareholders are "settlement payments" eligible for safe harbor protection under section 546(e), because they are payments for securities. The safe harbor applies because the payments were made to the sellers by a financial institution, that is, the disbursing agent bank. It does not matter that the bank, as disbursing agent, never acquired a beneficial interest in the funds. As long as the payments pass through the bank's hands, they are insulated. The court notes the unfairness of the result and expresses the hope that Congress will revisit section 546(e), because of the ability of LBO participants to insulate themselves completely from fraudulent transfer risk. *QSC Holdings, Inc. v. Alford (In re Quality Stores, Inc.)*, 355 B.R. 629 (Bankr. W.D. Mich. 2006).

2.1.aaaa. Termination of prepaid services contract may be a fraudulent transfer. The debtor prepaid for online advertising services under a long-term contract. Shortly before the debtor filed bankruptcy, the other party terminated the contract in accordance with a contract term that allowed termination upon the debtor's insolvency. The termination might be a fraudulent transfer. The debtor's contract rights to advertising services for which the debtor had prepaid was property of the debtor, which was transferred. The contract termination may be subject to avoidance even though it was made in accordance with and was authorized by the contract. Fraudulent transfer law by its nature permits a trustee to avoid otherwise legal transactions if they deprive a debtor of value during a limited period before bankruptcy. *EBC I, Inc. v. America Online, Inc. (In re EBC I, Inc.)*, 356 B.R. 631 (Bankr. D. Del. 2006).

2.1.bbbb. Fraudulent transfer statute does not have extraterritorial application. The Barbados debtor operated a Ponzi scheme. It transferred funds from its London bank account to a foreign exchange trader. The trader initially deposited the funds in a New York bank account but promptly moved them to its own London bank account. From the funds, the debtor paid the trader fees and spread on foreign exchange transactions. Although section 541(a)(1) applies to all interests in property of the debtor, wherever located, and although "property of the debtor" in section 548(a) is generally construed as property that would have become property of the estate if it had not been transferred, it cannot be construed to expand section 548's territorial application. Transfers avoided under section 548 or recovered under section 550 become property of the estate only after recovery. Because a debtor does not have any interest in transferred property, the transferred property is not initially included in property of the estate under section 541(a)(1). Therefore, the court cannot import section 541's extraterritorial reach into section 548, and the trustee may not avoid the transfer as actually fraudulent under section 548. *Barclay v. Swiss Fin. Corp. (In re Midland Euro Exchange Inc.)*, 347 B.R. 709 (Bankr. C.D. Cal. 2006)

2.1.cccc. Constructively fraudulent transfer is partially avoided based on a preponderance of the evidence that the debtor had unreasonably small capital. The debtor transferred several real estate parcels to his wife for no consideration, based in part on estate planning advice to equalize his and his wife's estates. At the time, the debtor faced a large note obligation. The wife sold several of the parcels to fund their living expenses and pay some of the debtor's debts. After bankruptcy, the debtor's trustee sued the wife under the UFTA to recover the transfers as constructively fraudulent. The trustee must prove the elements of a constructively fraudulent transfer by a preponderance of the evidence. Unlike avoidance of an actually fraudulent transfer, which requires clear and convincing evidence, avoidance of a constructively fraudulent transfer does not impose a stigma on the debtor but is aimed solely at assessing injury to creditors. That the assets were sold to pay living and business expenses and pay business debts and were the sole available source of such payments showed the debtor had unreasonably small capital at the time of the transfers. The UFTA authorizes recovery of the value of the property transferred "subject to adjustments as the equities may require." The court reduces the recovery amount by the amount of living and business expenses that the wife paid from the asset sale proceeds, because had the debtor retained the assets, he would have expended about the same amount for the same purposes, so recovery of the entire value of the property transferred would result in a windfall to the estate. *Dahar v. Jackson (In re Jackson)*, 459 F.3d 117 (1st Cir. 2006).

2.1.dddd. Bank account to bank account transfer may qualify as a "settlement payment." A holding company owned the debtor; an ESOP and the debtor's and holding company's directors and officers owned the holding company. To take advantage of a change in the tax law, the holding company redeemed the directors' and officers' shares, leaving the holding company solely the ESOP's hands. The debtor dividended the funds to the holding company to pay for the shares. The holding company made the payments to the bank that held most of the directors' and officers' shares in their IRA's. The payments were settlement payments protected from avoidance as "settlement payments" by section 546(e), even though the stock was privately held and the payments did not go through the securities clearing system or involve any intermediaries such as clearing houses, disbursing agents or stock brokers. In evaluating whether the payment from the debtor were settlement payments, the defendants could argue for collapsing the two transactions – the payment from the debtor to the holding company and the payment from the holding company to the shareholders. The payments were part of an integrated, single transaction and should be viewed as such. Because the payments were made by a financial institution – from the holding company's bank to the IRA bank – they were protected. The settlement payment safe harbor in section 546(e) permits avoidance under section 548(a)(1)(A). This exception incorporates only the bankruptcy actual fraudulent transfer provision, one made within two years before bankruptcy, but does not apply to an action under section 544(b) incorporating the actual fraudulent transfer provisions of nonbankruptcy law, such as the UFTA. *Official Comm. of Unsecured Creditors v. Clark (In re Nat'l Forge Co.)*, 344 B.R. 340 (W.D. Pa. 2006).

2.1.eeee. Pension plan amendment was a fraudulent transfer. While in financial trouble, the debtor adopted a KERP. In addition, it amended its management pension plan to increase benefits to about 400 employees. Because the plan was ERISA-qualified, the increased benefits could not later be revoked. The company incurred a cash cost to fund the benefits increase, although the precise amount was not

determined, and the company lost any surplus that would have been in the plan if the amendment had not been made. The liquidating trustee sued to recover the benefits increase as a fraudulent transfer. The amendment was a "transfer," because of the loss of the surplus and because the company incurred an increased obligation. The company received something of value in exchange, because the amendment was designed to help retain employees for a going-concern sale. However, the value received was uncertain and small, and although the amendment's precise cost was not determined, the benefit was not reasonably equivalent to the cost. Precision is not required for a determination of "reasonably equivalent value," which is a determination that can be made based on the totality of the circumstances. *Pension Transfer Corp. v. Beneficiaries Under the Third Amendment to Fruehauf Trailer Corp. Ret. Plan No. 003 (In re Fruehauf Trailer Corp.)*, 444 F.3d 203 (3d Cir. 2006).

2.1.ffff. Section 548 reaches a foreign real property transfer. Many years before bankruptcy, while the debtor and her children were all in Maryland, the debtor deeded Bahamian real property to her children. The children did not record the deed, because of high Bahamian transfer taxes, until shortly before bankruptcy. For purposes of section 548(d)(1), the transfer was not made until the deed was recorded in the Bahamian land records, and the transfer is avoidable, despite the real property's Bahamian location. Application of section 548(a) to this transfer does not involve extraterritorial application of the bankruptcy laws, because the debtor, her creditors, and the transferees were all located in the U.S., the debtor's insolvency occurred in the U.S., and the debtor's decisions to transfer and the transferees' decision to record the transfer were made in the U.S. However, the property's Bahamian location may involve extraterritorial application. The general presumption against extraterritorial application of U.S. laws does not apply to the fraudulent transfer laws, because Congress clearly intended bankruptcy laws to apply to property "wherever located." Comity does not interfere with avoiding the transfer, even though the action involves real property located in the Bahamas, because the transaction was primarily U.S.-based and because avoiding the transfer does not interfere with Bahamian real property laws but is intended only to adjust the relations between a U.S. debtor and her U.S. creditors. *French v. Liebmann (In re French)*, 440 F.3d 145 (4th Cir. 2006).

2.1.gggg. Debtor's purchase of related party's notes is a settlement payment that is exempt from avoidance. The debtor established a collateralized loan obligation (CLO) entity structure to sell interests in loan portfolios that it owned. The CLO issued notes, whose sole source of repayment was collections on the loan portfolios. When the loan portfolios declined in value, the debtor purchased the CLO notes in the market, paying for them through accounts of a stockbroker. Because the loan portfolios had declined in value, the CLO notes were worth less than par. The debtor nevertheless paid par for the notes to protect its credit rating. The debtor in possession sought to recover the payments as constructively fraudulent transfers. Section 546(e)'s safe harbor protects the debtor's payments for the CLO notes from avoidance, because the payments were settlement payments. In this case, there was no allegation of anything out of the ordinary other than paying more than market value for the notes. That does not come within the safe harbor's actual fraud exception, nor is it so unusual that the payments are not within the "settlement payment" definition of "payments commonly used in the securities trade." Therefore, the complaint is dismissed. *Enron Corp. v. Int'l Fin. Corp. (In re Enron Corp.)*, 341 B.R. 341 (Bankr. S.D.N.Y. 2006).

2.1.hhhh. Cross-stream guarantee was not a fraudulent transfer. A New York restaurant corporation debtor invested heavily in its new sister restaurant corporation's business premises construction and guaranteed its lease. The debtor did not benefit from any synergy with the new restaurant nor derive any other benefit from the guarantee. Although keeping the new restaurant alive would have enabled the debtor to recover its prior large investment in the new restaurant, that alone does not provide reasonably equivalent value. The survival of the other entity might provide reasonably equivalent value only if it would have enhanced the debtor's value substantially. Therefore, the debtor did not receive reasonably equivalent value for the guarantee. However, in this case, the debtor was not "insolvent," as defined in the UFCA, in effect in New York. In addition, under the UFCA, the "unreasonably small capital" test applies only to a transfer, not to an obligation. Therefore, the trustee could avoid the obligation only by meeting the third financial condition test, that the debtor "intends or believes that he will incur debts beyond his ability to pay as they mature." The test requires proof of the debtor's subjective intent or belief. Because the trustee did not introduce any evidence of intent or belief, the guarantee was not a fraudulent

obligation. *Silverman v. Paul's Landmark, Inc. (In re Nirvana Restaurant, Inc.)*, 337 B.R. 495 (Bankr. S.D.N.Y. 2006).

2.1.iiii. Ponzi scheme receiver may recover repayments as fraudulent transfers. The Ponzi scheme operator's receiver brought an action for actual fraudulent transfer under the UFTA against investors who were paid back their investments before the scheme collapsed. A transfer from a Ponzi scheme to an investor, as a matter of law, is a transfer with actual intent to defraud creditors. Under the UFTA, a recipient of an actual fraudulent transfer may defend if he took in good faith and gave reasonably equivalent value in exchange. In a Ponzi scheme, an investor and, in this case, a broker who aided the scheme, does not give reasonably equivalent value in exchange for any payments that he receives. *Warfield v. Byron*, 436 F.3d 551 (5th Cir. 2006).

2.1.jjjj. Bankruptcy court may not order partial avoidance of a fraudulent transfer. The debtor and her husband granted the bank a mortgage on their tenancy by the entirety house to prevent the IRS from obtaining a tax lien on it. When the debtor filed chapter 11 some years later, she sought to avoid the mortgage as an actual fraudulent transfer. The bankruptcy court found actual intent to hinder or delay the IRS and ordered the transfer avoided, but only to the extent necessary to pay administrative expenses in the chapter 11 case, with the bank retaining the mortgage for any excess value. Such an order is improper. Section 544(b) provides for avoiding (that is, making void) a transfer. It does not grant the court discretion, under its equitable powers or otherwise, to limit the avoidance. Section 550 authorizes recovery of an avoided transfer "for the benefit of the estate." That limitation is not present in section 544(b) and may not be imposed by the bankruptcy court. *Coleman v. Cmty Trust Bank (In re Coleman)*, 426 F.3d 719 (4th Cir. 2005).

2.1.kkkk. Substitution of one stock warrant for another may be a fraudulent transfer. The debtor issued a stock warrant. The debtor later accepted the warrant from the holder in exchange for another warrant that had a lower strike price. The holder exercised the warrant and sold the stock for a profit. Bankruptcy followed. The liquidating trustee sued the holder under section 544(b) and the Uniform Fraudulent Transfer Act, alleging that the exchange of a warrant for another warrant that had less value to the debtor was a transfer of the debtor's property that was for less than reasonably equivalent value. Whether the debtor's interest in the warrant is property for purposes of section 544(b) is a question of federal law. The phrase in section 544(b) is co-extensive with the phrase "interest of the debtor in property" in section 541(a)(1), which is to be broadly construed. The warrant is an option that is an executory contract in which the warrant issuer (the debtor) has a property interest because of its right to receive the purchase price if the holder exercises. When the debtor exchanged the warrant, its loss of the right to receive the strike price as a condition for issuing any shares was a transfer. *Lehtonen v. Time Warner, Inc. (In re PurchasePro.com, Inc.)*, 332 B.R. 417 (Bankr. D. Nev. 2005).

2.1.llll. Inadequate disclosure of corporate transaction that benefits insiders may imply actual fraudulent intent. The debtor's board approved a corporate acquisition involving payments to the debtor's stockholders and directors that ultimately resulted in the debtor's financial troubles. The trustee sued the directors on a theory of actual fraudulent transfer. Some of the inside directors benefited from the transaction by reason of their employment and stock option contracts with the debtor. As a result, they may have been "interested" directors. They did not completely disclose all of the transaction details to the other directors, there was no special committee of independent directors, and the board had recently increased their severance packages. From these facts, a trier of fact could infer actual fraudulent intent, resulting in a finding of liability for an actual fraudulent transfer. *Liquidation Trust v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537 (D. Del. 2005).

2.1.mmmm. Concealed transfer may toll statute of limitations. The debtor and its principal engaged in an intricate, international money laundering scheme to remove assets from the debtor for the benefit of the principal when the debtor was under litigation attack for its business activities. When the trustee sued to recover, the defendants continued a pattern of fraudulent concealment through discovery. The trustee could not obtain enough information to bring an action within the two-year statute of limitations, so the court extended the statute to a time based on when the information finally became available. Section 546(a) is a true statute of limitation, not a jurisdictional bar or statute of repose. Therefore, it may be

extended by court order based on these facts, and it may be extended by the defendants' actions under the equitable tolling doctrine. Here, both principles apply. *IBT Int'l, Inc. v. Northern (In re Int'l Admin. Servs., Inc.)*, 408 F.3d 689 (11th Cir. 2005).

2.1.nnnn. Change in form of ownership interest may result in lack of reasonably equivalent value. Before bankruptcy, the general partners in a partnership debtor had transferred their assets to family limited partnerships, at least in part to shield their assets from creditors. The transfers were therefore likely to be actually fraudulent transfers. In dictum, the court states they might also be constructively fraudulent transfers. Although the partners received limited partnership interests in the family limited partnerships, those interests did not provide reasonably equivalent value for the assets transferred, and the transfers rendered them insolvent, because creditors could no longer reach the transferred property to satisfy the partners' debts. *Bezanson v. Thomas*, 402 F.3d 257 (1st Cir. 2005).

2.1.oooo. Forgiveness of note may be a fraudulent transfer. The debtor forgave $200,000 owing on a $561,000 note. Although the forgiveness agreement stated that the forgiveness was in settlement of disputes between the debtor and the note's maker, there was no evidence of any dispute or any claims that the maker had against the debtor. The forgiveness constituted a "transfer" for purposes of section 548, because it disposed of an interest of the debtor in property—the claim against the maker—that would have become property of the estate if the debtor had not forgiven it. *Grochocinski v. Reliant Interactive Media Corp. (In re General Search.com)*, 322 B.R. 836 (Bankr. N.D. Ill. 2005).

2.1.pppp. Knowledge of the debtor's fraud to a third party does not defeat "good faith" for purposes of determining "fair consideration." When the lender suspected that the debtor was engaged in fraudulent accounting practices, inflating sales, receivables and inventory, and that the principals were looting the company, it did not call a default or accelerate the loan, but it put pressure on the debtor to refinance. The debtor did so, but ultimately failed. Although the new lenders asked the old lender for information about the debtor, the old lender did not respond. After bankruptcy, the new lenders sued the old lender under New York's Uniform Fraudulent Conveyance Law for recovery of the repayment as a constructively fraudulent transfer. The UFCA allows avoidance of a transfer that was not made for "fair consideration," which requires that the transfer be an exchange of a fair equivalent value, which must be made in good faith. Knowledge of the transferor's fraudulent conduct toward third parties (the new lenders) does not defeat the good faith of the old loan repayment, because a preference as between outsider creditors does not constitute bad faith. *Sharp Int'l Corp. v. State St. Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43 (2d Cir. 2005).

2.1.qqqq. Section 548 reaches a foreign real property transfer. Many years before bankruptcy, while the debtor and her children were all in Maryland, the debtor deeded Bahamian real property to her children. The children did not record the deed, because of high Bahamian transfer taxes, until shortly before bankruptcy. The court determines that the transfer was not made for purposes of section 548(d)(1) until the deed was recorded in the Bahamian land records and concludes that it is avoidable, despite the real property's location in the Bahamas. The court concludes that the presumption against extraterritorial application of U.S. laws does not apply to the fraudulent transfer laws, especially where the transfer was arranged and executed in the United States among U.S. parties. It also concludes that comity does not interfere with avoiding the transfer, because principles of comity require deference to the location of the primary insolvency proceeding, here, the U.S. *French v. Liebmann (In re French)*, 320 B.R. 78 (D. Md. 2004).

2.1.rrrr. Civil forfeiture order precludes fraudulent transfer claim. One of the debtor's shareholders was indicted for Medicaid fraud. The government seized the shareholder's shares in a civil forfeiture action related to the criminal indictment. So as not to be involved in the civil forfeiture action, the debtor entered into an agreement with the shareholder and the government under which it would repurchase the shares, and the cash purchase price would be substituted for the stock in the forfeiture action. The forfeiture court approved the agreement. Shortly before the debtor filed bankruptcy, the forfeiture court ordered forfeiture of the assets and, after publication notice and in accordance with federal forfeiture statutes which allow third parties with an interest in the assets to appear and be heard to protect their rights, extinguished the rights of all third parties in the assets. The trustee did not appear or file a claim for the assets. Shortly thereafter, the trustee brought a fraudulent transfer action, seeking to recover the amounts paid to

repurchase the debtor's stock. The forfeiture judgment determined all rights in the forfeited property, so the government had clear title. The fraudulent transfer action was an effort to reestablish the debtor's interest in the transferred property, contrary to the forfeiture judgment. The fraudulent transfer action is therefore barred as an impermissible collateral attack on the forfeiture judgment. *Uecker & Assocs., Inc. v. L.G. Hunt & Assocs. (In re American Basketball League, Inc.)*, 317 B.R. 121 (Bankr. N.D. Cal. 2004).

2.1.ssss. *Grupo Mexicano* does not preclude an asset-freezing injunction in conjunction with a fraudulent transfer or equitable action. The debtor's principal appeared to have diverted substantial assets to himself before bankruptcy. The trustee brought an action against him to recover the transfers as fraudulent, to impose a constructive trust, and to impose a permanent injunction and sought a preliminary injunction freezing the principal's assets pending the litigation on the merits. *Grupo Mexicano de Desarrollo S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), prohibited an asset-freezing injunction to prevent preferences in connection with an action to recover on defaulted bond principal. However, that case excepted fraudulent conveyance actions and equitable claims from the prohibition. Therefore, it did not preclude an asset-freezing preliminary injunction in this case. *Rubin v. Pringle (In re Focus Media Inc.)*, 387 F.3d 1077 (9th Cir. 2004).

2.1.tttt. Indirect benefit may constitute reasonably equivalent value. The debtor's shareholders issued a note to the lender for a loan under which the lender deposited the loan proceeds directly in the debtor's account. The debtor granted the lender a security interest in its assets to secure repayment of the loan. The trustee argued that the grant was a fraudulent transfer, because it satisfied the shareholders', not the debtor's obligation to the lender. However, because the debtor received the loan proceeds, the lender provided reasonably equivalent value to the debtor in exchange for the security interest, even though the value to the debtor did not come directly from the lender but only indirectly through the shareholders. *Frontier Bank v. Brown (In re Northern Merch., Inc.)*, 371 F.3d 1056 (9th Cir. 2004).

2.1.uuuu. Well-capitalized leveraged buyout does not give rise to fraudulent transfer claim. In a typical multi-step leveraged buyout, the buyer's contributed equity capital constituted about 47% of the purchase price. Because of the high equity contribution, the court refused to collapse the several steps in the transaction for fraudulent transfer analysis purposes. Collapsing is an equitable doctrine, and collapsing in this case would have been inequitable: Avoidance of the transaction as a fraudulent transfer would have harmed the lender, who had thought it was lending into a well-capitalized company, and benefited only general unsecured creditors, all of whom extended credit after the transaction and were (or could have been) aware of the leveraged buyout. *Official Comm. of Unsecured Creditors of Grand Eagle Cos. v. Asea Brown Boveri, Inc.*, 312 B.R. 219 (N.D. Ohio 2004).

2.1.vvvv. Debtor's settlement of claims does not moot fraudulent transfer action. The debtor made fraudulent transfers, which the chapter 7 trustee pursued. Before the claims went to trial, the debtor settled with all of its creditors, so that the fraudulent transfer recoveries would not have benefited them at all. The trustee still pursued the avoidance claims and trustee's counsel filed an application for the fees incurred in pursuing the action. The debtor objects, arguing that the avoidance would not be "for the benefit of the estate." The court awards the fees. It reasons that the estate is not synonymous with "unsecured creditors," that the estate encompasses other interests as well, such as administrative claimants. This was not a case where the trustee pursued the claims only to generate fees or where there would be no net benefit to the estate, because the unsecured claims had not been settled when the claims were brought, and the claims may have pressured the settlement. The debtor's settlement may not thwart the professionals' efforts to collect fees for their work to administer the estate. *Stalnaker v. DLC, Ltd.*, 376 F.3d 819 (8th Cir. 2004).

2.1.wwww. UFTA is not the exclusive remedy for recovering fraudulently transferred property. More than a year before bankruptcy, the debtor transferred his over-encumbered residence to his son for no consideration. A short time later, the bank recorded a judgment lien against all of the debtor's real property located in that county. After the debtor later filed bankruptcy, two junior lienors released their liens on the property, which would have created equity for the judgment creditor if the debtor had still owned the property. Some years later, the debtor's son reconveyed the property to the debtor for no consideration, and the debtor attempted to sell the property. As a condition to release of its judgment lien,

the judgment creditor demanded that the proceeds be placed into escrow pending resolution of its right to the proceeds. After the sale concluded, the debtor moved for an order reopening the bankruptcy case and directing payment of the escrow funds to the debtor. The bank cross-moved for turnover of the escrow proceeds. The court of appeals concludes that the Rhode Island Uniform Fraudulent Transfer Act is not the exclusive remedy for a creditor to recover fraudulently transferred property. Recognizing that the judgment creditor could not have avoided the transfer under the UFTA because the debtor had no equity in the property at the time of the transfer, the court holds that, as an alternative remedy, the debtor's son held the property in a resulting trust for the debtor, because a resulting trust occurs when a transfer has been made with an implied intent that the beneficiary retain an equitable interest in the property. The court here recognizes that the judgment creditor's execution created a lien on that equitable interest. *Fleet National Bank v. Valente (In re Valente)*, 360 F.3d 256 (1st Cir. 2004).

2.1.xxxx. The debtor's stock is not property of the debtor. The trustee sued under the fraudulent transfer statute to recover from a stockholder who had converted preferred stock into common stock, according to the terms of the preferred, while the debtor was insolvent. The issuance of the common stock to the defendant was not a transfer of property of the debtor, because the debtor's equity is not property of the debtor. It is only a unit of ownership interest in the debtor and has no value to the debtor itself. *Decker v. Advantage Fund Ltd.*, 362 F.3d 593 (9th Cir. 2004).

2.1.yyyy. Transferee's knowledge of fraud does not defeat good faith defense to recovery of a fraudulent conveyance. Although the lender knew that the corporation was insolvent and that its owners were engaged in a fraudulent scheme to loot the company, the company's repayment of the lender's debt was not constructively fraudulent under the Uniform Fraudulent Conveyance Act. That Act exempts from recovery a transfer made for "fair consideration," which requires that property be received or an antecedent debt be satisfied in good faith. A preference is not a fraudulent transfer, and the creditor's knowledge of fraud on third parties does not defeat good faith, because the fraud was not in the transfer but was rather in the company's other conduct. *Sharp Int'l Corp. v. State Street Bank and Trust Co. (In re Sharp Int'l Corp.)*, 302 B.R. 760 (E.D.N.Y. 2003).

2.1.zzzz. Debtor in possession may avoid fraudulent transfer only to the extent required to pay creditors. To prevent the IRS from seizing her property, the debtor granted a security interest in her residence to her bank. After she filed chapter 11, she sought to avoid the lien as a fraudulent transfer. The court permitted avoidance only to the extent necessary to pay creditors. That is, the bank would retain its lien to the extent that the property was not required to pay the claims of the IRS and other creditors. The court imported the language of section 550(b), that "the trustee may recover, for the benefit of the estate," into section 544(b), construed "benefit of the estate" to include only creditors, and accordingly limited the avoidance and recovery. *Coleman v. Community Trust Bank, N.A. (In re Coleman)*, 299 B.R. 780 (W.D. Va. 2003).

2.1.aaaaa. Creditors committee may bring avoiding power action in the name of the trustee. The Third Circuit, in an *en banc* decision, rules that the bankruptcy court may authorize an unsecured creditors committee to bring an action on behalf of the estate. The court concludes that the Supreme Court's narrow construction of "the trustee may" in section 506(c) in *Hartford Underwriters Ins. Co. v. Union Planners Bank, N.A.* 530 U.S. 1 (2001), does not restrict the authority of the bankruptcy court to authorize the committee to bring an action in the name of the estate. Section 506(c) is not an analogous context, chapter 11 as a whole contemplates committee derivative actions, pre-Code practice supports derivative actions, and derivative standing advances Congress' goals for chapter 11. *Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548 (3d Cir. 2003).

2.1.bbbbb. Debtor's fraudulent conduct is not imputed to the trustee under section 548. The debtor's president and sole shareholder fraudulently obtained loans from the creditor. The shareholder diverted the loan proceeds to his own personal use, but caused the corporate debtor to repay some of the loans. The trustee brought an action to recover the payments as fraudulent transfers under section 548, arguing that the payments were not in satisfaction of the corporation's debt to the creditor, because the president's fraudulent conduct precluded corporate liability. The creditor argues that the "sole actor exception" applies, so that even though the corporation's agent was acting fraudulently, the corporation

should be liable for the loans. The court rejects that defense, concluding that the trustee, when acting under his avoiding powers, is not bound or affected by the debtor's prepetition conduct. Accordingly, it did not matter that the debtor was in *pari delicto* with the agent; the trustee could treat the debt obligation as fraudulently incurred and therefore the payments as recoverable fraudulent transfers under section 548. *McNamara v. PFS (In re Personal and Business Ins. Agency)*, 334 F.3d 239 (3d Cir. 2003).

2.1.ccccc. *Res judicata* may indirectly bar trustee's fraudulent transfer suit. A creditor brought an action before bankruptcy to set aside a fraudulent transfer but lost. After bankruptcy, the trustee relied on that creditor's claim under section 544(b) to pursue the same fraudulent transfer action. The transferee's *res judicata* defense against the creditor does not bind the trustee, because the trustee is not in privity with the creditor. Nevertheless, if the creditor could not have brought the action, then an essential element of the trustee's cause of action is missing, namely, that the transfer could have been avoided by this creditor holding an allowed unsecured claim. Interestingly, the trustee was able to recover based on another creditor's allowable unsecured claim, even though it had been settled and paid by the time of the trial of the action, because the existence of the claim is determined as of the petition date. Finally, the full amount recovered created a surplus in the estate, which would be returned to the debtor under section 726(a)(6). Although the court did not expressly address whether a transfer avoidance could benefit the debtor, it applied *Moore v. Bay*, 284 U.S. 4 (1931), to hold that the entire transfer could be recovered for the benefit of the estate. *Stalnaker v. DLC, Ltd. (In re DLC, Ltd.)*, 295 B.R. 593 (8th Cir. B.A.P. 2003).

2.1.ddddd. Ponzi scheme interest payments are not fraudulent transfers. Recognizing a deep split in the courts that have considered the issue, the District Court rules that payments of interest to Ponzi scheme investors are not recoverable as fraudulent transfers. The court focuses on each individual payment to determine that the debtor received reasonably equivalent value - the use of the money - in exchange for the interest payment. The court disagrees with those cases that hold that the interest should be recoverable because the payments were part of an overall illegal scheme, noting that under such a rationale, repayment of principle would likewise be recoverable. *Daley v. Debtua (In re Carrozzella & Richardson)*, 286 B.R. 480 (D. Conn. 2002).

2.1.eeeee. Fraudulent transfer solvency analysis includes liabilities that are unliquidated at the time of the transfer. In an action for a fraudulent transfer that occurred four years before trial, the court determines that an analysis of the debtor's solvency at the time of the transfer must take into account all claims that existed at the time of the transfer, even though they were unliquidated and even unasserted and even though many of them remained unliquidated and unasserted at the time of trial. The court determines that it must make its best estimate of the unliquidated claims in the aggregate and does not need to try each one. The court rejects the defendant's argument that the debtor's reasonable belief in its solvency at the time of the transfer has any relevance, holding that the "insolvent" prong of the fraudulent transfer test does not take into account reasonableness or the debtor's beliefs. *Official Committee v. Sealed Air Corp. (In re W.R. Grace & Co.)*, 281 B.R. 852 (D. Del. 2002).

2.1.fffff. Ponzi scheme employees were not precluded from raising good faith defense. The trustee sued sales personnel and other employees who worked for a Ponzi scheme, to recover as fraudulent transfers payments they had received. The employees defended under section 548(c) on the ground that they had given value in good faith in exchange for the payments. The court of appeals allows the defense, holding that even though all of their efforts deepened the debtor's insolvency, that did not preclude them from showing that they provided value to the debtor by their services. *Orlick v. Kozyak (In re Financial Federated Title & Trust, Inc.)*, 309 F.3d 1325 (11th Cir. 2002).

2.1.ggggg. Fraudulent transfer liability requires diminution of the estate. The debtor had engaged in a Ponzi scheme that involved short selling of securities through its broker Bear Stearns. The trustee sought recovery from the broker under section 548(a)(1) on the grounds that the debtor had made the transfers to the broker with actual intent to hinder, delay, and defraud other creditors. The broker defended on the grounds that the transferred property would not, in any event, have been available to the debtor's other creditors if the transfers had not been made. Relying on *Begier v. IRS*, 496 U.S. 53 (1990), for the meaning of "an interest of the debtor in property" in section 548(a), the court concludes that the trustee may avoid a transfer only when, but for the transfer, the property would have been available to at

least one of the debtor's creditors. The court thus criticizes and distinguishes the Fourth Circuit's recent decision, *Tavenner v. Smoot*, 257 F.3d 401 (4th Cir. 2001), which rejected an "actual harm to creditors" test. The court concludes, however, that the trustee should not be required to bear the burden of an addition showing of "diminution of the estate" and so makes that the burden of the defendant. *Bear, Stearns Securities Corp. v. Gredd*, 275 B.R. 190 (S.D.N.Y. 2002).

2.1.hhhhh. Use of NOL in consolidated tax return is not a "transfer." The debtor's corporate parent used the debtor's NOL's in preparing a consolidated tax return for pre-petition years. The debtor sought to recover from the parent the value to the parent of the use of the debtor's NOL's. The court rules that the parent's use of the NOL's was not a transfer of property of the debtor, because the Internal Revenue Code required application of the NOL's at the parent level, so the debtor did not have a property interest. Rather, the NOL's are merely hypothetical and do not constitute property. *Marvel Entertainment Group, Inc. v. MAFCO Holdings, Inc. (In re Marvel Entertainment Group, Inc.)*, 273 B.R. 58 (D. Del. 2002).

2.1.iiiii. Casino liable for fraudulent transfer. The debtor was a lawyer who was conducting a Ponzi scheme and was taking clients money out of trust, all to support his excessive gambling. The bankruptcy court found that he transferred the money to the casino with actual intent to hinder, delay, or defraud creditors. The casino defended under section 548(c) on the ground that it received the funds in good faith. Because the casino did not adequately comply with applicable state law in investigating the debtor's creditworthiness before extending him credit on gambling markers, the casino was not in good faith, and the transfer could be avoided and recovered. *Meeks v. Red River Entertainment (In re Armstrong)*, 285 F.3d 1092 (8th Cir. 2002).

2.1.jjjjj. Reasonable estimate of solvency at the time of a transaction may provide fraudulent transfer defense. In an asbestos-driven chapter 11 case, the creditor's committee brought an action against the debtor's affiliates who received dividends from the debtor approximately 20 months before the chapter 11 filing. The parties stipulated to the value of the company at the time of the transfers but disputed the amount of future asbestos claims. The court rules that the claims analysis must be made as of the time of the transfer, without benefit of hindsight, and that future unasserted claims must be considered in determining solvency for the purposes of the fraudulent transfer laws. The court rejects, however, the plaintiff's argument that it must determine the actual amount of the debtor's then-future asbestos liabilities. It accepts the testimony of one of the experts that the debtor's estimate of its liabilities at the time of the transaction was "not unreasonable," "and applying an objective standard, the court cannot find that [the debtors'] estimate of future liability was so unreasonable [the debtor] was insolvent" at the time. The court concludes it can determine the amount of future liabilities only by determining whether the contemporaneous predictions were reasonable under the circumstances existing at the time they were made. *Official Asbestos Claimants' Committee v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.)*, 274 B.R. 230 (Bankr. E.D. La. 2002).

2.1.kkkkk. Partnership's tax payment to the IRS may be a fraudulent transfer. At a time when it was insolvent, a partnership debtor made tax payments to the IRS on behalf of its partners. Ultimately, the IRS refunded the tax payments to the partners based on subsequent losses. The bankruptcy court ruled that the IRS is not a mere conduit for the payments to the partners but is the initial transferee of the payments, so that the trustee may recover the payments directly from the IRS, if all of the elements of a fraudulent transfer are proven. *Liebersohn v. Internal Revenue Service (In re C.F. Foods, L.P.)*, 265 B.R. 71 (Bankr. E.D. Pa. 2001).

2.1.lllll. Transfer of exempt property may be a recoverable fraudulent transfer. Shortly before bankruptcy, and while the debtor was in financial trouble, he transferred over $200,000 to a family owned corporation. The cash was the proceeds of a settlement of a Federal Employer's Liability Act claim and was therefore exempt. In an action by the trustee to recover the transferred property as a fraudulent transfer, the Fourth Circuit rejects a "no harm, no foul" rule and holds that a transfer of exemptible property may be avoided as a fraudulent transfer. The court reasons that property is not exempt until the debtor makes a claim of exemption after the filing of the bankruptcy and also that section 522(g) permits a trustee to avoid a transfer of exemptible property. So as not to reward the debtor's wrongdoing, the court also rejects the debtor's argument that the transfers cannot be characterized as fraudulent because the creditors were

never entitled to the property in the first place. Finally, the Court rules that the debtor should be denied his discharge because of the transfer. *Tavenner v. Smoot*, 257 F.3d 407 (4th Cir. 2001).

2.1.mmmmm. Prepetition creditor avoiding power action does not bar trustee's action. Before bankruptcy, the debtor's ex-wife unsuccessfully brought a state court action to recover property that the debtor had fraudulently transferred to his son. After bankruptcy, the trustee brought a similar action under section 544(b) on behalf of all creditors. Under the section 544(b) avoiding power, the trustee cannot rely on the rights of an unsecured creditor (the ex-wife) who would be collaterally estopped to avoid the transfer or against whom the transferee would have any other valid defense. However, although one creditor may be collaterally estopped or subject to the defense of *res judicata*, the trustee may still use section 544(b) through the existence of some other unsecured creditor who is able to avoid the transfer under the applicable nonbankruptcy law, because the creditors whom the trustee represented under section 544(b) were not in privity with the single creditor who brought the prepetition action. Therefore the trustee's action was not barred by the doctrine of *res judicata*. In what appears to be a partial repudiation of *Moore v. Bay*, however, the Eighth Circuit rules, on equitable grounds, that the bankruptcy court should ensure that the none of the recovery directly or indirectly is used to satisfy the ex-wife's claim in the bankruptcy case. *Williams v. Marlar (In re Marlar)*, 267 F.3d 749 (8th Cir. 2001).

2.1.nnnnn. Payment of criminal fine and restitution is not avoidable as a fraudulent transfer. To settle criminal charges brought against it prepetition, the debtor agreed to pay reimbursement, restitution, and a substantial fine. In a case of apparent first impression, the court rules that the debtor received reasonably equivalent value for the settlement of the criminal prosecution, finding that the termination of the criminal prosecution, which allowed the debtor to stay in business, provided the necessary value. *Official Committee of Unsecured Creditors v. Florida (In re Tower Environmental, Inc.)*, 260 B.R. 213 (Bankr. M.D. Fla. 1998).

2.1.ooooo. Foreign law does not apply to a fraudulent transfer of real property. A Japanese debtor transferred real property in Colorado shortly before its bankruptcy. The Japanese administrator commenced an ancillary case under section 304 and sought to recover the real property under the Japanese fraudulent transfer statute. Although the Court of Appeals recognized the importance of comity in dealing with a request by a foreign representative under section 304 to administer property located in the United States, it rules that the particularly local nature of real estate requires application of local law. Therefore, the court required analysis of the transaction under the Colorado Uniform Fraudulent Transfer Act rather than under Japanese fraudulent transfer law. In so doing, it concluded, following *In re BFP*, 511 U.S. 531 (1994), that a regularly conducted, non-collusive tax foreclosure sale was conclusively for reasonably equivalent value and therefore not a fraudulent transfer as long as the tax sale involved a public competitive bidding procedure. *Kojima v. Grandote International LLC*, 252 F.3d 1146 (10th Cir. 2001).

2.1.ppppp. Bankruptcy court may not grant creditors standing to bring avoiding power action. Dissatisfied with the trustee's pursuit of a fraudulent transfer action, a creditor sought authority to file suit to recover the transfers. The court denied standing, holding under a strict, literal reading of section 548, only the trustee may bring a fraudulent transfer action and that the bankruptcy court could not grant standing to a creditor to do so. The court relied in part on *Norwest Bank Worthington N.A. v. Ahlers*, 485 U.S. 197 (1988), for the proposition that the bankruptcy court's equitable powers under section 105 could not expand upon the authority granted by specific statutory sections. *SurfNSun Apts., Inc. v. Dempsey*, 253 B.R. 490 (M.D. Fla. 1999).

2.1.qqqqq. FCC C-block license auction did not impose enforceable obligation. For purposes of determining fraudulent transfer liability, the debtor's obligation to pay for C-block licenses did not arise at the conclusion of the FCC auction. The auction entitled the debtor only to apply for the license and obligated the debtor only to pay a penalty if the licensee was not qualified. Because the licensee was qualified, the debtor never became obligated for a penalty and became obligated to pay for a license only upon approval of the license application. *United States v. GWI PCS One, Inc. (In re GWI PCS One, Inc.)*, 230 F.3d 788 (5th Cir. 2000).

2.1.rrrrr. Prepetition creditor avoiding power action does not bar trustee's action. Before bankruptcy, the debtor's ex-wife unsuccessfully brought a state court action to recover property that the debtor had fraudulently transferred to his son. After bankruptcy, the trustee brought a similar action under section 544(b) on behalf of all creditors. Although the ex-wife would be benefited as a creditor by the trustee's action, the creditors whom the trustee represented under section 544(b) were not in privity with the single creditor who brought the prepetition action. Therefore the trustee's action was not barred by the doctrine of *res judicata*. *Williams v. Marlar (In re Marlar)*, 246 B.R. 606 (Bankr. W.D. Ark. 2000).

2.1.sssss. Election to forego an NOL carryback may be a fraudulent transfer. The debtors incurred a large tax NOL, entitling them to a refund of taxes for prior years. Instead of taking the refund, they made an irrevocable election under IRC section 172(b)(3) to waive the carryback and carry the NOL forward to be applied against future years' income. They filed bankruptcy a few months later. The Ninth Circuit permits the trustee to avoid the election as a fraudulent transfer, holding that the irrevocability of the election only prevents the right to the NOL from becoming property of the estate under section 541 but does not prevent a trustee from recovering if the transfer was made for less than reasonable equivalent value. The government conceded the value question. The court also rules that the right to the refund was "property" for purposes of section 548, relying on *Segal v. Rochelle*, 382 U.S. 375 (1966). *United States v. Simms (In re Feiler)*, 218 F.3d 948 (9th Cir. 2000).

2.1.ttttt. LBO settlement payments are not avoidable. The settlement payment exception to avoidability of section 546(e) applies to payments made to a financial institution and by the institution to selling shareholders in a leveraged buyout, even though the payments do not go through the clearing system. *Lowenschuss v. Resorts International, Inc. (In re Resorts International, Inc.)*, 181 F.3d 505 (3d Cir. 1999).

2.1.uuuuu. Property transferred was not "property of the debtor" and therefore not recoverable. Under the plan, the reorganized debtor was entitled to receive the property of one of its former shareholders, as a result of a settlement of an SEC action against the shareholder. The shareholder transferred a portion of that property before bankruptcy. The transferred property was not "property of the debtor" at the time of the transfer and so was not recoverable as a fraudulent transfer under section 544(a) by the reorganized debtor under the plan. *Trinity Gas Corp. (Reorganized) v. IRS (In re Trinity Gas Corp.)*, 242 B.R. 344 (Bankr. N.D. Tex. 1999).

2.1.vvvvv. Revocation of subchapter S status may be a fraudulent transfer. The closely-held corporate debtor revoked its subchapter S status shortly before its bankruptcy petition, with the result that the capital gains tax liability that it would incur upon sale or foreclosure of its assets in its bankruptcy case would be the liability of the corporate estate, not of the individual shareholder. The revocation was a fraudulent transfer and could be set aside by the corporation's trustee in bankruptcy. *Parker v. Saunders (In re Bakersfield Westar, Inc.)*, 226 B.R. 227 (9th Cir. B.A.P. 1994).

2.1.wwwww. Indirect benefits to a guarantor may prevent fraudulent transfer attack. One company guaranteed the bank debt of its sister corporation. In dicta, the Seventh Circuit describes at length how an indirect benefit to the guarantor might provide reasonably equivalent value to prevent the guarantee from being attacked as a fraudulent obligation. In this case, however, no indirect benefit was shown, and the guarantee was set aside as a fraudulent obligation. *Leibowitz v. Parkway Bank and Trust Co. (In re Image Worldwide, Ltd.)*, 139 F.3d 574 (7th Cir. 1998).

2.1.xxxxx. Law firm retainer is not a fraudulent transfer. Knowing that he was about to be attacked by his creditors, the debtor paid a non-refundable retainer to his law firm under a retainer agreement which stated, "we wish to reduce or eliminate the risk of retainer funds being garnished or levied upon by potential or existing judgment creditors." Because the transfer was not of all or substantially all of the debtor's assets, because there was no special relationship between the debtor and the transferee, and because the debtor did not retain possession of any of the property, the transfer was not made with actual intent to hinder, delay or defraud creditors. *National Credit Union Administration Board v. Johnson*, 133 F.3d 1097 (8th Cir. 1998).

2.1.yyyyy. Loss of redemption right to a pawnbroker may be a fraudulent transfer. The debtor pawned an object and before bankruptcy forfeited her redemption right to the pawnbroker for nonpayment. The court refused to apply *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), which held that a regularly conducted, noncollusive foreclosure sale of real property was not avoidable as a fraudulent transfer. Instead, the court determines that the loss of the right of redemption constituted a second transfer (the first being the pawn itself), for which the pawnbroker must give reasonably equivalent value. *Carter v. H & B Jewelry and Loan (In re Carter)*, 209 B.R. 732 (Bankr. D. Ore. 1997).

2.1.zzzzz. Check-kiting scheme does not create fraudulent transfer liability for the bank. In denying fraudulent transfer liability of the debtor's bank, the district court rules (i) the security interest created under UCC section 4-210 in a check in favor of the collecting bank is an equitable interest in the check, while the depositor/debtor retains the legal interest in the check; (ii) the validity of the section 4-210 security interest in a fraudulent transfer action does not depend on the bank's good faith under section 548(c) (iii) the creation of the security interest under section 4-210 is not a transfer for purposes of the Bankruptcy Code, despite the breath of the definition of "transfer" in section 101, because the depositor/debtor continues to have the right to withdraw the funds and the assets available to the debtor have not changed (iv) whether there was a "diminution of the estate" should be considered in determining whether there was a fraudulent transfer. *Pioneer Liquidating Corporation v. San Diego Trust & Savings Bank (In re Consolidated Pioneer Mortgage Entities)*, 211 B.R. 704 (S.D. Cal. 1997).

2.1.aaaaaa. Loan commitment fee avoided as fraudulent transfer. A loan commitment that had little chance of closing did not provide reasonably equivalent value for the loan commitment fees that the debtor paid while insolvent, which were attacked as a fraudulent transfer. In affirming the judgment of the bankruptcy court avoiding the fees, the Third Circuit held that the opportunity to receive an economic benefit constitutes value as long as there is some chance that the disputed transfer will generate a positive return. *Mellon Bank, N.A. v. Official Committee of Unsecured Creditors of R.M.L., Inc. (In re R.M.L. Inc.)*, 92 F.2d 139 (3d Cir. 1996).

2.2 Preferences

2.2.a. Posting loan proceeds to secured letter of credit to secure new contract is not a preference. As a government contractor, the debtor needed to post surety bonds to secure its performance obligations. Its surety refused an additional bond the debtor needed for a new contract unless it received collateral for the new bond and for the debtor's contingent obligations under the existing bonds. The debtor obtained a letter of credit in favor of the surety and borrowed cash to cash collateralize the letter of credit. Once the debtor posted the letter of credit, the surety issued the bond and the debtor received the new contract. The debtor filed bankruptcy within 90 days. The trustee may avoid as a preference a transfer of property of the debtor for or on account of an antecedent debt, made within 90 days before bankruptcy, that enables the creditor to a greater percentage than if the transfer had not been made. However, under the "earmarking doctrine," if the property passes from a new creditor to the transferee creditor, whether or not through the debtor's hands first, the transfer is not a preference. The theory is that the property never became property of the debtor but was used by the new creditor to "buy" the old creditor's claim, although the court here says that the transfer is not avoidable because it "does not diminish the estate." Here, the cash went from the new lender, through the debtor, to the surety, but not to satisfy an antecedent debt owing to the surety. Therefore, the earmarking defense does not apply. Rather, the court looks to the contemporaneous exchange defense (which the court refers to as the "new value" defense). Under section 547(c)(1), the trustee may not avoid a transfer to the extent it was intended to be a contemporaneous exchange for new value given to the debtor and in fact was a substantially contemporaneous exchange. "New value" means "money or money's worth in goods, services, or new credit, or release … of property previously transferred …." The defense applies even where a third party provides the debtor the new value, as long as it offsets the loss in value to the estate resulting from the transfer of property of the debtor. The debtor received the new government contract, which the court valued as worth at least as much as the transferred property. Therefore, the defense applies. A dissent argues that a contract confers only the right to receive money in the future and therefore should not count as new value, as that term is defined. The majority rules that the contract is an

asset that has inherent value. *Campbell v. The Hanover Ins. Co. (In re ESA Enviro. Specialists, Inc.)*, 709 F.3d 389 (4th Cir. 2013).

2.2.b. An insurance premium payment to an insurance agent who was contingently liable to the insurer was to and for the benefit of the agent. The debtor purchased insurance through an insurance agent. The agent's contract with the insurer required the agent to hold all premiums that it collected in a segregated trust account for the insurer, but if the insured failed to pay, the agent remained liable to the insurer for the premiums. The debtor made several past-due payments to the agent within 90 days before bankruptcy. Among the elements of a preference is that the debtor's transfer be made to or for the benefit of a creditor. The holder of a contingent claim is a creditor. The agent was contingently liable to the insurer if the debtor did not pay the premium, and through subrogation, had a contingent claim against the debtor for any premium that the agent paid to the insurer. In addition, the debtor's payment to the agent, in trust for the insurer, relieved the agent of its contingent liability to the insurer. Therefore, the agent was a creditor. The debtor's payments were both to and for the benefit of the agent. Therefore, the payments met that preference element. *Guttman v. Construction Program Group (In re Railworks Corp.)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 95627 (D. Md. July 8, 2013).

2.2.c. Honoring a check before the midnight deadline is not a preference. When a payee presents a check to its own bank, the bank passes the check through the clearinghouse system, which provisionally credits the payee bank and provisionally debits the payor bank. The payor bank has until midnight on the next banking day to determine whether to honor the check or return it. Under U.C.C. 4–215, payment of the check is final when the payor bank pays it in cash, irrevocably settles it or fails to revoke the provisional settlement before the midnight deadline. In this case, the debtor's bank received numerous provisionally settled checks from the clearinghouse when the debtor did not have sufficient funds in the account to cover them. Each day, before the midnight deadline, the bank contacted the debtor to advise how much was needed to fund the checks that had been presented. On most days, the debtor funded the account, and its bank did not dishonor the checks by the midnight deadline and allowed them to clear. On some days, however, when the debtor did not fund the account, the bank dishonored the checks. The trustee sued the bank to avoid the debtor's deposits to cover the "intraday" overdrafts as preferences. The trustee may avoid a transfer as a preference if the transfer is for or on account of an antecedent debt. A debt is a liability on a claim, and a claim is a right to payment. Under U.C.C. 4–215, the bank did not have a claim against the debtor until it had honored a check. The provisional settlement, which is automatic in the banking system, did not amount to honoring a check. Therefore, until the midnight deadline, the bank did not have a claim, and the debtor's transfers to fund the account were not for or on account of an antecedent debt. *Sarachek v. Luana Sav. Bank (In re Agriprocessors, Inc.)*, 490 B.R 852 (Bankr. N.D. Iowa 2013).

2.2.d. Private placement note purchase is exempt under section 546(e) from preference avoidance. The debtor's finance subsidiary issued private placement notes under a note purchase agreement. The agreement permitted prepayment by the issuer and purchase by its affiliates, two of whom had guaranteed the notes. Once the notes were paid in full, the holders were required to surrender the notes to the issuer for cancellation. Within 90 days before bankruptcy, a guarantor sent notice to the holders of purchase of the notes. The guarantor transferred the purchase price to the notes trustee, which was a bank. The notes trustee wired the funds to the noteholders, who then sent the notes to the guarantor for cancellation. Section 546(e) exempts from avoidance as a preference a transfer in connection with a securities contract to or for the benefit of a financial institution. Section 741(7) defines securities contract as "a contract for the purchase … of a security …." Section 101(49)(A)(i) defines security to include a note. The note purchase agreement provided for the initial sale and for the affiliate to purchase the notes. The payment was a transfer to purchase the notes and therefore was made in connection with a securities contract. The transfer was made to a financial institution, even though the notes trustee did not have a beneficial interest in the notes or the payment and was a mere conduit. Such a construction furthers section 546(e)'s purpose, because unwinding a payment made through a bank could be as disruptive to the financial markets as a payment for the bank's benefit. 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.)*, ___ F.3d ___, 2013 U.S. App. LEXIS 11615 (2d Cir. June 10, 2013).

2.2.e. Payment of proceeds of bailed property is not a preference. Under an agreement with the creditor, the debtor regularly sold livestock for the creditor, received payment from the buyer, commingled the funds in its general account and was required to pay the creditor. The debtor was slow in paying but ultimately paid all that it owed. After bankruptcy, the trustee sued the creditor to avoid the payments as a preference. The trustee may avoid a transfer as a preference if, among other things, the transfer is of an interest of the debtor in property and enables the creditor to receive more than in a liquidation case. Nonbankruptcy law determines what property of the debtor is. "A bailment is the delivery of property for some purpose upon a contract … that after the purpose has been fulfilled, the property shall be redelivered to the bailor." In a bailment, the bailee acquires only a possessory interest in the property. Commingling of funds does not defeat a bailment. Here, because the debtor and the creditor agreed that the debtor was selling the creditor's livestock only as an accommodation for the creditor, the debtor did not acquire any interest in the livestock or its proceeds. Therefore, the payment was not a transfer of an interest in property of the debtor and was not avoidable as a preference. *Miss. Valley Livestock, Inc. v. J & R Farms*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 14865 (N.D. Ill. Jan. 18, 2013).

2.2.f. Exchange Act definitions do not apply in determining insider status in bankruptcy. An investment bank financed an LBO through multiple entities. Four funds that the bank managed acquired 19.8% of the stock of a holding company that acquired 75% of the debtor. A bank affiliate appointed one director of the debtor, and another affiliate had a management contract with the debtor. At one point, the debtor refinanced an unsecured bridge loan that had financed the LBO with a secured loan and used some of the secured loan proceeds to repay a bank affiliate about five months before bankruptcy. The LBO failed, and the target filed bankruptcy. The debtor confirmed a plan, which vested in the reorganized debtor certain avoiding power claims against the bank's affiliates. The reorganized debtor sought to recover the payment to the bank affiliate as an insider preference. A corporation's insider is an entity that is a director, officer or person in control of the debtor or an "affiliate, or an insider of an affiliate as if such affiliate were the debtor". An affiliate is an entity that holds or controls 20% or more of the debtor's equity securities. The bank lenders were not the debtor's affiliates, nor were the funds, which held only 19.8% of a 75% equity interest in the debtor. Rules issued under section 13 of the Securities Exchange Act of 1934, which aggregate share holdings of persons who agree to act together for purposes of applying section 13, by their terms do not apply in applying Bankruptcy Code definition. State, rather than federal, veil-piercing law may apply in determining whether more than one related entity should be combined to apply the Code's insider definition, but veil-piercing law requires not only complete dominion and control and disregard of corporate separateness, but also that the corporate form was used to perpetrate some form of fraud or injustice. The facts alleged in the complaint here do not support any grounds for treating the bank lenders as insiders, so the court dismisses the complaint. *Capmark Fin. Group Inc. v. Goldman Sachs Credit P'ners L.P.*, ___ B.R. ___, 2013 WL 1420243 (S.D.N.Y. Apr. 9, 2013).

2.2.g. Section 546(e) does not apply to customer withdrawals from its FCM account with the debtor. The statutes and regulations governing futures commission merchants and investment advisors require that they segregate customer funds. The debtor was both. It provided investment services for other FCM's, who sent their own customer funds to the debtor for investment. The debtor invested the funds in segregated common securities pools, rather than in segregation for each customer, from which the debtor bought and sold securities. As it sunk into financial trouble, the debtor breached its segregation requirements and diverted segregated customer funds to its own lender. Shortly before bankruptcy, it transferred some of the remaining segregated funds to a customer. Section 546(e) prohibits a trustee from avoiding a transfer that is a "settlement payment" or a "transfer … in connection with a securities contract". Congress enacted the section 546(e) safe harbor to insulate legitimate securities and commodities transactions from the potentially destabilizing effect of later avoidance, especially when a debtor buys or sells a security right before bankruptcy. Where a debtor is a financial institution that buys or sells securities on behalf of third parties, especially other financial institutions, application of the safe harbor could have a destabilizing effect itself, because it could permit the debtor's arbitrary, unpredictable actions to prevent equal treatment of its customers. Although the court does not address directly the question of whether the transfer was a settlement payment or a transfer in connection with a securities contract, it notes that the relevant securities transaction here was between the debtor and a third party, not the customer, that the legislative history does not suggest that the safe harbor was intended to govern the debtor's distribution of proceeds of a securities transaction to a third party, and that customer deposits

and withdrawals with the debtor did not affect the settlement payments chain. *Grede v. FCStone, LLC*, 485 B.R. 854 (N.D. Ill. 2013).

2.2.h. Payment of liquidation sale proceeds to a lender with an unperfected security interest is avoidable. The bank perfected its security interest in inventory and receivables shortly after the debtor agreed to conduct a going-out-of-business sale. The debtor fully paid the bank's claim from the sale proceeds, leaving a small amount remaining for the debtor. An involuntary petition was filed against the debtor 90 days after the bank perfected its security interest. The trustee sued to avoid the payments to the bank as preferences. A trustee may avoid a transfer of property of the debtor to or for the benefit of a creditor for or on account of an antecedent debt made within 90 days before bankruptcy if it enabled the creditor to receive more than it would have received in a liquidation case. Section 547(c)(5) provides a defense for "creation of a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfer … caused a reduction, as of the date of the filing of the petition [of the amount by which the creditor was undersecured] … 90 days before the date of the filing of the petition". The test applies from the beginning of the preference period. A creditor who enters the preference period unperfected is deemed to be fully unsecured at the beginning of the period, so that any transfer of inventory, receivables or their proceeds to the creditor reduces the amount by which the creditor is undersecured. Because the bank's security interest was unperfected at the beginning of the 90-day period, the defense does not apply. Section 547(c)(2) provides a defense for a transfer made in the ordinary course of business or according to ordinary business terms. Payments from a going-out-of-business sale are not in the ordinary course or according to ordinary business terms, so this defense does not apply either. *Velde v. Border State Bank (In re Hovdebray Enterps.)*, 483 B.R. 187 (8th Cir. B.A.P. 2012).

2.2.i. An interim trustee appointment does not extend section 546(a) statute of limitation. The court converted the chapter 11 case to chapter 7, and the U.S. trustee appointed an interim chapter 7 trustee under section 701, one day short of two years after the petition date. The creditors did not elect a permanent trustee under section 702, so the interim trustee became the permanent trustee by operation of section 702 after the section 341 meeting, about six weeks later. Section 546(a)'s avoiding power action statute of limitation runs on the later of two years after the petition date or "1 year after the appointment or election of the first trustee under section 702". An interim trustee is appointed under section 701, not section 702. Therefore, the statute of limitations reference to section 702 limits the one-year extension to circumstances in which the permanent trustee is appointed or elected within the two-year period after the petition date. Section 702 provides for election of a trustee, not appointment, but also provides that if creditors do not elect a trustee, then the interim trustee becomes the permanent trustee. The section 546(a) reference to section 702 should be read to include the automatic appointment of the permanent trustee, or else an elected trustee could be disadvantaged, and creditors might have an incentive not to elect a trustee, contrary to section 702's election authorization. *Fogel v. Shabat (In re Draiman)*, ___ F.3d ___, 2013 U.S. App. LEXIS 7045 (7th Cir. Apr. 8, 2013).

2.2.j. 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.k. 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.l. 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.m. 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.n. 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.o. 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.p. 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.q. 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).

2.2.r. A payment on an electricity supply contract is exempt from preference avoidance. The debtor contracted with a power supply company to purchase "full electric requirements" for two years at a fixed price. After falling behind on payments, the debtor made a catch-up payment within 90 days before bankruptcy. The trustee sued to recover the payment as a preference. Section 546(e) exempts from preference avoidance "a settlement payment … made by or to [a] … forward contract merchant … in connection with … a forward contract." Section 101(25) defines "forward contract" as "a contract … for the purchase, sale, or transfer of a commodity." The definition is not limited to a contract that specifies a specific quantity or delivery date. Therefore, the electricity supply contract in this case qualifies as a forward contract, and the payment is exempt from avoidance as a preference. *Lightfoot v. MXEnergy Electric, Inc. (In re MRS Mgmt. Servs., Inc.)*, 690 F.3d 352 (5th Cir. 2012).

2.2.s. Reimbursement of a letter of credit draw that was used to redeem bonds is not a settlement payment. The debtor was indirectly liable on industrial revenue bonds. The bank had issued an annually renewable letter of credit to the bond indenture trustee, which the indenture trustee could draw if the debtor defaulted on its obligations or if the bank refused to renew the LC. The bank gave the indenture trustee notice of non-renewal. The debtor then directed the indenture trustee to redeem the bonds and deposited the amount of the redemption payment in its account at the bank. The indenture trustee sent bondholders a redemption notice, and when they tendered the bonds, drew on the LC for funds to redeem the bonds. After the draw, the bank debited the debtor's account to reimburse itself for the LC draw. The debtor filed bankruptcy less than 90 days later. The trustee sued the bank to avoid the debtor's deposit into its account and the bank's account debit as a preference. Section 546(e) prohibits the trustee from avoiding as a preference a "settlement payment" or a "payment in connection with a securities contract". "Settlement payment" is broadly defined as a payment to complete a securities transaction. The court must examine each transaction in a series to determine whether it is a settlement payment, even if the series results in a securities transaction. Here, the debtor's payment to the bank was to fulfill an obligation to reimburse the bank for the LC draw, which is a transaction that was independent from the bond redemption. Therefore, neither the deposit nor the debit was a settlement payment. *EPLG I, LLC v. Citibank, N.A. (In re Qimonda Richmond, LLC)*, 467 B.R. 318 (Bankr. D. Del. 2012).

2.2.t. Court may extend time for service of preference complaint until after plan confirmation. The debtor in a complex chapter 11 case needed more time to develop a plan. The bankruptcy court, after notice to all potential defendants, granted the debtor in possession authority to file an omnibus preference complaint against over 400 defendants and to delay service of the summons and complaint until after plan confirmation. The debtor hoped that a 100% plan might obviate the need for preference actions, and it did not want the preference litigation to interfere with the plan process. The debtor in possession filed the complaint within the two-year statute of limitations. Consistent with the court's order, the creditors trust, which succeeded to the avoiding power actions, did not serve the complaint on each defendant until after plan confirmation, nearly three years after the statute of limitations had expired. After service, the court authorized bifurcation of the complaint for administrative convenience, and the trustee filed amended complaints against the defendants. Rule 7004, incorporating Fed. R. Civ. Proc. 4(m), requires service of

the complaint within 120 days. Rule 9006 authorizes the court to enlarge a time period set by the Rules for cause. The court did so here by its original order authorizing the omnibus complaint and the delay in service. The effort to develop and confirm a plan that would have obviated the need for preference actions provided good cause for the delay. Therefore, the statute of limitations did not bar the action. *U.S. Bank Nat'l Assoc. v. SMF Energy Corp. (In re Interstate Bakeries Corp.)*, 460 B.R. 222 (8th Cir. B.A.P. 2011).

2.2.u. A prepetition real property foreclosure sale may result in an avoidable preference. The debtor's lender foreclosed on real property within 90 days before bankruptcy in a regularly conducted, noncollusive foreclosure sale. The lender purchased the property for a credit bid of about half of the debt. The debtor in possession brought an action to avoid the foreclosure as a preference, alleging that the property's fair market value was substantially higher than the debt. The creditor filed a motion to dismiss for failure to state a claim. A preference is a transfer of the debtor's property to or for the benefit of a creditor within 90 days before bankruptcy on account of an antecedent debtor that enables the creditor to receive more than it would receive in a chapter 7 liquidation case if the transfer had not been made. The foreclosure sale is a transfer that may meet all of these elements. *In re BFP, Inc.*, 511 U.S. 531 (1994), ruled that a regularly conducted, noncollusive foreclosure sale produced "reasonably equivalent value" for purposes of section 548(a)(1)(B), recognizing that a foreclosure sale seldom produces a fair market value purchase price, in part to prevent a cloud on titles of real estate that had gone through foreclosure. Section 547 differs, and the statutory language controls. Section 547 does not use "reasonably equivalent value". Rather, the test is whether the creditor received more than it would have received in a hypothetical chapter 7 case. A trustee is more likely to conduct a more measured, better-marketed sale if there is equity in the property, so it may be possible that a creditor foreclosing on valuable property received more through the foreclosure sale. The potential cloud on title is limited, because the preference reach-back period is only 90 days, and the trustee may not recover from a third party buyer, only from the creditor. Therefore, the motion to dismiss is denied. *Whittle Dev. Inc v. Branch Banking & Trust Co. (In re Whittle Dev. Inc.)*, 463 B.R 796 (Bankr. N.D. Tex. 2011).

2.2.v. Court may extend time for service of preference complaint until after plan confirmation. The debtor in a complex chapter 11 case needed more time to develop a plan. The bankruptcy court, after notice to all potential defendants, granted the debtor in possession authority to file an omnibus preference complaint against over 400 defendants and to delay service of the summons and complaint until after plan confirmation. The debtor hoped that a 100% plan might obviate the need for preference actions, and it did not want the preference litigation to interfere with the plan process. The debtor in possession filed the complaint within the two-year statute of limitations. Consistent with the court's order, the creditors trust, which succeeded to the avoiding power actions, did not serve the complaint on each defendant until after plan confirmation, nearly three years after the statute of limitations had expired. After service, the court authorized bifurcation of the complaint for administrative convenience, and the trustee filed amended complaints against the defendants. Rule 7004, incorporating Fed. R. Civ. Proc. 4(m), requires service of the complaint within 120 days. Rule 9006 authorizes the court to enlarge a time period set by the Rules for cause. The court did so here by its original order authorizing the omnibus complaint and the delay in service. The effort to develop and confirm a plan that would have obviated the need for preference actions provided good cause for the delay. Therefore, the statute of limitations did not bar the action. *U.S. Bank Nat'l Assoc. v. SMF Energy Corp. (In re Interstate Bakeries Corp.)*, 460 B.R. 222 (8th Cir. B.A.P. 2011).

2.2.w. A prepetition real property foreclosure sale may result in an avoidable preference. The debtor's lender foreclosed on real property within 90 days before bankruptcy in a regularly conducted, noncollusive foreclosure sale. The lender purchased the property for a credit bid of about half of the debt. The debtor in possession brought an action to avoid the foreclosure as a preference, alleging that the property's fair market value was substantially higher than the debt. The creditor filed a motion to dismiss for failure to state a claim. A preference is a transfer of the debtor's property to or for the benefit of a creditor within 90 days before bankruptcy on account of an antecedent debtor that enables the creditor to receive more than it would receive in a chapter 7 liquidation case if the transfer had not been made. The foreclosure sale is a transfer that may meet all of these elements. *In re BFP, Inc.*, 511 U.S. 531 (1994), ruled that a regularly conducted, noncollusive foreclosure sale produced "reasonably equivalent value" for purposes of section 548(a)(1)(B), recognizing that a foreclosure sale seldom produces a fair market value purchase price, in part to prevent a cloud on titles of real estate that had gone through foreclosure.

Section 547 differs, and the statutory language controls. Section 547 does not use "reasonably equivalent value". Rather, the test is whether the creditor received more than it would have received in a hypothetical chapter 7 case. A trustee is more likely to conduct a more measured, better-marketed sale if there is equity in the property, so it may be possible that a creditor foreclosing on valuable property received more through the foreclosure sale. The potential cloud on title is limited, because the preference reach-back period is only 90 days, and the trustee may not recover from a third party buyer, only from the creditor. Therefore, the motion to dismiss is denied. *Whittle Dev. Inc v. Branch Banking & Trust Co. (In re Whittle Dev. Inc.)*, 463 B.R 796 (Bankr. N.D. Tex. 2011).

2.2.x. Bailed property becomes property of the debtor if it is commingled and untraceable. The debtor provided utility management services to its customers. Among other things, it collected customer's monthly electric payments to pay to their utilities, usually within two days after receiving a customer's payment. The debtor used only a single bank account for the payments and 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 no longer paid utilities directly from customers' payments within a day or two after receipt. After bankruptcy, the trustee sued the utilities who received payments to avoid the payments as preferences. A preference is a transfer of property of the debtor. For this purpose, "property of the debtor" is property that would have become property of the estate if the transfer had not been made. Property that the debtor holds in trust does not become property of the estate. Money that the debtor holds as an agent or bailee does not become property of the estate. However, the debtor holds property as a bailee only if the property is specifically identifiable as the bailor's property. If the debtor commingles the property and treats it as its own, even if in breach of an agreement with the bailor, it become property of the debtor. Therefore, if the bailor (or, in this case, the preference defendants) could not trace the source of the money used to pay the defendants, then the property was property of the debtor, and the payments are subject to avoidance and recovery as preferences. *Stoebner v. Consumers Energy Co. (In re LGI Energy Solutions, Inc.)*, 460 B.R. 720 (8th Cir. B.A.P. 2011).

2.2.y. Excluded LLC member remains an insider. The controlling member of the LLC debtor caused the debtor to deny access to its business records to a member of the LLC and of its board of managers. The member sued for access. The board then formally voted to suspend the member's access pending an investigation. The member and the board settled their dispute, with the member resigning from the board and the LLC paying the member $200,000 on the same day. The LLC filed bankruptcy four months later. The trustee may recover a transfer as a preference if the debtor made the transfer to an insider within a year before bankruptcy. The Code defines "insider" to include a director or person in control of the debtor. Courts have construed "insider" to include others, not listed in the definition, under a "similarity" approach and a "control" approach. Under the former approach, an individual is an insider if he holds a position similar to one of the listed positions. The member of an LLC board of managers holds a position similar to a director of a corporation, in that each is statutorily authorized to manage the affairs of the LLC or corporation, although the individual's title is not dispositive if the individual does not in fact have the legal rights to manage the entity. Here, though the LLC denied the member access to its business records, the member remained a member of the board until after he received the $200,000 payment. Therefore, he was an insider when the debtor made the transfer. *In re Longview Aluminum, L.L.C.*, 657 F.3d 507 (7th Cir. 2011).

2.2.z. Private placement note prepayment is exempt from preference avoidance under section 546(e). The debtor had issued private placement notes, 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 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. Section 546(e) does not distinguish among the possible capacities in which the financial institution might receive the payment. A settlement payment is a transfer of cash to complete a securities transaction. The definition of settlement payment is not limited to payments made

through a settlement process, such as a clearing house or other central intermediary. Section 101(49)(A)(i) defines security to include a note. Whether or not the notes trustee was a mere conduit for the payment, the debtor made the transfer to the bank. Therefore, the payment is expressly exempt from avoidance as a preference. In addition, because of the size of the payments and because the notes were issued in the active private placement market, the exemption is consistent with Congress's intent in section 546(e) to protect the securities markets broadly. *Official Comm. Of Unsecured Creditors v. Am. U. Life Ins. Co. (In re Quebecor World (USA) Inc.)*, 453 B.R. 201 (Bankr. S.D.N.Y. 2011).

2.2.aa. The definition of "new value" in section 547(c)(2) does not depend on the debtor's use of the funds. The individual debtor and his law firm, also a debtor, maintained two banking relationships: one of the banks held the account from which the law firm conducted a Ponzi scheme. The law firm borrowed from the other bank and granted it additional collateral. The firm transferred the loan proceeds to the first bank and from there repaid a Ponzi scheme investor. The trustee sued the lending bank to avoid the granting of the lien on the additional collateral as a preference. The trustee may not avoid a preference if the debtor and the transferee intended the transfer to be, and the transfer in fact was, a substantially contemporaneous exchange for new value. The definition of "new value" does not depend on the debtor's use of the funds. Thus, the fact that the debtor used the funds to pay an antecedent unsecured debt to another creditor does not prevent the lending bank from using the defense that it gave new value to the debtor. *Gowan v. Wachovia Bank, N.A. (In re Dreier LLP)*, 453 B.R. 499 (Bankr. S.D.N.Y. Aug. 3, 2011).

2.2.bb. Floating lien preference exception does not apply to unperfected security interest. The creditor's loans to the debtor were secured by a security interest in the debtor's accounts receivable. The creditor did not properly file a financing statement to perfect the security interest until 27 days before the debtor's bankruptcy. The loan amount exceeded the receivables' value 90 days before the bankruptcy. Section 547(c)(5)(A) provides a floating lien secured creditor with a defense to preference avoidance to the extent that the transfer of a security interest in receivables during the 90-day period did not cause "a reduction, as of the date of the filing of the petition … of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of" 90 days before bankruptcy, that is, to the extent that the creditor did not improve its position during the 90 days before bankruptcy. If the debt does not exceed the value of the collateral, then there can be no such reduction, and the creditor's security interest in the receivables (or, more precisely, the transfer of a security interest in new receivables to the creditor) is not avoidable. However, if the creditor's security interest in receivables is not perfected, and is therefore avoidable, as of the 90th day before bankruptcy, then the creditor's perfection of its security interest during the 90-day period is a transfer that results in a reduction in the creditor's deficiency claim, that is, the creditor improves its position by perfecting during the 90-day period. Section 547(c)(5) therefore does not protect a creditor who perfects a prior secured claim during the 90-day pre-bankruptcy period. *Lange v. Inova Cap. Funding, LLC (In re Qualia Clinical Serv., Inc.)*, 652 F.3d 933 (8th Cir. 2011).

2.2.cc. Ordinary course of business defense requires the credit to have been extended in the ordinary course. The parents of the debtor's principals lent the debtor funds on a revolving credit basis. They received repayments during the preference period. The trustee sought to avoid the repayments as preferences. Section 547(c)(2) permits a transferee to retain a preference "to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or (B) made according to ordinary business terms". Here, because the parents were not in the lending business and had not previously made business loans, the debt was not incurred in the ordinary course of business or financial affairs of the transferee and was avoidable. *Shubert v. Mull (In re Frey Mech. Group, Inc.)*, 446 B.R. 208 (Bankr. E.D. Pa. 2011).

2.2.dd. Subsequent new value defense applies to a revolving credit line. The parents of the debtor's principals lent the debtor funds on a revolving credit basis. They received repayments during the preference period and made re-advances, which they sought to apply under the subsequent new value rule of section 547(c)(4) to reduce preference liability. Section 547(c)(4) provides an affirmative defense to preference avoidance "to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor (A) not secured by an otherwise unavoidable security interest; and (B) on account of

which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor". The defense applies equally to a revolving credit lender as it does to a supplier. The defense does not require that all advances remain unpaid, only that the debtor not have made "an otherwise unavoidable transfer to or for the benefit of such creditor". In this case, the subsequent advances under the credit line were not repaid, so the creditor was entitled to the benefit of the defense. *Shubert v. Mull (In re Frey Mech. Group, Inc.)*, 446 B.R. 208 (Bankr. E.D. Pa. 2011).

2.2.ee. Settlement payment safe harbor protects redemption of commercial paper. Within 90 days before bankruptcy, the debtor retired its commercial paper. The transaction occurred through Depository Trust Company by a debit to a broker-dealer's DTC account, a corresponding credit to the noteholder's account, a credit of the commercial paper to the broker-dealer's account for further credit to the debtor's issuing and paying agent, whereupon the commercial paper was extinguished in the DTC system. The debtor in possession sought to recover the payment to the noteholder as a preference. Section 546(e) prohibits avoidance of a preference that is a settlement payment made by or to or for the benefit of a financial institution. "Settlement payment" is defined as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities industry". The definition is very broad. The grammatical structure of the definition requires that "commonly used in the securities industry" be read to modify only "similar payment", not all of the other terms in the definition. Thus, whether the payment was ordinary is not relevant to a determination of whether the safe harbor applies. The definition is not limited to the purchase or sale of a security but applies to any securities transaction that involves a settlement, including a redemption or retirement of the security. Finally, the definition does not require that a financial intermediary take title to or a beneficial interest in the security in the settlement process. Therefore, the safe harbor applies, and the payments are protected from avoidance. *Enron Creditors Recovery Corp. v. Alfa, S.A.V. de C.V.*, 651 F.3d 329 (2d Cir. 2011).

2.2.ff. Payment for electricity under a requirements supply contract is not subject to avoidance as a preference. The debtor contracted with an electricity supplier to deliver all the debtor's electricity requirements for two years at a fixed price, commencing seven days after the contract date. After bankruptcy, the trustee sued to avoid contract payments as preferences. Section 546(e) exempts from avoidance a payment by or to a forward contract merchant in connection with a forward contract. A forward contract is one for the purchase, sale or transfer of a commodity with a maturity date more than two days after the contract date. The contract here was for the sale of electricity, which is a commodity, and for delivery on a date more than two days after the contract date. The forward contract definition does not require that the contract be for a fixed quantity nor that delivery be on a specified date. Therefore, the contract qualifies, and the payments are not subject to avoidance as a preference. *Lightfoot v. MXenergy, Inc.*, 2011 U.S. Dist. LEXIS 54546 (E.D. La. May 19, 2011).

2.2.gg. Section 547(c)(5) improvement in position preference exception does not apply to an unperfected security interest. The debtor granted a security interest in its receivables to a lender. The lender perfected its security interest within 90 days before bankruptcy and after the lender last gave new value to the debtor. The receivables' value exceeded the amount the debtor owed to the lender during the entire 90 days before bankruptcy. Section 547(c)(5) excepts from preference avoidance a transfer "that creates a perfected security interest" in accounts receivable during the 90 days before bankruptcy if the lender did not improve its position during the 90-day period. Section 547(c)(5) does not apply here, because the lender was not perfected at the beginning of the 90-day period. *Lange v. Inova Cap. Funding, LLC (In re Qualia Clinical Serv., Inc.)*, 441 B.R. 325 (8th Cir. B.A.P. 2011).

2.2.hh. 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.ii. 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.jj. 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).

2.2.kk. Transfer arranged while the creditor was an insider but not made until later is not subject to one-year reach-back. The debtor's CEO entered into a severance agreement providing for a severance payment, which was paid shortly after the CEO resigned. The debtor filed bankruptcy more than 90 days but less than one year after the payment date. Its estate representative brought an action against the former CEO to avoid the payment as a preference. Section 547(b) permits a trustee to avoid a transfer to a creditor made "between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider". The statute applies only to a transfer "made" within one year if the creditor was an insider "at the time of such transfer", not to a transfer arranged while the creditor was an insider. Therefore, the transfer was not avoidable as a preference. *Zucker v. Freeman (In re Netbank, Inc.)*, 424 B.R. 568 (Bankr. M.D. Fla. 2010).

2.2.ll. LLC manager is an "insider". One of the limited liability company debtor's managers, who had a 12% interest in the debtor, got into a dispute with the majority owner. Under a settlement, the debtor paid the manager $200,000. Upon receiving the payment, the manager forfeited his LLC interest and resigned as a manager. The debtor filed bankruptcy five months later. A trustee may recover a preference to an insider made more than 90 days and less than one year before bankruptcy. An insider "includes" an

officer, director or person in control of the debtor. The insider definition does not list an LLC manager, but the definition is illustrative and not limiting. An LLC manager is the legal equivalent for an LLC to a corporate director for a corporation. Therefore, the manager was an insider when the debtor paid the settlement amount. *Brandt v. Tabet, Vito & Rothstein, LLC (In re Longview Aluminum, L.L.C.)*, 419 B.R. 351 (Bankr. N.D. Ill. 2009).

2.2.mm. Release of surety and of right to file a mechanics lien is not "new value". The debtor subcontractor rented equipment to use on the construction job. The debtor obtained a bond for the job from a surety, who had the right to receive payments from the general contractor if required to pay on the bond. The rental company had the right under nonbankruptcy law to file a mechanics lien and the right to claim under the debtor's surety bond, but it did neither before it received a payment on the rental invoices. The debtor filed bankruptcy within 90 days after the payment. A trustee may avoid a payment as a preference if, among other things, the payment enables the creditor to receive more than it would have received if the payment had not been made and the creditor received payment on the claim to the extent provided under the Bankruptcy Code. The hypothetical payment under this test is a payment from the estate in the bankruptcy case, not a payment from a third party, such as a surety. The trustee may not avoid a transfer that was intended to be a contemporaneous exchange for new value and was in fact substantially contemporaneous. The creditor could have obtained a mechanics lien if it had not been paid or could have claimed against the surety, with the result that the surety would have received payments from the general contractor that the debtor otherwise would have received. The creditor released those rights upon receiving payment, and the debtor received the payment from the general contractor. However, application of the exception requires a showing that the parties intended the exchange to be contemporaneous and that it was in fact contemporaneous. There was no showing here that the parties so intended or that the payment from the general contractor was in fact substantially contemporaneous. In addition, the release of a right to file a mechanics lien, rather than of a lien itself, does not transfer an interest in property to the debtor. Therefore, the trustee may avoid the payments. *United Rentals, Inc. v. Angell*, 592 F.3d 525 (4th Cir. 2010).

2.2.nn. Section 503(b)(9) administrative claim does not reduce availability of subsequent advance defense. The debtor in possession sued a supplier to avoid a preference. The debtor had received goods from the supplier after the preference and within 20 days before bankruptcy, for which the supplier filed an administrative expense claim under section 503(b)(9). Section 547(c)(4) provides a preference defense to the extent that the creditor "gave new value to or for the benefit of the debtor … not secured by an otherwise unavoidable security interest [and] on account of which the debtor did not make an otherwise unavoidable transfer to or for the benefit of the creditor". Section 547(c)(4) refers only to the debtor, not the estate. The subsequent new value defense therefore applies only to prepetition transfers from the debtor. A section 503(b)(9) administrative expense claim arises only upon the filing of the petition and entitles the supplier to payment by the estate after bankruptcy. The filing, allowance or even payment of such a claim therefore does not fit within either of the "otherwise unavoidable transfer" limitations on use of the subsequent new value defense. The supplier's administrative expense claim differs from a reclamation claim, which arises upon the debtor's receipt of the goods and allows the supplier to keep a "string" on the goods, and results from the supplier's enhancing the debtor's value before bankruptcy, which is the period that the subsequent new value defense addresses. *Commissary Ops., Inc. v. Dot Foods, Inc. (In re Commissary Operations, Inc.)*, 421 B.R. 873 (Bankr. M.D. Tenn. 2010).

2.2.oo. *DePrizio* waiver does not protect guarantor against preference exposure. The debtor's parent corporation had guaranteed the debtor's debt to its principal secured lender but had waived any claim against the debtor for contribution, reimbursement, indemnity, subrogation or otherwise if it had to pay on the guarantee. A trustee may recover as a preference a transfer to a "creditor" under specified circumstances. A guarantor has a contingent claim against the debtor that becomes fixed when the guarantor pays on the guarantee. Under *In re DePrizio Constr. Co.*, 874 F.2d 1186 (7th Cir. 1989), the contingent claim makes the guarantor a creditor for purposes of section 547. The attempted waiver of any claims is merely an attempt to evade by contract a bankruptcy policy reflected in the *DePrizio* rule. It is therefore unenforceable to protect the guarantor from preference liability. In any event, the guarantor may be liable under section 550(a) for recovery of the transfer as an entity for whose benefit the transfer was made. *Miller v. Greystone Bus. Credit II, L.L.C. (In re USA Detergents, Inc.)*, 418 B.R. 533 (Bankr. D. Del. 2009).

2.2.pp. Court measures "insolvency" for a registered limited liability partnership the same as for a corporation. Section 101(32) of the Bankruptcy Code defines "insolvent" differently for a corporation than for a partnership. For a general partnership, insolvency is determined by including the assets of the general partners in addition to the assets of the partnership. The Code defines "corporation" to include a "partnership association organized under a law that makes only the capital subscribed responsible" for its debts. New York law authorizes the creation of a "registered limited liability partnership", in which only licensed professionals may be partners. A partner, unlike a general partner, is not liable for any debts of the partnership, except for professional negligence that the partner or any person under the partner's direct supervision or control commits while rendering professional services. Although the debtor is a partnership, so the partnership definition of "insolvent" applies, there are no "general partners", because the partners are not generally liable for the partnership's obligations. So there are no general partner assets to include in the insolvency calculation. Thus, the effect is the same as if the corporate insolvency definition applies. *Wallach v. Douglas (In re Promedicus Health Group, LLP)*, 416 B.R. 389 (Bankr. W.D.N.Y. 2009).

2.2.qq. Transfer of security interest in tax refund occurs only at end of taxable year. In July, the debtor granted its lenders a security interest in general intangibles, which included any right to a tax refund. After suffering substantial losses that year, the debtor became entitled upon the close of the year to a tax refund based on a carryback of its losses to prior years. The debtor filed its petition in January. A preference is avoidable if made within 90 days before bankruptcy. A transfer is "made" when it takes effect between the parties. The security interest took effect between the debtor and the lenders in July, before the petition date. But a transfer does not occur until the debtor has rights in the property. The debtor does not have rights in a tax refund until the close of the taxable year. Therefore, the debtor obtained rights in the tax refund on January 1, which was within 90 days before the petition, and the preference is avoidable. *Official Comm. of Unsecured Creditors v. Citicorp N. Am., Inc. (In re TOUSA, Inc.)*, 2009 Bankr. LEXIS 3311 (Bankr. S.D. Fla. Oct. 13, 2009).

2.2.rr. "Subsequent new value" defense applies only to value transfers that are not avoidable. Within 90 days before bankruptcy, the debtor paid the supplier, who shipped goods after the payments. The supplier asserted a defense under section 547(c)(4) to a preference action, which provides that a transfer may not be avoided as a preference "to the extent that, after such transfer, such creditor gave new value … on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor". The Circuits have apparently split on the interpretation of this provision between the "remains unpaid" and "subsequent advance" rules, but the Third Circuit's rulings have been only dicta. The statute's plain language requires the court to determine the extent to which the creditor received payments that are otherwise unavoidable rather than how much of a subsequent transfer to the debtor remains unpaid. That is, if the trustee may avoid the debtor's later transfer, then the creditor should receive credit for the creditor's transfer to the debtor. If the trustee may not avoid the debtor's later transfer, then the creditor has been satisfied for its transfer to the debtor and should not be permitted to use it as a defense against an earlier preference. "Remains unpaid" therefore is an inaccurate shorthand to describe the defense's extent, and the court follows the "subsequent advance" interpretation. *Wahoski v. Am. & Efrid, Inc. (In re Pillowtex Corp.)*, 416 B.R. 123 (Bankr. D. Del. 2009).

2.2.ss. Settlement payment exception protects commercial paper prepayment from avoidance. The debtor issued uncertificated commercial paper electronically through The Depository Trust Company (DTC). The debtor prepaid the paper within 90 days before bankruptcy at par plus accrued interest, though the note was trading at a discount at the time. To effect the prepayment, the debtor transferred funds to DTC, who credited the holder's DTC account and debited the debtor's commercial paper from the holder's account. DTC then credited the debtor's account with the commercial paper, which extinguished the commercial paper. Under section 546(e), a "settlement payment" is exempt from preference avoidance and recovery. "Settlement payment" is defined in a circular way as "a preliminary settlement payment, a parties settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or other similar payment commonly used in the securities trade". The rule of the last antecedent requires that the clause "commonly used in the securities trade" be read to modify only the last antecedent, "other similar payment". Therefore, a settlement payment need not be made in the ordinary course or be commonly made to qualify for the exemption. All five courts of appeals that have addressed the question agree that Congress intended that the definition be read broadly as reaching beyond ordinary course or common transactions. Courts generally restrict the term's application to

securities transactions. However, "transaction" is not limited to a purchase or sale but encompasses any dealing in securities. Under the Bankruptcy Code's definition of "security", which is broader than the Securities Act's definition, commercial paper is a security. Therefore, section 546(e)'s exemption applies to the debtor's early redemption of its commercial paper through the clearing system. *Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp. (In re Enron Creditors Recovery Corp.)*, 422 B.R. 423 (S.D.N.Y. 2009).

2.2.tt. Debtor does not acquire rights in a carryback tax refund until the end of the tax year. The debtor granted its lender a security interest in general intangibles six months before its January bankruptcy. The debtor suffered a substantial tax loss in the tax year before bankruptcy, which entitled it to a tax refund resulting from carryback of the loss to prior profitable years. The debtor's refund right arises under federal tax law only at the end of the tax year. A tax refund is a general intangible, so the refund was subject to the lender's security interest. The trustee may avoid a transfer of property of the debtor to a creditor on account of an antecedent debt if the transfer occurs within 90 days before bankruptcy and enables the creditor to receive a greater recovery than if the transfer had not been made. Under section 547(e)(3), a transfer of property does not take place until the debtor has rights in the property. The transfer to the lender of the security interest in the tax refund did not occur until the end of the taxable year on midnight, December 31, because the debtor did not have rights in the tax refund until then. *Official Comm. of Unsecured Creditors v. Citicorp N. Am., Inc. (In re TOUSA, Inc.)*, 406 B.R. 421 (Bankr. S.D. Fla. 2009).

2.2.uu. Commercial paper prepayment is a preference that is not protected by the settlement payment exception. The debtor issued uncertificated commercial paper electronically through the Depository Trust Company. The debtor prepaid the paper within 90 days before bankruptcy at par plus accrued interest, though the note was trading at a discount at the time. To effect the prepayment, the debtor transferred funds to DTC, who credited the holder's DTC account and debited the debtor's commercial paper from the holder's account. It then credited the debtor's account with the commercial paper, which extinguished it. Under section 546(e), a "settlement payment" is exempt from preference avoidance and recovery. "Settlement payment" is defined in a circular way but by reference to "any other payment commonly used in the securities trade". A settlement payment occurs only upon a purchase and sale. Commercial paper is a note evidencing a debt. When a commercial paper issuer pays off the note, it does not purchase the note but simply repays the debt. Therefore, the payment is not a settlement payment and is not exempt from preference attack. *Enron Creditors Recovery Corp. v. J.P. Morgan Secs., Inc. (In re Enron Creditors Recovery Corp.)*, 407 B.R. 17 (Bankr. S.D.N.Y. 2009).

2.2.vv. Award of prejudgment interest in a preference action is discretionary. The trustee prevailed against a preference defendant after a trial involving facts that were disputed in good faith. Neither party delayed the litigation. As a matter of federal law, bankruptcy courts may award prejudgment interest in a preference action. Any such award must be equitable, and a reasonableness standard applies. Thus, failure to award prejudgment interest after a reasonable dispute is not an abuse of discretion. *Carrier Corp. v. Buckley (In re Globe Mfg. Corp.)*, 567 F.3d 1291 (11th Cir. 2009).

2.2.ww. "Insider" may include anyone not dealing at arms" length with the debtor. The debtor and a supplier entered into a strategic partnership agreement, under which the supplier would become the debtor's exclusive telecommunications equipment and software supplier and would provide the debtor with substantial financing to make purchases from the supplier. The financing agreement permitted the supplier to call its loan if the debtor's capital expenditures or the loan balance exceeded specified amounts and required, among other things, that the debtor use any increase in its bank facility to pay down the supplier's credit line. The supplier used the debtor "as a mere instrumentality to inflate [the supplier's] own revenues …. [W]hat began as a 'strategic partnership' … degenerated into a relationship in which the much larger company bullied and threatened the smaller into taking actions that were designed to benefit the larger at the expense of the smaller … to prop up its own revenue … in the form of purchases … of unneeded equipment". The supplier used its position as lender to ensure the debtor's cooperation by repeated threats to stop the funding. Eventually, the debtor sought to increase its bank credit line by $200 million. Though it was in default with the supplier, caused in part by the supplier's requiring unnecessary equipment purchases, the supplier delayed issuing the refinancing notice so as not to default the debtor before it obtained the increased bank loan and refused to allow the debtor to use the loan proceeds for any purpose other than paying the supplier, 131 days before bankruptcy. A payment made between 90 days and one year before bankruptcy is recoverable as a preference only if the creditor is an

"insider". The Bankruptcy Code defines "insider" to include an officer, director and "person in control of the debtor", but the definition is open-ended. A person not listed in the definition of "insider" may be a non-statutory insider. The statutory term "person in control" requires actual control. However, actual control is not necessary to qualify as a non-statutory insider. Otherwise, "person in control" would virtually eliminate the concept of nonstatutory insider. Rather, a nonstatutory insider includes anyone not dealing at arms' length with the debtor, such that its conduct should be subject to closer scrutiny. In this case, the supplier's ability to coerce the debtor into unnecessary and disadvantageous transactions showed that the parties were not dealing at arms' length, making the supplier a nonstatutory insider, even though the supplier had the right under its credit agreement to call its loan or require payment of the bank loan increase to itself. Therefore, the loan payment was recoverable as an insider preference. *Schubert v. Lucent Techs. Inc. (In re Winstar Comm'ns, Inc.)*, 554 F.3d 382 (3d Cir. 2009).

2.2.xx. Lease termination payment is made on account of an antecedent debt. The debtor paid its landlord a termination payment within 90 days before bankruptcy in full satisfaction of all of the debtor's remaining obligations under the lease. The trustee may recover a transfer as a preference if, among other things, the transfer is made "for or on account of an antecedent debt". The Code defines "debt" as co-extensive with "claim", which is defined to include a claim that is unmatured, unliquidated or contingent. Under applicable state law, the landlord could not collect or sue for the rent until it became due each month under the lease, and the rent might never be owing if the premises were destroyed or the landlord constructively evicted the debtor. These factors made the debtor's obligation to the landlord unmatured and contingent, but unmatured or contingent obligations are within the Code's definition of "debt". Because the obligations were incurred at lease signing, they were antecedent to the debtor's lease termination payment, which the trustee could therefore recover as a preference. *Midwest Holding #7, LLC v. Anderson (In re Tanner Family, LLC)*, 556 F.3d 1194 (11th Cir. 2009).

2.2.yy. Bank to bank credit card transfer is a preference. The debtor used a check drawn on one credit card account to pay down another card account within 90 days before bankruptcy. The trustee sued the payee bank to avoid the payment as a preference. A payment may be avoided as a preference only if the payment is of property of the debtor. Where a new creditor requires that the funds it is advancing be used to pay a particular old creditor, the funds are earmarked for the old creditor and, because the debtor did not have full control over the funds, are not property of the debtor. Although the funds here came from the payor bank, the debtor had control over whom to pay with the funds. As such, the funds were property of the debtor and were not earmarked for the old creditor. Therefore, the earmarking doctrine does not apply, and the old creditor is liable for a preference. *Yoppolo v. MBNA Am. Bank, N.A. (In re Dilworth)*, 560 F.3d 562 (6th Cir. 2009); *accord MBNA Am. Bank, N.A. v. Meoli (In re Wells)*, 561 F.3d 633 (6th Cir. 2009).

2.2.zz. BAPCPA's fix to the *DePrizio* repeal applies retroactively to pending actions. The creditors committee had brought an action to recover as a preference a mortgage that the debtor had granted more than 90 days before bankruptcy to a bank that had a guarantee from an insider. Under *In re DePrizio*, 874 F.2d 1186 (7th Cir. 1989), the mortgage grant was avoidable and recoverable as to the bank, because the 1994 amendment to section 550 to overrule *DePrizio* did not overrule it as to the granting of a preferential lien. However, BAPCPA fixed that oversight and applied the fix to pending cases. Such application to pending cases is constitutional. A plaintiff does not have a property right for purposes of the Fifth Amendment Takings Clause in pending litigation that has not been reduced to judgment. Similarly, the committee does not have a property interest in the unencumbered real property, because the avoiding powers do not grant such an interest until after judgment, and the mortgage cannot be said to have an implied clause incorporating preference law, such that the committee or the estate had a vested property interest despite the mortgage. Finally, retroactive application does not violate due process, because Congress had a rational purpose in applying the amendment to pending litigation. *Official Comm. of Unsecured Creditors v. Bank of America, N.A. (In re ABC-NACO, Inc.)*, 402 B.R. 816 (N.D. Ill. 2009).

2.2.aaa. Debtor's direct payment of a credit card debt with an advance from another credit card is a preference. In a balance transfer transaction, the debtor directed one of its credit card companies to pay another credit card company. The debtor filed bankruptcy within 90 days. The trustee sought recovery of the payment amount from the transferee company as a preference. A preference involves a transfer of property of the debtor, that is, property that would have become property of the estate if it had not been transferred. Here, "[t]echnology masks the processes involved". Although the funds flowed electronically

from the transferor company to the transferee and never actually passed through the debtor's hands, the debtor actually drew on its credit line at the transferor company and used the loan proceeds, not the untapped credit line, to pay the transferee. Thus, the loan proceeds became property of the debtor, even if only for a nanosecond. The earmarking doctrine requires at a minimum that the new lender require the loan proceeds be paid to the old creditor. Here, the transferor company imposed no such requirement. *Parks v. FIA Card Servs., N.A. (In re Marshall)*, 550 F.3d 1251 (10th Cir. 2008).

2.2.bbb. A loan made as an exception to a lender's lending policy is not made in the ordinary course. The bank gave the debtor an emergency, short term loan to make payroll and prevent evictions as a bridge to an SBA-guaranteed loan. The bridge loan was unsecured but guaranteed by the debtor's principal and was at an interest rate below prime. The bank's internal documents noted the loan "was made on a non-conforming basis" and "was approved as a policy exception out of margin". Section 547(c)(2) provides an exception to preference avoidance for a transfer made in payment of a debt "incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee" if the payment was also in the ordinary course or according to ordinary business terms. The fact that the loan was made to prevent a financial emergency for the debtor did not render the loan made out of the ordinary course of business. If it did, it would condemn and therefore discourage new dealings with a troubled debtor, making it excessively difficult for a distressed debtor to recover financial health. Similarly, the fact that the loan was a bridge loan, to be paid from proceeds of a later loan rather than from cash flow or earnings, does not make the loan out of the ordinary course, because such loans are consistent with bank policy. However, because the loan admittedly was not in compliance with the lender's loan policy, the loan was not in the ordinary course of business of the transferee (the bank), so the ordinary course exception does not apply. *Caillouet v. First Bank & Trust (In re Entringer Bakeries, Inc.)*, 548 F.3d 344 (5th Cir. 2008).

2.2.ccc. Lease termination is a payment on account of an antecedent debt. The debtor paid the landlord in exchange for the landlord's early termination of the lease and a release from future liability. Section 547(b) permits avoidance of a "transfer for or on account of an antecedent debt owed by the debtor before such transfer was made". The Bankruptcy Code defines debt as "liability on a claim". "Claim" means a right to payment, whether matured or unmatured, fixed or contingent. A lessee's future liability for rent is therefore a debt. Where a lessee receives only a liability release in exchange for the termination payment, the payment is for or on account of an antecedent debt. *Midwest Holding #7, LLC v. Anderson*, 387 B.R. 892 (N.D. Ga. 2008).

2.2.ddd. Equitable subrogation may perfect a new mortgage before recording. The debtor refinanced his house 122 days before bankruptcy. After the federally required three business days (which was 5 calendar days because of an intervening weekend) after the closing, the new lender delivered a check to the old lender and sent its mortgage to the county clerk for recording, who recorded it 28 days later, which was 89 days before bankruptcy. The county clerk recorded the cancellation of the old mortgage 74 days before bankruptcy. Under applicable state law, a lender who pays off a prior mortgage is equitably subrogated to the prior mortgage, and a bona fide purchaser takes subject to the new mortgage, even though the new mortgage is not recorded until later, as long as the new mortgage is recorded before the old mortgage is released. Under section 547(e)(2), a transfer is made when it takes effect between the parties if it is perfected within 10 days (pre-BAPCPA). Under section 547(e)(1)(A), a transfer of real property is perfected when a bona fide purchaser "cannot acquire an interest that is superior to the interest of the transferee". Because of the state's law on equitable subrogation, a bona fide purchaser could not have obtained a superior interest to the new lender's mortgage. The new lender subrogated to the old lender's rights when it paid off the old lender, 5 days after the transfer took effect between the debtor and the new lender. Therefore, the transfer was "made" when it took effect between the parties 122 days before bankruptcy, outside the preference period. The Bankruptcy Code's non-recognition of equitable liens does not apply here, because equitable subrogation affects only priority, not the creation of the new lender's lien. *Gordon v. Novastar Mortgage, Inc. (In re Hedrick)*, 524 F.3d 1175 (11th Cir. 2008).

2.2.eee. Earmarking does not save a late-perfected refinancing mortgage. The debtor refinanced his mortgage with the same lender. The lender issued a discharge of the prior mortgage 25 days later. The new mortgage was recorded 72 days after the refinancing transaction, and the discharge was recorded 30 days after that. The debtor filed bankruptcy 77 days after the new mortgage was recorded. Under section 547(e), a real property transfer is made when it is perfected, unless perfected within 10 days (pre-BAPCPA) after

the transfer takes effect between the parties. It is perfected "when a bona fide purchaser … cannot acquire an interest that is superior to the interest of the transferee …." Here, a bona fide purchaser could acquire a superior interest to the new mortgage, despite the continued recordation of the discharged mortgage. Therefore, the transfer was not perfected until it was recorded, and the transfer was therefore on account of an antecedent debt. The earmarking doctrine prevents preference liability if a new creditor agrees to lend the debtor money to pay a specific antecedent debt, the agreement is performed according to its terms, and the transaction does not diminish the estate, because the new loan proceeds do not become property of the debtor for purposes of section 547(b). Here, the lender was not a "new creditor", but was refinancing its own loan. More important, the property transferred to secure the new loan was an interest in the debtor's real property, not the new loan funds the creditor advanced. Therefore, the property was property of the debtor, and the earmarking doctrine does not provide a preference defense. The court refuses to collapse the advance of new funds, the granting of the new mortgage, and the payoff and discharge of the old debt and mortgage into a single transaction to prevent preference attack, because it would ignore the Bankruptcy Code's plain transfer definition as including the mortgage. *Chase Manhattan Mortgage Corp. v. Shapiro (In re Lee)*, 530 F.3d 458 (6th Cir. 2008).

2.2.fff. Creditor owning 10.6% of the debtor's stock, whose CEO is on the debtor's board, is not an insider. The debtor agreed to serve as the creditor's exclusive distribution company in the United States. In exchange, the creditor invested cash and obtained a 10.6% interest in the debtor's stock and designated its CEO as one of the debtor's 10 directors. The director did not exert any undue influence over the debtor and conducted all business between the two companies on an arm's-length basis. The director recused himself from any deliberations relating to the debtor's relations with the creditor. The trustee sued to recover payments that the creditor received from the debtor more than 90 days but less than one year before bankruptcy on the ground that the stock ownership and the director relationship made the creditor a nonstatutory insider. A close business relationship over a period of years does not alone make a creditor an insider. Rather, a creditor becomes a nonstatutory insider only when it exercises control to gain an advantage in a manner that strays from an arm's-length relationship. Moreover, applying insider status to any company whose executive officer sits on the debtor's board would impermissibly expand the statutory "insider" definition. In this case, the creditor did not exercise any improper control and therefore is not an insider. *Anstine v. Carl Zeiss Meditec AG (In re U.S. Medical, Inc.)*, 531 F.3d 1272 (10th Cir. 2008).

2.2.ggg. "Substantially contemporaneous" is not a bright-line rule measured by section 547(e)(2)'s relation-back time period. The debtor refinanced his house 29 days before bankruptcy. After the federally required three business days (which was 8 calendar days because of an intervening holiday weekend) after the closing, the new lender mailed a check to the old lender and sent its mortgage to the county clerk for recording, who recorded it 13 days later, which was 5 days before bankruptcy. The county clerk recorded the cancellation of the old mortgage after bankruptcy. Under applicable state law, a lender who pays off a prior mortgage is equitably subrogated to the prior mortgage, and a bona fide purchaser takes subject to the new mortgage, even though the new mortgage is not recorded till later, as long as the new mortgage is recorded before the old mortgage is released. Section 547(c)(1) provides a transferee a preference liability defense for a transfer that the debtor and a transferee intend to be contemporaneous for new value and that is in fact a substantially contemporaneous exchange. This defense operates independently of section 547(e)(2)'s 10-day (pre-BAPCPA) relation back provision, so "substantially contemporaneous" is not measured by that 10-day period. If it were, it would render section 547(e)(2)(B) superfluous. "Substantially contemporaneous" is not a bright-line test but rather is based on all relevant facts, including the nature of the transaction, the objective reasonableness of the time taken to perfect, the normal course of business or affairs, the transferee's diligence, and the reasons for the delay. Moreover, section 547(e)(2)'s purpose is to move promptly perfected transfers that occur between 80 (pre-BAPCPA) and 90 days before bankruptcy outside of the preference period; section 547(c)(1) is not so limited. Here, the new lender acted diligently, did not attempt to obtain a secret lien, and acted in good faith, so the 8-day delay in perfection was reasonable and therefore substantially contemporaneous. The court does not address why section 547(e)(2)'s relation-back provision for transfers perfected within 10 days would not have taken this transfer entirely out of the "antecedent debt" preference requirement. *Gordon v. Novastar Mortgage, Inc. (In re Hedrick)*, 524 F.3d 1175 (11th Cir. 2008).

2.2.hhh. Prejudgment attachment for breach of a swap is subject to financial contract safe harbor. The debtor entered into a swap agreement with the creditor. The creditor made its payment under the swap but the debtor did not. The creditor promptly sued and obtained a prejudgment attachment on the debtor's bank account. The debtor filed a chapter 11 case within 90 days and sued to set aside the

attachments as a preference. Section 546(g) provides that "a trustee may not avoid a transfer, made by or to (or for the benefit of) a swap participant or financial participant, under or in connection with any swap agreement and that is made before the commencement of the case". The attachment is a transfer, but it is not made "under" the swap agreement, because it was not accomplished according to the procedure stated in the swap agreement. However, it is "in connection with" the swap because it arises from the failure of the swap transactions. *Casa de Cambio Majapara S.A. de C.V. v. Wachovia Bank, N.A. (In re Casa de Cambio Majapara S.A. de C.V.)*, 380 B.R. 595 (Bankr. N.D. Ill. 2008).

2.2.iii. Preference claims are not subject to arbitration. The debtor's contracts with the creditor contained a broad arbitration clause that required arbitration of "[a]ny and all differences and disputes of whatsoever nature arising out of" the contract. A liquidating trustee sued the creditor to recover as a preference a payment under the contract made within 90 days before bankruptcy. An arbitration clause is generally enforceable between the parties to the contract. A preference action is a statutory claim that vests in the estate for the benefit of creditors and is not based on the contract between the debtor and the counterparty. Therefore, the arbitration clause does not bind the estate or its representatives in bringing an action to avoid a preference. *Bethlehem Steel Corp. v. Moran Towing Corp. (In re Bethlehem Steel Corp.)*, 390 B.R. 784 (Bankr. S.D.N.Y. 2008).

2.2.jjj. Earmarking doctrine does not protect a payment by a credit card convenience check. The debtor used credit card "convenience checks" to pay another credit card company debt within 90 days before bankruptcy. The check issuer did not direct the debtor's use of the funds. The debtor had complete dominion and control over the funds and could have used them for any purpose. A transfer of property of the debtor within 90 days before bankruptcy while the debtor was insolvent may be avoidable as a preference. The transferred funds were property of the debtor and became such at the moment the check issuer extended credit to the debtor by honoring the checks. The earmarking doctrine does not apply to protect the recipient because the lender did not direct their use. The court relies on cases reaching the same result in the context of kited checks, in which the bank extends provisional credit to the debtor upon deposit of the kited check, even though the check has not cleared. The court rejects the idea that the credit that the check issuer extends to the debtor is not property of the debtor on which creditors could realize any recovery and rejects any "diminution of the estate" analysis. *Meoli v. MBNA Am. Bank, N.A. (In re Wells)*, 382 B.R. 355 (6th Cir. B.A.P. 2007).

2.2.kkk. Greater percentage test is applied as of the petition date. The debtor financed its insurance premiums. It made two payments within 90 days before bankruptcy. At the time of each payment and at the petition date, the unearned premium that secured the debtor's premium obligation exceeded the remaining unpaid premium. However, if the payments had not been made, the unearned premium would have been less than the remaining unpaid premium as of the petition date. The trustee claimed that as a result, the transfers met section 547(b)(5)'s greater percentage test requirement that the transfers "enabled the creditor to receive more than such creditor would receive if (A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title." *Palmer Clay Prods. v. Brown*, 397 U.S. 227 (1936), requires the court to conduct this hypothetical analysis as of the petition date, not the transfer date. Subparagraph (B) then requires the court to add back the transfers to the creditor's remaining petition date claim and compare it to the creditor's petition date collateral value. Here, the hypothetical petition date claim exceeded the petition date collateral value, so the transfers enabled the creditor to receive more than if the transfers had not been made. These provisions apply equally to secured and unsecured claims, except that for a secured claim, a payment typically releases collateral of equal value. That would provide a fully secured creditor with a section 547(c)(1) contemporaneous exchange for new value defense, but it is important analytically to keep the preference elements and defenses clear. The court rejects application of a hypothetical analysis of what a secured creditor might have done, such as canceling the insurance policy, if the transfer had not been made. *Falcon Creditor Trust v. First Ins. Funding (In re Falcon Prods., Inc.)*, 381 B.R. 543 (8th Cir. B.A.P. 2007).

2.2.lll. Transfer to a creditor secured by leased property is not a preference. The debtor paid a creditor $100,000 as partial payment for maintenance of an airplane the debtor leased and filed bankruptcy within 90 days after the payment. The trustee sought to recover the payment as a preference. The creditor had a perfected possessory lien on the airplane, which was senior to the rights of the lessor and to the debtor's possessory interest in the airplane. Because the creditor's lien was valid, the trustee

could not show that the payment enabled the creditor to receive more than it would have received in a hypothetical chapter 7 case. The court apparently applies the greater percentage test as of the transfer date and does not address the value, if any, of the creditor's possessory lien as against the debtor. *Triad Int'l Maint. Corp. v. So. Air Transport, Inc. (In re So. Air Transport, Inc.)*, 511 F.3d 526 (6th Cir. 2007).

2.2.mmm. Preference return under a settlement revives guarantee liability. The debtor guaranteed the obligations of its insurance company affiliate. Before the insurance company entered conservation, it paid the guaranteed creditor in full under a settlement agreement among the debtor, the insurance company, and the creditor, which provided that the guarantee would be released and that if the payment were avoided as a preference, the creditor could enforce the guarantee. In the insurance company conservatorship, the creditor settled with the conservator and agreed to return part of the preference. It then filed a claim against the debtor in its bankruptcy case. Under general principles of suretyship and guarantees, a guarantor's obligation to a creditor revives when the creditor performs an obligation to surrender a preference. The result is the same when the creditor settles a preference, because a lawsuit removes any element of voluntariness from the payment. The guarantee release in the initial settlement agreement does not affect the result, as that agreement also contained the revival provision, both of which are consistent with the general rule. *Centre Ins. Co. v. SNTL Corp. (In re SNTL Corp.)*, 380 B.R. 204 (9th Cir. B.A.P. 2007); *aff'd*, 571 F.3d 826 (9th Cir. 2009).

2.2.nnn. Trustee may recover preferences to pay administrative expense claims. After the debtor's chapter 11 case failed and was converted to chapter 7, the trustee borrowed from the prepetition secured lenders to pay certain administrative expense claims required to administer the case. The trustee secured the loan with recoveries under avoiding power actions and ultimately agreed with the creditor to distribute recoveries first to litigation expenses and chapter 7 trustee fees, then 2/3 to the creditor and 1/3 to the estate to pay unpaid chapter 11 administrative expense claims. The trustee may bring preference actions to pay these amounts, even though none of the proceeds will inure to the benefit of holders of general unsecured prepetition claims. Section 550(a) permits recovery "for the benefit of the estate", which represents all potentially interested parties, not just general unsecured prepetition claims. The loan and the preference recoveries benefit the estate by allowing it to satisfy priority claims, as well as a secured loan whose proceeds were used to pay administrative claims. *Gonzales v. Conagra Groc. Prods. Co. (In re Furr's Supermarkets, Inc.)*, 373 B.R. 691 (10th Cir. B.A.P. 2007).

2.2.ooo. Trustee may recover preference from creditor with only a contingent claim that receives collateral. A surety company issued surety bonds for the debtor's business. The debtor indemnified the surety for any loss on the bonds. When the debtor's financial condition deteriorated, the surety company demanded collateral, which the debtor provided, to secure the debtor's indemnity obligation to the surety if the bonds, none of which had yet been called, were later called. Bankruptcy followed within 90 days, as did calls on the bonds. The surety had a claim against the debtor under the indemnity agreement, even though the bonds had not been called, contingent on a bond beneficiary making demand on the surety. The debtor's collateral transfer to the surety was therefore to a creditor on account of an antecedent debt and, if the other preference elements were present, was avoidable. *Hutson v. Greenwich Ins. Co. (In re E-Z Serve Conv. Stores, Inc.)*, 377 B.R. 491 (Bankr. M.D.N.C. 2007).

2.2.ppp. Tenth Circuit BAP construes ordinary course defense narrowly. In the months before bankruptcy, the debtor paid the creditor irregularly, holding checks, voiding and reissuing them later, having daily internal meetings to decide which suppliers to pay, and sending payments by overnight delivery rather than regular mail. The creditor frequently contacted the debtor for payment of specific invoices, placed the debtor on credit hold and withheld orders until it was brought current. The conduct did not meet pre-BAPCPA section 547(c)(2)(B)'s ordinary course of business subjective test ("made in the ordinary course of business between the debtor and the transferee"). The Tenth Circuit construes the ordinary course exception narrowly. Four factors determine compliance with the subjective test: (1) the time the parties were engaged in the transaction; (2) whether the payment amount or form differed from past practices; (3) whether the parties engaged in unusual payment or collection activity; and (4) the payment circumstances. The third factor dooms the payments here, because the course of dealing differed substantially from the payment and collection practices before the debtor encountered financial difficulty. The conduct also fails section 547(c)(2)(C)'s objective test ("made according to ordinary business terms") under Tenth Circuit precedent, because it did not comport with terms that creditors use when debtors are

financially healthy. *Gonzales v. Conagra Groc. Prods. Co. (In re Furr's Supermarkets, Inc.)*, 373 B.R. 691 (10th Cir. B.A.P. 2007).

2.2.qqq. Reclamation right defeats subsequent advance defense. The creditor supplied the debtor almost daily with fresh inventory. When the debtor filed bankruptcy, the creditor sent a reclamation notice, which the court recognized and allowed. As part of a critical vendor order, the debtor in possession paid the creditor the entire amount of the reclamation claim, but the order did not waive preference claims. In response to the liquidating trustee's preference action, the creditor asserted section 547(c)(4)'s subsequent advance defense. The defense requires that the new value given after the preference not be "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 such creditor." The postpetition payments were not such an "otherwise unavoidable transfer," because the preference analysis stops at the petition date and therefore does not take into account postpetition payments to the creditor. (Tied more closely to the statutory language, the postpetition payment was a transfer by the estate, not by the debtor.) However, the creditor's reclamation right defeated the subsequent advance defense. The reclamation right acted as a "string" on the post-preference shipments that prevented them from being new value to the debtor or the estate. *Phoenix Restaurant Group, Inc. v. Proficient Food Co. (In re Phoenix Restaurant Group, Inc.)*, 373 B.R. 541 (M.D. Tenn. 2007).

2.2.rrr. Improvement in position exception does not necessarily protect a creditor with a blanket security interest in all assets. The debtor operated a service business that used substantial equipment but little inventory. The creditor had a blanket security interest in all the debtor's assets, including inventory and accounts receivable, which increased in value during the 90-day preference period. Each creation of a new item of inventory or account receivable (except to the extent the receivable was proceeds of inventory) was a transfer of property of the debtor that could enable the creditor to receive more than in a liquidation for purposes of section 547(b)(5), because under section 547(e)(3), a secured creditor's lien does not attach until the debtor obtains rights in the asset. The creditor's blanket security interest might defeat the greater percentage analysis of section 547(b)(5) if the new assets were proceeds of the creditor's other collateral. Here, however, "proceeds" should be construed consistently with section 552(b), which allows a security interest to attach to property the estate acquires postpetition only if the property is proceeds of the creditor's petition-date collateral. Because the debtor was in a service business, the new inventory and accounts did not appear to be proceeds of the creditor's other collateral. (Query, however, whether, to the extent cash proceeds of existing accounts were used to purchase new inventory and to pay for operating expenses, the new accounts were proceeds.) The creditor does not benefit from the improvement in position exception of section 547(c)(5) for the same reason. The improvement appears to have been "to the prejudice of creditors holding unsecured claims," because the accounts and inventory that were transferred to the creditor upon creation would have otherwise been available for unsecured claims. The court examines only the increase in the value of inventory and accounts, not the entire collateral package. The court expressly departs from *In re Castletons, Inc.*, 990 F.2d 551 (10th Cir. 1993). *Qmect, Inc. v. Burlingame Cap. P'ners II, L.P. (In re Qmect, Inc.)*, 373 B.R. 100 (Bankr. N.D. Cal. 2007). *See also Qmect, Inc. v. Burlingame Cap. P'ners II, L.P. (In re Qmect, Inc.)*, 373 B.R. 682 (N.D. Cal. 2007), *infra* (affirming bankruptcy court's determination that secured creditor's lien extend to assets generated postpetition).

2.2.sss. Earmarking is not an affirmative defense. The trustee sued a creditor to recover a preference. The creditor first raised an earmarking defense in its opposition to the trustee's summary judgment motion. Under Fed. R. Civ. Proc. 8, failure to raise an affirmative defense in an answer waives the defense. The earmarking defense is an argument that the transferred property was not property of the debtor when transferred and so goes to the trustee's affirmative case to establish an avoidable preference under section 547(b). The creditor therefore did not waive the defense by failing to raise it in its answer. The burden of proof still remains on the creditor. Once the trustee introduces evidence that the property was property of the debtor, the burden of persuasion shifts to the creditor to show that the funds were earmarked. *Metcalf v. Golden (In re Adbox, Inc.)*, 488 F.3d 836 (9th Cir. 2007).

2.2.ttt. Creditor owning 10.6% of the debtor's stock, whose CEO is on the debtor's board, is not an insider. The debtor agreed to serve as the creditor's exclusive distribution company in the United States. In exchange, the creditor invested cash and obtained a 10.6% interest in the debtor's stock and designated its CEO as one of the debtor's 10 directors. The director did not exert any undue influence over

the debtor and conducted all business between the two companies on an arms' length basis. The director recused himself from any deliberations relating to the debtor's relations with the creditor. The trustee sued to recover payments that the creditor received from the debtor more than 90 days but less than one year before bankruptcy on the ground that the stock ownership and the director relationship made the creditor a nonstatutory insider. A close business relationship over a period of years does not alone make a creditor an insider. Rather, a creditor becomes a nonstatutory insider only when it exercises control to gain an advantage in a manner that strays from an arms' length relationship. In this case, the creditor did not exercise any such control and therefore is not an insider. Carl Zeiss Meditec AG v. Anstine (In re U.S. Medical, Inc.), 370 B.R. 340 (10th Cir. B.A.P. 2007).

2.2.uuu. A director emeritus is not a per se insider. The debtor resigned as a director of a bank in 1990. He received the title "director emeritus", $400 monthly compensation, and a listing in the bank's annual report. He attended board meetings only occasionally and did not vote at the meetings. The debtor paid the bank a substantial amount on an unsecured loan between 90 days and one year before he filed bankruptcy in 2001. The trustee sued the bank for recovery of the payments as avoidable preferences, on the ground that the bank was an insider at the time of the transfers. The debtor's status as director emeritus did not make the bank a per se insider. "Director" in the insider definition refers to one actually serving on the board of directors. As a director emeritus, the debtor did not necessarily have the control that a director would ordinarily have and to which the statute is directed. It is a question of fact, however, relating to the degree of control that the director exercised over the bank at the time of payment, whether the bank is a insider by reason of the bank's relationship to or control of the debtor. *Rupp v. United Sec. Bank (In re Kunz)*, 489 F.3d 1072 (10th Cir. 2007).

2.2.vvv. Replacement check qualifies for contemporaneous exchange for new value exception. The debtor grain elevator paid for grain received from its customer with a bad check. The debtor replaced the check within 90 days before bankruptcy with a good check, payable to both the customer and the customer's bank, to obtain a release of the bank's security interest in the grain. The debtor's customer's receipt of the bad check did not release the customer's bank's security interest in the grain; only the replacement check did. Although a replacement check for goods previously sold free and clear to the debtor is not typically a contemporaneous exchange, because the bad check converts the transaction to a credit transaction, here the security interest release was a substantially contemporaneous exchange for the replacement check payment, and it was intended to be contemporaneous. Therefore, the replacement check payment qualifies for the section 547(c)(1) contemporaneous-exchange-for-new-value exception to preference avoidance. *Velde v. Reinhardt*, 366 B.R. 894 (D. Minn. 2007); *Velde v. Kirsch*, 366 B.R. 902 (D. Minn. 2007), *aff'd*, 543 F.3d 469 (8th Cir. 2008).

2.2.www. A credit transaction may result in a contemporaneous exchange for new value. When the debtor's financial condition deteriorated after its 15-year relationship with a supplier, the supplier imposed new, substantially tighter credit terms of 1%, 7 days, net 8, required wire transfer payments, and substantially reduced the debtor's credit limit. Within five months, the debtor filed bankruptcy. During the five-month period, the debtor paid within credit terms, wiring funds in many cases on the day it received the goods. In response to the trustee's preference action, the supplier argued that the payments were excepted from preference recovery under section 547(c)(1) because they were intended by the debtor and the supplier to be a contemporaneous exchange for new value. A credit transaction may qualify as one intended to be "a contemporaneous exchange for new value". Although by its nature a credit transaction involves a delay between delivery and payment, section 547(c)(1) applies only if section 547(b) applies, which requires a finding that the payment was for an antecedent debt, hence a credit transaction. Therefore, section 547(c)(1) does not categorically exclude credit transactions from its coverage. The bankruptcy court must examine the parties' intent in establishing the relationship, in which payments were generally made contemporaneously with receipt of goods, to determine whether the transaction was in fact intended to be a contemporaneous exchange for new value. *Hechinger Inv. Co. of Del., Inc. v. Univ. Forest Prods., Inc. (In re Hechinger Inv. Co. of Del., Inc.)*, 489 F.3d 568 (3d Cir. 2007).

2.2.xxx. Is a loan repaid within 15 days a substantially contemporaneous exchange for new value? The debtor ran out of cash. Its president advanced $100,000, to be repaid as soon as the debtor had funds. The debtor repaid 15 days later and filed bankruptcy a few months after that. In response to the trustee's preference claim, the president argued that section 547(c)(1) insulated the payment from avoidance because the repayment was intended to be a contemporaneous exchange for new value (the

loan) and was in fact substantially contemporaneous. The court denied the president's motion for summary judgment, because an intent to repay when funds become available differs from an intention of contemporaneity. In addition, although "substantially" is a flexible term that is subject to examination in each case, the evidence here was insufficient to support summary judgment on the question of whether the repayment was substantially contemporaneous. The trustee apparently did not argue case law or the legislative history, which say that section 547(c)(1) is intended to apply only to a cash transaction, not to a credit transaction, no matter how short. *Tomsic v. Stockard (In re Salience Assocs., Inc.)*, 371 B.R. 571 (Bankr. D. Mass. 2007).

2.2.yyy. Change in credit terms may take on-time payments out of the ordinary course of business defense. When the debtor's financial condition deteriorated after its 15-year relationship with a supplier, the supplier imposed new, substantially tighter credit terms of 1%, 7 days, net 8, required wire transfer payments, and substantially reduced the debtor's credit limit, in a manner that was "extreme" and "out of character with the long historical relationship between these parties". Within five months, the debtor filed bankruptcy. During the five-month period, the debtor paid nearly all invoices within the new credit terms, wiring funds in many cases on the day it received the goods. In response to the trustee's preference action, the supplier argued that the payments were excepted from preference recovery under section 547(c)(2) because they were made within the new credit terms. However, compliance with credit terms is not enough by itself to bring payments within the defense that the payments were "made in the ordinary course of business or financial affairs of the debtor and the transferee". The change in credit terms, method of payment, and credit limit imposed when the debtor began exhibiting financial trouble were enough to take all of the payments out of the lengthy historical ordinary course of business between the parties. *Hechinger Inv. Co. of Del., Inc. v. Univ. Forest Prods., Inc. (In re Hechinger Inv. Co. of Del., Inc.)*, 489 F.3d 568 (3d Cir. 2007).

2.2.zzz. Earmarking doctrine does not save a late-filed mortgage. The debtor refinanced her house within 90 days before bankruptcy. The new lender recorded its mortgage 14 days after the refinancing; the old lender did not release its old mortgage until several weeks after that. The late-recorded mortgage was not filed within section 547(e)(2)(B)'s then-applicable 10-day grace period. Thus, the transfer of the interest in the debtor's property occurred when the new lender recorded the mortgage. The earmarking doctrine does not save the transaction, even though the old lender's mortgage was still recorded, because the mortgage interest was transferred to the new lender *by* the debtor, not *through* the debtor from the old lender to the new lender. Finally, section 547(c)(2)(B)'s "substantially contemporaneous" defense does not override section 547(e)(2)(B)'s express grace period requirement. Therefore, the late-recorded mortgage was a preference. *Collins v. Greater Atl. Mortgage Corp. (In re Lazarus)*, 478 F.3d 12 (1st Cir. 2007).

2.2.aaaa. Prepetition return of mistakenly deposited check is not a preference. The debtor received and deposited a check addressed and payable to another business located in the same building. The debtor and the other business had no other connections or business between them. When notified of the error, the debtor paid the amount to the other business. The debtor filed bankruptcy days later. The funds were not property of the debtor, because the debtor held them in constructive trust for the other business. State law determines whether there is a constructive trust and when it arises. Here, Illinois law imposes a constructive trust when a party receives funds, either wrongfully or mistakenly, to which it has no claim, whether under contract or otherwise, so the debtor did not have any legal or equitable claim to the funds. The debtor's payment to the other business before bankruptcy therefore did not transfer an interest of the debtor in property. In addition, the other business was not a "creditor," because it did not have a "right to payment" from the debtor under a consensual or other relationship imposed by law (such as a tort claim) but rather a right to a return of its property. Finally, a transfer did not occur, because under section 547(e)(3), "a transfer is not made until the debtor has acquired rights in the property." Here, the debtor did not have any rights in the property. The trustee therefore could not avoid the payment as a preference. For the same reasons, the trustee's strong arm power under section 544(a) did not defeat the other business's interest in the funds. A hypothetical judicial lien creditor would have taken subject to the other business's beneficial interest under the constructive trust. *Claybrook v. Consol. Foods, Inc. (In re Bake-Line Group, LLC)*, 359 B.R. 566 (Bankr. D. Del. 2007).

2.2.bbbb. The first time may be in the ordinary course. The debtor contracted for product development services with a developer with whom the debtor had never previously done business. Alleging

that the debtor owed for work already performed, the developer obtained a settlement agreement from the debtor that provided for a lump sum payment and monthly payments for 12 months. After eight payments, the debtor filed bankruptcy. The trustee sued for recovery of the last two payments as preferences. Section 547(c)(2) excepts a transfer from preference avoidance if, among other things, "(A) [the] debt [is] incurred by the debtor in the ordinary course of business of financial affairs of the debtor and the transferee." Although "ordinary course" case law generally focuses on the prior dealings between the debtor and the creditor, a first-time debt may also be incurred "in the ordinary course" if it is of the kind that would be expected as part of the debtor's and creditor's ordinary business operations, that is, if it is similar to this particular debtor's and this particular creditor's past practices in dealing with other, similarly situated parties. If one of the parties has never engaged in similar transactions, the court may still consider whether similarly situated parties would engage in this kind of transaction as part of normal business practices. *Wood v. Stratos Prod. Dev., LLC (In re Ahaza Sys., Inc.)*, 482 F.3d 1118 (9th Cir. 2007).

2.2.cccc. Determining whether a debt is incurred in the ordinary course requires evaluation of the underlying obligation. The debtor contracted for product development services with a developer. Alleging that the debtor owed for work already performed, the developer obtained a settlement agreement from the debtor that provided for a lump sum payment and monthly payments for 12 months. After eight payments, the debtor filed bankruptcy, and the trustee sued for recovery of the last two payments as preferences. Section 547(c)(2) excepts a transfer from preference avoidance if, among other things, "(A) [the] debt [is] incurred by the debtor in the ordinary course of business of financial affairs of the debtor and the transferee." "Debt" includes any payment obligation. The settlement agreement only restructures an existing debt; it does not create or incur a debt. The court therefore must determine whether the original debt was incurred in the ordinary course with reference to the original product development agreement and the obligations it imposed on the debtor, not simply with reference to whether the settlement agreement was in the ordinary course. *Wood v. Stratos Prod. Dev., LLC (In re Ahaza Sys., Inc.)*, 482 F.3d 1118 (9th Cir. 2007).

2.2.dddd. Forbearance is not "new value." The debtor purchased software from a Microsoft reseller. Microsoft retained the right to revoke the software license if the debtor did not complete its installment payments to the reseller. The debtor fell behind in payments but eventually made them up, shortly before bankruptcy. The reseller's failure to notify Microsoft of the payment defaults and the resulting forbearance did not provide new value, that is, the debtor's ability to continue to use the software despite the payment defaults was not new value. First, its was Microsoft, not the reseller, who had the authority to revoke the license; the reseller therefore did not provide new value by not exercising a right it did not have. Second, the sale agreement differs from lease or a license, which requires periodic payments to retain the underlying asset. In that case, the asset retention without payment might provide the debtor with new value. Here, the sale was completed, and the debtor's payment obligation was not in exchange for on-going use of the license. *In re ABC-NACO, Inc.*, 483 F.3d 470 (7th Cir. 2007).

2.2.eeee. Satisfaction of an existing contractual obligation does not provide "new value." The debtor contracted to purchase manufacturing equipment. It agreed to make 10 payments for the equipment over the course of a year, the last of which was due after installation and operation. After the debtor made the ninth payment, the supplier started machine delivery and would have completed delivery had the debtor not instructed it to stop because of financial troubles. Within 90 days after the ninth payment, the debtor filed bankruptcy. The supplier did not provide "new value" to the debtor before the bankruptcy so as to have a valid defense to the trustee's preference claim. Under section 547(a)(2), "new value" does not include "an obligation substituted for an existing obligation." Because the supplier was contractually obligated to deliver the machine under a single unified contract, the value it provided was not new—it was an existing obligation. "The fact that the parties structured both payment and delivery obligations under the contract to extend over a period of time does not transform each payment, or each delivery of goods, into an independent transaction," unlike delivery under an installment contract. *Gouveia v. RDI Group (In re GlobeBldg. Materials, Inc.)*, 484 F.3d 946 (7th Cir. 2007).

2.2.ffff. Superior bargaining position does not make a counterparty an insider. The debtor's supplier loaned it money under an agreement that required half of the loan proceeds to be used to purchase the

supplier's product, in part to cross-promote the debtor's and supplier's goods and services. The debtor misused the note proceeds. When the supplier found out, it called a default, which it promptly withdrew at the debtor's request pending further negotiations, so that the debtor would not have to make public disclosure of the default. The negotiations resulted in the debtor's making a settlement payment to the supplier. The debtor filed bankruptcy more than 90 days later. The supplier was not a "non-statutory" insider. The strategic relationship between the debtor and the supplier was strictly to enhance both companies' businesses and did not give the supplier too close a relationship with the debtor or control over the debtor's business. The withdrawal of the default notice was not evidence to the contrary. The supplier's ability to apply financial pressure and its superior bargaining power did not make it an insider. *MCA Fin. Group, Ltd. v. Hewlett-Packard (In re Fourthstage Techs., Inc.)*, 355 B.R. 155 (Bankr. D. Ariz. 2006).

2.2.gggg. First cousin once removed is a "relative." "Insider" includes "relative" if the debtor is an individual. Under section 101(45), "relative" means "individual related by affinity or consanguinity within the third degree as determined by the common law." Canon law measures degrees by counting steps to the individuals from the common ancestor. Civil law measures steps by counting up from one individual to the common ancestor and then back down to the other. The common law determines degrees under the canon law method. Moreover, using the common law method is more consistent with preference law principles, which require particular scrutiny of transfers to insiders who may have unfair influence over the debtor. A relationship as close as cousin (second degree under canon law but fourth degree under civil law) is likely to influence a debtor unfairly as compared to other creditors. Therefore, a first cousin once removed is related in the third, not the fifth, degree. The cousin's wife is related in the same degree, because the "relative" definition includes "affinity," which describes a marital relationship the same as a blood relationship. *O'Neal v. Arnold (In re Gray)*, 355 B.R. 777 (Bankr. W.D. Mo. 2006).

2.2.hhhh. "Insider" may include a person who is not a *per se* insider. The debtor's director's son was the sole member of an LLC that provided the debtor professional services. The director and his son were *per se* insiders, under the "insider" definition for a corporation in section 101(31)(B): "(i) director of the debtor … or (vi) relative of a … director." The LLC was not a *per se* insider. However, beyond the Code's definition, which uses the non-exclusive word "includes," "insider" status may be based on a sufficiently close business or personal relationship to permit the person to gain an advantage based solely on affinity. The relationship here qualifies under the broader, nonstatutory concept. *In re Fortune Nat. Res. Corp.*, 350 B.R. 693 (Bankr. E.D. La. 2006).

2.2.iiii. BAPCPA gives "ordinary business terms" preference defense new meaning. Before BAPCPA, a creditor could defeat a preference claim under section 547(c)(2) by showing that the transfer was both "made in the ordinary course of business of the debtor and the transferee" *and* "made according to ordinary business terms." Under BAPCPA, the creditor may defeat a preference by showing either one. Changing the conjunctive to a disjunctive effectively changed the meaning of the phrases. Previously, "ordinary business terms" provided an objective test, based on the practice in the creditor's industry, while "ordinary course of business" required a subjective analysis, based on the practice between the debtor and the creditor. The former test prevented a creditor from relying on a payment pattern with a debtor that would not be so unusual as to be outside industry norms, but the "ordinary course of business" test was the more important, if the debtor and the creditor had a significant history of dealing. If not, the "business terms" test became more important on a sliding scale to the extent the parties' dealings provided less of a guide. By separating the tests, they take on equal importance, requiring the creditor to make a thorough evidentiary showing, not merely conclusory allegations at a high level of generality, about the practice in the creditor's industry, to sustain this defense. In this case, the debtor paid the bank's notes, which were guaranteed by the principal, shortly before the notes' due dates. The bank had not pressed for payment and was willing to extend the notes' maturity. Because the payments were near year-end, the bank believed the debtor's explanation that the notes were being paid in full as part of year-end personal financial planning. In fact, the debtor was winding down its business and paying off guaranteed debt. The payments were not according to ordinary business terms, as there was no evidence that such conduct is consistent with sound business practice or continuation of a business and therefore is not the kind of transfer that new section 547(c)(2)(B) is designed to protect. *Hutson v. Branch Banking & Trust Co. (In re Nat'l Gas Distribs., LLC)*, 346 B.R. 394 (Bankr. E.D.N.C. 2006).

2.2.jjjj. Payments to a health insurance administrator may be avoidable preferences. The debtor provided a health insurance plan to its employees, which was funded in part by employee withholding and in part by employer contributions. An administrator administered the plan for the debtor, for which it charged a fee. It paid employee health care claims and then requested reimbursement from the debtor for the amounts paid. To the extent that a payment within 90 days before bankruptcy was made from funds withheld from employees, it is not avoidable as a preference, because the funds are trust funds from the moment they are withheld from an employee's compensation and are never property of the debtor. The portion of the payment from the employer's contribution is, however, from property of the debtor and may therefore be recoverable. The administrator is not a mere conduit of the payments to employees, because the payments reimbursed the administrator for payments that it had already made to employees, making it a creditor of the debtor. *Golden v. Guardian (In re Lenox Healthcare, Inc.)*, 343 B.R. 96 (Bankr. D. Del. 2006).

2.2.kkkk. Debtor's obligation to pay for fuel was an antecedent debt. The debtor ordered fuel through its affiliate, which had good credit, and agreed to pay the affiliate the cost of the fuel and the applicable taxes by wire transfer before the fuel supplier debited the affiliate's account for the charges. In fact, the debtor paid late. The payments to the affiliate were on account of an antecedent debt. Even though the debtor was supposed to pay before the affiliate was required to pay the supplier, the affiliate extended credit to the debtor, because the debtor became obligated to pay the affiliate for the fuel from the moment the debtor obtained the fuel from the supplier. *Callahan v. Petro Stopping Center #72 (In re Lambert Oil Co.)*, 347 B.R. 173 (W.D. Va. 2006).

2.2.llll. Trustee may not use state receiver's preference statute to avoid a preference. Wisconsin permits a receiver or assignee to recover a preference that a debtor made within four months before the filing of a receivership petition. The trustee in the debtor's subsequent bankruptcy tried to use this right as successor to creditors under section 544(b) to recover a preference that the debtor made more than 90 days before bankruptcy but within four months before the receivership. The trustee may not do so, because section 544(b) permits the trustee to invoke only the rights of a creditor holding an allowable unsecured claim. Under Wisconsin law, only a receiver or assignee, not an unsecured creditor, may recover the preference, and the trustee does not succeed to the rights of a receiver. *Dubis v. B.W. Supply (In re Delta Group)*, 336 B.R. 405 (E.D. Wis. 2004).

2.2.mmmm. Earmarking doctrine applies to a late-filed mortgage. The debtor refinanced her home shortly before bankruptcy. The new lender paid the loan proceeds to the old lender but did not record the new mortgage until over two weeks later. The old lender's mortgage was not released from the property until two weeks after that. The case was governed by the pre-BAPCPA version of section 547(e)(2), which gave a lender only a 10-day grace period to perfect. Under these circumstances, where it was clear that the new loan was intended to repay the old loan, and the property records never showed the property as unencumbered, the transactions are treated as an integrated whole, and the delay in perfection, which would ordinarily constitute a transfer on account of an antecedent debt, did not result in a preference, because the three elements of the earmarking doctrine were present: the debtor agreed that the new funds would pay the old creditor, the agreement was performed, and the transaction did not diminish the estate. *Collins v. Greater Atl. Mortgage Corp. (In re Lazarus)*, 334 B.R. 542 (Bankr. D. Mass. 2005).

2.2.nnnn. A director emeritus is not necessarily an insider. The debtor resigned as a director of the bank in 1990 and after his resignation attended board meetings only occasionally. He did not vote at the meetings. He received the title "director emeritus," $400 monthly compensation, and a listing in the bank's annual report. The debtor paid the bank a substantial amount on an unsecured loan between 90 days and one year before he filed bankruptcy in 2001. The trustee sued the bank for recovery of the payments as avoidable preferences, on the ground that the bank was an insider at the time of the transfers. The debtor's status as director emeritus did not necessarily make the bank an insider. It was a question of fact, relating to the amount of control that the director exercised over the bank at the time of payment, that was not appropriate for summary judgment in favor of the trustee. *Rupp v. United Sec. Bank (In re Kunz)*, 335 B.R. 170 (B.A.P. 10th Cir. 2005).

2.2.oooo. Subsequent new value defense is not cumulative with ordinary course of business defense. The creditor defended against preference litigation on the grounds that the payments were in

the ordinary course of business and were protected by subsequent new value advances. The court rejects the ordinary course defense and upholds the subsequent new value defense, in part. It notes, however, that if the ordinary course defense were successful, the defenses would not be cumulative. That is, a payment protected by the ordinary course defense would vitiate a subsequent advance defense as applied to a prior payment, because the subsequent advance defense applies only if "the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." A payment protected by the ordinary course defense is "otherwise unavoidable." However, if the debtor, after it receives a subsequent advance that offsets a prior preference, returns the goods because they were damaged or out of date, the return does not diminish the subsequent new value defense, because the goods were worthless. The court does not address whether the creditor should receive subsequent new value credit for worthless goods. *G.H. Leidenheimer Baking Co. v. Sharp (In re SGSM Acq. Co.)*, 439 F.3d 233 (5th Cir. 2006).

2.2.pppp. Payments for purchase of natural gas are forward contract settlement payments. The debtor produced plastic resins. It purchased large quantities of natural gas as a raw material for the production process under a long-term contract from a gas supplier. The liquidating trustee under the chapter 11 plan sued the supplier for recovery of a preference. The contract was a "forward contract," because it provided for the sale of natural gas, which is a "commodity," as defined under the Commodity Exchange Act, for delivery more than two days in the future. Although the long-term nature of the contract had a hedge quality to it, it is not relevant to the forward contract determination that the debtor entered into the contract to purchase a commodity for use in its business, rather than as a financial hedge or transaction. A contract for the ordinary purchase and sale of goods used in a debtor's business still qualifies as a commodity contract. The legislative history confirms that Congress intended the definition to be extremely broad to provide maximum protection to forward contract merchants. The supplier was a "forward contract merchant," because its business consisted largely of entering into contracts to supply natural gas. Finally, the prepetition payment was a settlement payment, because, like the definition of "commodity contract," that definition is intended to be broad. It includes all kinds of payments in wide use in the forward contract markets. *BCP Liquidating LLC v. Bridgeline Gas Mktg. LLC (In re Borden Chems. and Plastics Operating Ltd. P'ship)*, 336 B.R. 214 (Bankr. D. Del. 2006).

2.2.qqqq. Preference to foreign creditor is recoverable. The debtor contracted with a Taiwan company to import goods manufactured in China. The Taiwan company ordered the goods and arranged for their shipment to the United States, including completing all customs forms. Title did not pass to the debtor until the debtor inspected the goods on delivery in the United States. The debtor wire transferred payment for the goods to the Taiwan company from a U.S. bank to a Taiwan bank within 90 days before bankruptcy. The payment was a preference to which section 547 applied. Whether or not section 547 has extraterritorial reach, this transfer occurred in the United States. The goods were ordered from and delivered in the United States, and title passed in the United States. The location of the creditor, who sought business in the United States, and of the receiving bank did not affect the result. In addition, comity does not require deference to the laws of Taiwan, which does not provide for avoidance of preferences. Comity becomes important in this context only where there are bankruptcy proceedings in both jurisdictions, which there are not. *Florsheim Group Inc. v. USAsia Int'l. Corp. (In re Florsheim Group Inc.)*, 336 B.R. 126 (Bankr. E.D. Ill. 2005).

2.2.rrrr. BAPCPA's fix to the *DePrizio* repeal applies retroactively to pending actions. The creditors committee had brought an action to recover as a preference a mortgage that the debtor had granted more than 90 days before bankruptcy to a bank that had a guarantee from an insider. Under *In re DePrizio*, 874 F.2d 1186 (7th Cir. 1989), the mortgage grant was avoidable and recoverable as to the bank, because the 1994 amendment to section 550 to overrule *DePrizio* did not overrule it as to the granting of a preferential lien. However, BAPCPA fixed that oversight and applied the fix to pending cases. Such application to pending cases is constitutional. A plaintiff does not have a property right for purposes of the Fifth Amendment Takings Clause in pending litigation that has not been reduced to judgment. Similarly, the committee does not have a property interest in the unencumbered real property, because the avoiding powers do not grant such an interest until after judgment, and the mortgage cannot be said to have an implied clause incorporating preference law, such that the committee or the estate had a vested property interest despite the mortgage. Finally, retroactive application does not violate due process, because Congress had a rational

purpose in applying the amendment to pending litigation. *Official Comm. of Unsecured Creditors v. Bank of America, N.A. (In re ABC-NACO, Inc.)*, 331 B.R. 773 (Bankr. N.D. Ill. 2005).

2.2.ssss. Settlement of lease dispute is not payment of an antecedent debt. The debtor offered to buy out a tenant's lease. When it could not reach agreement, it claimed the tenant was in breach, sent a termination letter, and brought eviction proceedings. The debtor and the tenant ultimately settled, the tenant vacated, and the debtor paid the settlement amount within 90 days before bankruptcy. The trustee sued to recover the payment as a preference. The court should look behind the settlement to determine the nature of the claim and the payment. On that basis, there was no preference. The debtor's termination letter did not constitute an anticipatory breach, which would have given rise to a claim against the debtor. Therefore, the debtor's payment was not on account of an antecedent debt. In addition, under state law, the tenant had an interest in real property, which the debtor purchased with the settlement payment. *Peltz v. Vancil, Inc. (In re Bridge Info. Sys., Inc.)*, 327 B.R. 382 (Bankr. 8th Cir. 2005); *aff'd*, *Peltz v. Edw. C. Vancil, Inc. (In re Bridge Info. Sys., Inc.)*, 474 F.3d 1063 (8th Cir. 2007).

2.2.tttt. "Greater percentage test" does not require tracing of security interest proceeds. The creditor provided floor plan financing for the car dealership debtor. The debtor had repaid some of the amounts owing in the 90 days before bankruptcy. The trustee sued to recover a preference. The creditor argued that the trustee did not meet the greater percentage test because the payments were car proceeds. The trustee argued that the creditor had to trace the proceeds of car sales to the payments to the creditor to establish a valid security interest in the proceeds and show that it would have received as much in a chapter 7 case as if the payments had not been made. The Fourth Circuit rules that tracing is irrelevant, because UCC § 9-306(4) provides the rules for determining the extent of a perfected security interest in proceeds "in the event of insolvency proceedings instituted by or against a debtor." It provides that the secured party has a perfected security interest in identifiable proceeds and in non-identifiable cash proceeds received by the debtor within the 10-day period before the insolvency proceeding, less any payments to the secured party during that period. The court remands for a determination under this standard. *Hall v. Chrysler Credit Corp. (In re JKJ Chevrolet, Inc.)*, 412 F.3d 545 (4th Cir. 2005).

2.2.uuuu. Trustee avoids involuntary gap payment as a preference in a subsequent bankruptcy. Three creditors filed an involuntary petition against the debtor. The debtor paid off the creditors, and the court dismissed the case. Within 90 days, the debtor filed a voluntary bankruptcy. The trustee sued one of the creditors for recovery of a preference. The court carefully describes the similarities and differences between "antecedent debt" and "contemporaneous exchange for new value" analyses. Although a particular transfer may be one, both, or neither, in this case, the transfer was only on account of an antecedent debt. Even though it obtained the dismissal of the involuntary case, the debt existed before the payment, and the payment was in satisfaction of that obligation. The dismissal did not provide new value, because "new value" is "money or money's worth, in goods, services, or release by a transferee of property previously transferred to such transferee" and must be "given to the debtor" to qualify for the preference exception in section 547(c)(1). Although the dismissal provided value to the debtor, it was only a secondary or tertiary benefit, not a part of a contemporaneous exchange that the statute requires. In addition, the creditor argued that the payment satisfied a statutory lien and therefore met the exception in section 547(c)(6). However, section 547(c)(6) applies only to the fixing of a statutory lien, not the satisfaction, which must be tested under the greater percentage test of section 547(b)(5). Here, the creditor's lien was not perfected and so did not qualify. *Baker Hughes Oilfield Operations, Inc. v. Cage (In re Ramba, Inc.)*, 416 F.3d 394 (5th Cir. 2005).

2.2.vvvv. Estate representative may not rescind contract assumption to pursue preference action. The plan transferred avoiding power claims to an estate representative, who sued the debtor's health insurer for recovery of prepetition payments. When the insurer defended on the ground that the insurance contract had been assumed under the plan, thereby immunizing the prepetition payment from preference attack, the representative moved under Rule 60(b)(6) to vacate the order approving assumption. Because the representative succeeded to the estate's right, it was bound by the estate's action in assuming the contract and was estopped by its predecessor-in-interest's action in assuming the contract. In addition, Rule 60(b)(6) permits relief only in extraordinary circumstances or extreme and undue hardship. The possibility of reduced recovery to unsecured creditors is not such a circumstance.

Unsecured Claims Estate Representative v. Cigna Healthcare, Inc. (In re Teligent, Inc.), 326 B.R. 219 (S.D.N.Y. 2005).

2.2.wwww. Manufacture of specialty goods does not constitute "new value." The debtor provided purchase orders to the supplier for the manufacture of specialty goods that were unique to the debtor. The supplier manufactured the goods but did not ship them to the debtor before bankruptcy. It claimed that the manufacturing, at the debtor's order, constituted "new value" that could be offset under section 547(c)(4) against potential preference liability. The court rules that "new value" requires that the debtor receive something of direct material benefit or that the creditor in some fashion "replenish the estate" for the preference received. *Moltech Power Sys., Inc. v. Truelove & Maclean, Inc. (In re Moltech Power Sys., Inc.)*, 326 B.R. 179 (Bankr. N.D. Fla. 2005).

2.2.xxxx. "New value" exception requires "otherwise unavoidable transfer," not payment. The debtor made payments to the creditor during the preference period, but the creditor sold new product after the payments, for which it was not paid, and claimed the "new value" defense in response to the trustee's preference action. The new value defense does not requires that the creditor not have been paid for the new value. It requires that the creditor gave new value "on account of which new value the debtor did not make any otherwise unavoidable transfer to or for the benefit of such creditor." The issue is therefore not whether there was a payment, but whether it is "otherwise unavoidable." It does not become so simply because the trustee allows the statute of limitations in section 546(c) to lapse. *Hall v. Chrysler Credit Corp. (In re JKJ Chevrolet, Inc.)*, 412 F.3d 545 (4th Cir. 2005).

2.2.yyyy. Payments on illegal securities contracts are not "settlement payments." The debtor ran a Ponzi scheme. The investment interests were issued in violation of the securities laws. Shortly before bankruptcy, one of the investors withdrew a significant portion of his investment. The investor defended against the trustee's preference action by arguing that the payment was a "settlement payment." The Bankruptcy Appellate Panel concludes the payment does not meet the definition of "settlement payment." The definition lists various kinds of settlement payments and concludes, "or any other similar payment commonly used in the securities trade." That phrase defines the scope of the definition. Payments on illegal securities are not commonly used in the securities trade. Congress enacted the Bankruptcy Code's settlement payments provisions to protect the proper functioning of the securities markets, to assure their integrity, and to enhance enforcement of the securities laws. Recognizing payments on illegal securities as settlement payments would undermine that purpose. The payment here was not made on a public market and did not involve the process of clearing trades. Therefore, the payments are not protected. *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527 (B.A.P. 9th Cir. 2005).

2.2.zzzz. Financial contract safe harbor does not protect illegal transaction. The debtor had entered into a contract in the form of a swap, on an ISDA form, to purchase its own shares at a fixed price at a future date. The contract could be settled in cash or in kind. The debtor was insolvent at the time. The transaction was illegal under Oregon law, which prohibits a corporation from purchasing its own shares while insolvent, and makes the directors liable to the corporation for the amount paid. The debtor filed bankruptcy within a year after the purchase, and the trustee sought recovery as a fraudulent transfer or illegal dividend of the payment to the counterparty, who moved to dismiss on the ground that the payment was protected by the settlement payment provision in section 546(e) and the financial contract safe harbor in section 546(g). Although those sections are designed to protect settlement payments and swaps to ensure the smooth functioning of the financial markets, they do not protect an illegal transaction. Protecting such a transaction does not protect the financial markets; it does just the opposite. The payment was therefore not a "settlement payment," and the defendant's motion to dismiss is denied. *Enron Corp. v. Bear, Stearns Int'l, Ltd. (In re Enron Corp.)*, 323 B.R. 857 (Bankr. S.D.N.Y. 2005).

2.2.aaaaa. Bankruptcy Code preempts preference provision in state assignment for the benefit of creditors statute. The debtor made an assignment for the benefit of creditors. Applicable law gave the assignee the power to avoid pre-assignment preferences under standards very similar to those set forth in section 547. The federal bankruptcy law is pervasive and so dominant as to preclude enforcement of state laws on the same subject, except in those areas in which the Bankruptcy Code incorporates state law, such as in determining property rights, allowability of claims, or avoidability of certain transfers under

section 544(b) by a creditor holding an unsecured claim. The Bankruptcy Code embodies the two policies of fresh start and equitable distribution. The fresh start provision preempts state discharge laws; so do the equitable distribution provisions. Similarly, the Code preempts the state's attempt to foster equitable distribution by a preference statute. The federal system is so complete a system for the adjustment of debtors' and creditors' rights that use of the state law system creates improper intrusion into the use of the federal system. The same rule would not, however, prevent application of a state preference law under which a creditor (rather than an assignee) had the right to recover, because section 544(b) accommodates such claims. *Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198 (9th Cir. 2005).

2.2.bbbbb. Critical vendor order does not a provide preference defense. When the debtor in possession sued to recover a preference, the creditor defended on the ground that debtor in possession could not satisfy the greater percentage test of section 547(b)(5), because the creditor was a critical vendor who would have been paid under the court's first-day critical vendor order if it had not been paid on the eve of filing. However, because the critical vendor order gave the debtor in possession discretion to pay and did not require payments to certain vendors, the creditor was unable to show that it would have been paid under the order. Moreover, even though the creditor argued that its goods were critical to the debtor in possession's operation and it would not have shipped had it not been paid, the court cannot conclude that it would have granted the critical vendor order if the creditor's large unpaid balance had been included in the debtor in possession's request. *Zenith Indus. Corp. v. Longwood Elastomers, Inc. (In re Zenith Indus. Corp.)*, 319 B.R. 810 (Bankr. D. Del. 2005).

2.2.ccccc. Insider of a relative is not an insider. More than 90 days before bankruptcy, the debtor granted a security interest to a creditor that was a wholly owned professional corporation of the wife of an officer and director of the debtor. The professional corporation is not liable for the preference, because it is not an insider. "Insider" includes a relative of an officer or director (§ 101(31)(B)(vi)). It also includes an "insider of an affiliate as if such affiliate were the debtor" (§ 101(31)(E)). But it does not specifically include an insider of a relative of an insider. The professional corporation is an insider of the relative, not an insider of an affiliate. Therefore, the trustee could not avoid the security interest. *Miller Ave. Prof'l and Promo'l Servs., Inc. v. Brady (In re Enterprise Acquisition Partners, Inc.)*, 319 B.R. 626 (B.A.P. 9th Cir. 2004).

2.2.ddddd. Attorney's fee payment as part of settlement is subject to preference recovery. Before bankruptcy, the debtor settled an action under the ADA. The settlement required the debtor to make physical modifications to its properties and to pay the plaintiff's attorney's fees. The obligation to pay fees became fixed only when the court approved the settlement agreement. After bankruptcy, the debtor in possession sued the attorney for recovery of the fees as a preference. The definitions of "claim," "debt," and "creditor" in section 101 apply to determine when a claim becomes an "antecedent debt" and whether the holder is a "creditor." The claim for fees arose when the claim was asserted under the ADA, even though the claim was contingent and disputed and did not become fixed until settlement. Therefore, the fee payment was on account of an antecedent debt, and the holder of the claim was a creditor. *Phoenix Restaurant Group, Inc. v. Fuller, Fuller & Assocs., P.A. (In re Phoenix Restaurant Group, Inc.)*, 316 B.R. 671 (Bankr. M.D. Tenn. 2004).

2.2.eeeee. Payment under a single transaction with a vendor may qualify for ordinary course exception to preference. The debtor ordered a capital asset from a vendor with whom it had not previously done business. The vendor installed the asset and invoiced the debtor on 20-day terms. The debtor refused to pay because of defective installation. The vendor adjusted the installation, and the debtor paid 6 days later. The payment qualifies for the ordinary course of business exception to preference recovery. In a case of first impression, the court rules that the parties need not previously establish a course of business to qualify. Here, the invoice was paid promptly after installation was properly completed. Even though it was paid substantially after the original invoice date, that is not the controlling date when other factors dictate otherwise, as the improper installation did here. *USOP Liquidating LLC v. Service Supply, Ltd., Inc. (In re US Office Products Co.)*, 315 B.R. 37 (Bankr. D. Del. 2004).

2.2.fffff. Valueless returned goods do not diminish new value defense. In the 90 days before bankruptcy, the debtor made numerous payments to the supplier, but the supplier also shipped a substantial amount of product to the debtor, some of which went stale before the debtor sold it. The

debtor returned the stale product to the supplier and received credit for the original invoice amount of the returned product. The supplier asserted that the value of the product shipped should give rise to a new value defense to preference recovery. The trustee asserted that the invoice price of the returned goods should be deducted from the amount allowable as new value, because the debtor did not retain the goods or their value. The court rules that the supplier is entitled to the defense, because the return of valueless goods to the supplier did not constitute an otherwise avoidable transfer that would take the goods out of the new value defense available to the supplier. *Gonzales v. Nabisco (In re Furr's Supermarkets, Inc.)*, 317 B.R. 423 (B.A.P. 10th Cir. 2004).

2.2.ggggg. Debtor's issuance of convertible debt may constitute a transfer. After the creditor received repayment of a $20 million loan, the creditor loaned the debtor $30 million on a convertible subordinated note. The trustee sought recovery of the $20 million payment; the creditor defended under section 547(c)(4), arguing that the $30 million loan constituted subsequent new value for which "the debtor did not make an otherwise unavoidable transfer." The issuance of a note would not be a transfer, but the convertibility feature, constituting a call option on the debtor's stock, was a transfer of something of value from the debtor to the creditor. The court focuses on "whether the transactions in question have in some way negatively impacted the debtor's financial condition." Because the debtor could have sold the call option and because the presence of the call option diluted the debtor's ability to raise capital through the issuance of equity, the grant of the call option was a potentially avoidable transfer that diminished the creditor's subsequent new value defense. *Peltz v. Welsh, Carson, Anderson & Stowe VII, L.P. (In re Bridge Info. Sys., Inc.)*, 311 B.R. 781 (Bankr. E.D. Mo. 2004).

2.2.hhhhh. Payment of assigned lease proceeds is not a preference. The debtor agreed to sell three leases. The buyer gave the debtor a license to use the leased premises after the sale for two months to liquidate its inventory, and the buyer held the sale proceeds until the debtor vacated. The debtor granted a security interest in the lease proceeds to its lender. The lender perfected its lien under the U.C.C., but not under the real property recording statutes. The sale closed more than 90 days before the debtor's bankruptcy petition, but the debtor vacated the premises and the lender received the sale proceeds less than 90 days before the petition date. The lender did not receive a preference, because it received a perfected security interest in the proceeds, which is all that the debtor owned once the sale had closed, more than 90 days before bankruptcy. The debtor no longer owned the leases themselves, so it did not matter that the lender had not perfected under the real property recording laws. *Biase v. Congress Fin. Corp. (In re Tops Appliance City, Inc.)*, 372 F.3d 510 (3d Cir. 2004).

2.2.iiiii. Permissive critical vendor order does not insulate against preference recovery. A critical vendor order that permits but does not require the debtor in possession to pay prepetition claims of critical vendors does not prevent the recovery from the vendor of prepetition payments as preferences. The preferences were made before the critical vendor order and were not litigated at the time of the order, so the order does not by itself protect them. In addition, because the order was not mandatory, it was not a determination that all payments for prepetition balances should be protected. *HLI Creditor Trust v. Export Corp. (In re Hayes Lemmerz Int'l, Inc.)*, 313 B.R. 189 (Bankr. D. Del. 2004). *Contra Official Comm. v. Medical Mut. (In re Primary Health Sys., Inc.)*, 275 B.R 709 (Bankr. D. Del. 2002), *aff'd*, C.A. No. 02-301 (D. Del. Feb. 27, 2003).

2.2.jjjjj. Subsequent new value rule does not require unpaid advances. The subsequent advance (or new value) preference defense of section 547(c)(4) requires that for any qualifying subsequent advance, "the debtor did not make an otherwise unavoidable transfer to or for the benefit of the creditor." This language does not require that the subsequent new advance be unpaid to qualify. Any unavoidable transfer will render the defense unavailable; conversely, unpaid advances or advances for which the debtor made avoidable transfers qualify for the defense. The district court remands for determination of whether the subsequent repayments, including some postpetition payments, disqualify subsequent advances as an affirmative defense. *Chrysler Credit Corp. v. Hall*, 312 B.R. 796 (E.D. Va. 2004).

2.2.kkkkk. Trustee has burden of proof on tracing commingled collateral proceeds. The debtor commingled the lender's collateral proceeds with its general funds and made several payments to the lender within 90 days before bankruptcy. At all times, the creditor was undersecured. The trustee sought

preference recovery. The lender argued that the trustee did not satisfy the greater percentage test of section 547(b)(5), because the payments came from the lender's collateral. The court could not determine whether they did without tracing. Section 9-315 of the U.C.C. requires a secured creditor to trace its collateral into commingled accounts to show priority of its security interest in proceeds. But in a preference action, section 547(g) places the burden on the trustee to prove all elements of the preference. So the burden was on the trustee to trace to show that the lender was not paid from proceeds of its collateral. *Chrysler Credit Corp. v. Hall*, 312 B.R. 796 (E.D. Va. 2004).

2.2.lllll. Ohio preference statute does not apply to payments. Only four states have general preference statutes, Ohio, Kentucky, Maryland, and New Mexico. Ohio's statute, enacted in 1898, permits a receiver to recover a preferential "sale, conveyance, transfer, mortgage, or assignment." The Ohio Supreme Court construed the statute in 1903 to exclude payments from its reach. Nevertheless, the debtor in possession sued to recover a payment as a preference under this statute. Rejecting the argument that the bankruptcy court is not bound to follow a 100-year-old decision, the court dismisses the debtor in possession's complaint. *Roberds, Inc. v. Broyhill Furniture (In re Roberds, Inc.)*, 313 B.R. 732 (Bankr. S.D. Ohio 2004).

2.2.mmmmm. Property that debtor received as an agent is not "property of the debtor" for preferences. The debtor was a purchasing cooperative, which acted as an agent for each of its members to make bulk purchases for the members. At the end of each year, the suppliers issued a rebate check to the debtor for distribution to the members, based on the amount of their purchases. The debtor placed the refund check in a special bank account and promptly distributed the amounts owing to each of its members. Because of the agency relationship, the debtor held the property in a resulting trust and held only legal title, not any beneficial interest. As such, the funds were not the property of the debtor for purposes of determining whether their payment to the members within 90 days before bankruptcy was a preference. *Weiner v. A.G. Minzer Supply Corp. (In re UDI Corp.)*, 301 B.R. 104 (Bankr. D. Mass. 2003).

2.2.nnnnn. Lender who exercises control may be an insider. Where a secured lender had sufficient influence to cause the placement of a new chief financial officer from a turnaround management firm and initiate an acquisition transaction that would provide the lender with additional collateral, the lender may have sufficient control to qualify as a "person in control," as used in the definition of "insider" in section 101(31)(B)(iii). *Official Committee of Unsecured Creditors v. Credit Suisse First Boston (In re Exide Technologies, Inc.)*, 299 B.R. 732 (Bankr. D. Del. 2003).

2.2.ooooo. Claim settlement does not preclude subsequent preference recovery. In the early days of this chapter 11 case, the debtor entered into a settlement agreement with a creditor over the allowable amount of the creditor's claims, in order to facilitate a sale of the debtor's assets. Later in the case, the debtor sued the creditor to recover a preference. The creditor argued that the claims settlement barred preference recovery, because section 502(d) precludes claims allowance until a creditor has returned a preference. So allowance of the claims constituted a determination that the creditor had not received a preference. The bankruptcy court rejects this argument. It holds that section 502(d) is available *after* the claims allowance process "to coerce creditors to comply with judicial orders." *Rhythms NetConnections Inc. v. Cisco Systems Inc. (In re Rhythms NetConnections Inc.)*, 300 B.R. 404 (Bankr. S.D.N.Y. 2003).

2.2.ppppp. Contract assumption bars preference recovery. Once the debtor in possession assumes an executory contract, the subsequent chapter 7 trustee may not recover as a preference any payments made before bankruptcy. The payments do not meet the "greater percentage" test of section 547(b)(5), because the assumption of the contract means that the preference defendant was no longer an unsecured creditor. *Kimmelman v. Port Authority of New York and New Jersey (In re Kiwi Int'l Airlines, Inc.)*, 344 F.3d 311 (3d Cir. 2003).

2.2.qqqqq. Provisional check credit is not an extension of credit for preference purposes. When a drawer's check is presented to a bank, the bank has until midnight of the next day (the midnight deadline) to determine whether to honor the check. The bank may contact the drawer to advise the drawer that it needs to deposit additional funds to cover the check, failing which the bank may dishonor. In this case, the depositor deposited the additional funds before the midnight deadline, so the bank did not dishonor

the check for insufficient funds. This process did not involve the extension of credit by the bank to the drawer, because the bank had advanced no funds of its own and was not liable for payment of the check until the midnight deadline. *Jacobs v. State Bank of Long Island (In re Apponline.com, Inc.)*, 296 B.R. 602 (Bankr. E.D.N.Y. 2003).

2.2.rrrrr. Potential preference defendant is not entitled to a declaratory judgment. The Declaratory Judgment Act, 28 U.S.C. §§ 2201-2202, was intended to provide a potential defendant with a forum to resolve a potential dispute that could affect the defendant's conduct. It was not intended to permit a potential defendant to force a determination of liability for past conduct. Accordingly, the bankruptcy court dismisses a declaratory judgment action by recipients of potentially avoidable transfers for a determination of the avoidability of the transfers. *Allen v. Official Employment-Related Issues Committee (In re Enron Corp.)*, 297 B.R. 382 (Bankr. S.D.N.Y. 2003).

2.2.sssss. *In re Shared Technologies Cellular, Inc.*, 281 B.R. 804 (Bankr. D. Conn. 2002) (February 2003, paragraph 2.2.c), affirmed by 293 B.R. 89 (D. Conn. 2003).

2.2.ttttt. Stolen funds, paid through escrow, are recoverable as a preference. The debtor ran a Ponzi scheme. Two investors deposited funds in escrow for the debtor, which the debtor improperly withdrew. The debtor defrauded another investor and used the other investor's funds to replenish the escrow, which was then repaid to the initial investor. The trustee sought recovery of the funds from the initial investor of the funds as a preference. The court rules the funds recoverable. Even though the debtor obtained the funds through fraud, they were property of the debtor under Utah law and under the Bankruptcy Code, because they would have become property of the estate had the bankruptcy been filed while the debtor still held the funds. Moreover, the creditor, not the escrow company, was the initial transferee, while the escrow company was a mere conduit. In the Tenth Circuit, to be an initial transferee, the transferee must actually receive the funds and have full dominion and control for its own account, as opposed to receiving the funds in trust or as agent. Mere physical control is not adequate; the transferee must have the right to use the funds for its own purpose. The escrow company here did not. *Bailey v. Big Sky Motors, Ltd. (In re Ogden)*, 314 F.3d 1190 (10th Cir. 2002).

2.2.uuuuu. Client of Qualified Like-kind Exchange Intermediary has preference liability for payments made to property seller. The debtor was a Qualified Intermediary for like-kind exchange transactions under section 1031 of the Internal Revenue Code. M&H used the debtor for a like-kind exchange under which M&H sold property and subsequently was to acquire raw land on which a facility was to be built. The debtor received the proceeds of the sale, commingled it with its other funds (as it was permitted to do), acquired the new land, and made payments to the builder of the new facility within 90 days before its bankruptcy. The trustee sought recovery of the payments from M&H as the entity for whose benefit the payments were made. The court determines that the property transferred was property of the debtor and the transfer was on account of an antecedent debt owed to M&H. The court also determines that the debtor did not receive new value in exchange for the transfers and that the transfer was not in the ordinary course of business of M&H and the debtor, because this was an unusual transaction for M&H. Accordingly, the court grants judgment to the trustee. On M&H's motion, however, the court requires the trustee to transfer the new property and facility to M&H. *Manty v. Miller & Holmes, Inc. (In re Nation-Wide Exchange Services)*, 291 B.R. 131 (Bankr. D. Minn. 2003).

2.2.vvvvv. Replacement of NSF check does not constitute new value. The debtor paid a subcontractor, who released its lien on the contractor's bond. The check bounced. The debtor replaced the check with a cashier's check a few days later. The bankruptcy appellate panel holds that because the subcontractor unconditionally released the lien on the bond before it received the cashier's check, the cashier's check was not a contemporaneous exchange for new value and that the preference defense of section 547(c)(1) did not apply. The B.A.P. also holds that, to the extent the construction bond is less than the remaining subcontractor claims against the debtor, a payment by the debtor in exchange for a release of a lien on the bond might not constitute a contemporaneous exchange for new value. *Janas v. Marco Crane and Rigging Co. (In re JWJ Contracting Co., Inc.)*, 287 B.R. 501 (9th Cir. B.A.P. 2002).

2.2.wwwww. Ordinary course defense of section 547(c)(2)(C) does not require compliance with industry averages. Adopting the reasoning of *In re Tolona Pizza*, 3 F.3d 1029 (7th Cir. 1993), the Ninth Circuit rules that a debtor's payments that are within the broad range of terms that encompass the practices employed by debtors and creditors, including those that are ordinary for those under financial distress is consistent with ordinary business term. The creditor need not prove that the payment occurred within the industry average time. *Ganis Credit Corp. v. Anderson (In re Jan Weilert R.V., Inc.)*, 315 F.3d 1192 (9th Cir. 2003).

2.2.xxxxx. Section 546(c) governs prepetition reclamation. The creditor had shipped goods to the debtor before bankruptcy, discovered that the debtor was insolvent, and demanded reclamation under U.C.C. section 2-702. The debtor returned the goods. After bankruptcy, the trustee sued the creditor for receiving a preference. The creditor claimed that because U.C.C. 2-702 permitted reclamation, there was no preference. The court holds under the terms of section 546(c), the creditor has a valid defense to preference recovery only if the creditor complies with section 546(c), even pre-petition. In this case, the reclamation demand was not in writing, so it did not comply with section 546(c). *Zeta Consumer Products Corp. v. Equistar Chemical, LP (In re Zeta Consumer Products Corp.)*, 291 B.R. 336 (Bankr. D.N.J. 2003).

2.2.yyyyy. Assumption of contract validates preference. The debtor had entered into a merger agreement before bankruptcy. The merger agreement provided for deferred payment of a portion of the purchase price. The deferred portion was paid before bankruptcy within the preference period. The confirmed plan provided that all contracts not rejected were assumed. Under this provision, the court holds that the merger agreement was assumed and that as a result, the creditor did not receive a greater percentage than it would have received in a chapter 7 liquidation. The court ruled that the greater percentage test is applied taking into account the effect of assumption, even though in a chapter 7 case, the contract would not have been assumed. *Philip Servs. Corp. v. Luntz (In re Philip Servs. (Delaware), Inc.)*, 284 B.R. 541 (Bankr. D. Del. 2002).

2.2.zzzzz. How to determine whether payments are "according to ordinary business terms." A creditor who has received a preference may defend on the ground that the payment was of a debt incurred in the ordinary course of business, made in the ordinary course of business between the debtor and creditor, and "made according to ordinary business terms." Section 547(c)(2)(C). Following the Seventh Circuit's decision in *In re Tolona Pizza Products Corp.*, 3 F.3d 1029 (7th Cir. 1993), the Fifth Circuit rules that subparagraph (C) expresses an objective standard for the relevant industry. It does not require compliance with specific business terms but only that the dealings between the parties not be so far out of line as to what others in the industry do, that it is not according to ordinary business terms. The Fifth Circuit requires the creditor to "provide evidence of credit arrangements of other debtors and creditors in a similar market, preferably both geographic and product." *Gulf City Seafoods, Inc. v. Ludwig Shrimp Co., Inc. (In re Gulf City Seafoods, Inc.)*, 296 F.3d 363 (5th Cir. 2002).

2.2.aaaaaa. Preference litigation in dueling bankruptcies. The liquidating trustee under the plan of debtor 1 objected to the creditor's claim and sued to recover a preference. Before the preference issue was decided, the creditor became debtor 2 in a different bankruptcy court. The liquidating trustee sought relief from the stay in debtor 2's case to pursue the preference action against debtor 2 in debtor 1's case. The debtor 2 court grants relief from the stay on the condition that debtor 1's liquidating trustee not use any preference determination as an objection to debtor 2's proof of claim in debtor 1's case under section 502(d), which requires disallowance of the claim of a transferee of an avoided transfer, unless the transferee "has paid the amount" for which it "is liable under section" 550. The court suggests (but does not hold) that the liquidating trustee's recovery in debtor 2's case of the preference at the dividend rate may satisfy section 502(d), on the theory that the debtor 2 estate is liable only for the percentage of the preference that is equal to the dividend percentage payable on unsecured claims. *Golden Associates, L.L.C. v. Shared Technologies Cellular, Inc. (In re Shared Technologies Cellular, Inc.)*, 281 B.R. 804 (Bankr. D. Conn. 2002).

2.2.bbbbbb. Allowance of claim bars preference recovery. After the trustee's objection to a creditor's claim had been sustained and the claim allowed for a lesser amount than filed, the trustee commenced a preference action against the creditor. The court rules that section 502(d) bars the trustee's claim for

recovery of a preference. Section 502(d) prohibits allowance unless the creditor has turned over any voidable transfers. Thus, allowance constitutes a determination that there are no avoidable transfers. *LaRoche Industries, Inc. v. General American Transportation Corp. (In re LaRoche Industries, Inc.)*, 284 B.R. 406 (Bankr. D. Del. 2002).

2.2.cccccc. Receipt of unreturned preference precludes allowance of administrative claim. Section 502(d) requires disallowance of any claim of an entity that received a voidable transfer who has not returned the transfer. The Ninth Circuit B.A.P. rules that this disallowance provision applies as well to administrative claims. Even though the provision is in section 502, which deals only with pre-petition claims, the provision uses the word "claim" which is not limited to pre-petition claim. The B.A.P. dismisses any argument that the ruling will discourage pre-petition creditors from providing post-petition goods or services to a debtor-in-possession, on the theory that the pre-petition creditor would be liable for the preference in any event, but does not discuss whether the preference liability and the administrative claim may be offset. *MicroAge, Inc. v. Viewsonic Corp. (In re MicroAge, Inc.)*, 284 B.R. 914 (9th Cir. B.A.P. 2002).

2.2.dddddd. Casino markers create "antecedent debt." The debtor received casino chips in exchange for his marker, which acts like a check under the Uniform Commercial Code. However, the casino agreed not to deposit the marker against the debtor's bank account for a period of time, in this case, 30 days. As such, the marker was not a concurrent transaction in which the debtor exchanged a check for chips. Rather, it was a credit transaction, much like a post-dated check, in which the casino extended credit to the debtor. Accordingly, the marker created an antecedent debt, the satisfaction of which was a preference. It was also not a contemporaneous exchange that meets the exception of section 547(c)(1). *Harrah's Tunica Corp. v. Meeks (In re Armstrong)*, 291 F.3d 517 (8th Cir. 2002).

2.2.eeeeee. Gambling chips did not constitute "subsequent new value." The debtor paid off a gambling debt to a casino. About a month later, the casino made a new loan of gambling chips to the debtor. The gambling chips did not qualify for the subsequent new value exception of section 547(c)(4), because the chips provided the debtor only with entertainment, not with valuable currency that could be used outside the casino. The new chips did not replenish the estate, and the creditor should not be permitted to improve its position against other creditors by the advance of such intangible value. *Harrah's Tunica Corp. v. Meeks (In re Armstrong)*, 291 F.3d 517 (8th Cir. 2002).

2.2.ffffff. Ninth Circuit states preference rules for floating lien creditors. The creditor's claim was secured by a floating lien on inventory. The debtor paid the claim from its general funds each time an item of inventory was sold; the creditor paid inventory suppliers directly for additions to inventory. Within the 90 days before bankruptcy, the debtor paid the creditor $12 million. At the date of bankruptcy, the creditor liquidated its remaining collateral for slightly more than was owed at that date. The trustee did not prove that the creditor was undersecured at any time during the 90-day period, arguing that the $12 million in payments made during the preference period should be added back to the bankruptcy-date claim amount to apply the "greater amount" test of section 547(b)(5). The Ninth Circuit disagrees. It rules that unless the trustee proved that a floating lien secured creditor was undersecured at some point during the preference period, the payments were effectively presumed to come from the creditor's own collateral, negating the possibility of a preference. The court does not require the trustee to trace collateral proceeds, holding that the burden on the creditor to trace applies only in the context of a lien on proceeds under U.C.C. Section 9-315. A strong dissent argues that the elements that the majority requires the trustee to prove are actually elements of the creditor's defense under sections 547(c)(1) and (5). Both the majority and the dissent entirely miss the concept that the additions to inventory during the preference period constitute additional potentially preferential transfers. *Batland v. TransAmerica Comm. Fin. Corp. (In re Smith's Home Furnishings, Inc.)*, 265 F.3d 959 (9th Cir. 2001).

2.2.gggggg. Prepetition foreclosure on oversecured claim may constitute a preference. The creditor foreclosed on real property within 90 days before bankruptcy, bid in its claim, and acquired the property at the foreclosure sale. The creditor was substantially oversecured. Because the foreclosure enabled the creditor to receive "more" than it would have received in a chapter 7 liquidation, the foreclosure was subject to avoidance as a preference. *Andrews v. Norwest Bank Minnesota, N.A. (In re Andrews)*, 262 B.R. 299 (Bankr. M.D. Pa. 2001).

2.2.hhhhhh. Payment of an unperfected statutory lien is not an avoidable preference. Under section 547(c)(6), the trustee may not avoid a preference "that is the fixing of a statutory lien that is not avoidable under section 545." In this case, the debtor paid off the statutory lien in the time between when the lien attached and the lien creditor would have been required to perfect the lien. The trustee argued that the exception did not apply, because the lien had not been perfected. The bankruptcy court rules otherwise, following the decision of the district court in *Cimmaron Oil Co. v. Cameron Consultants, Inc.*, 71 B.R. 1005 (N.D. Tex. 1987), while explaining at length why the court disagrees with the decision it is bound to follow. *Rand Energy Co. v. Strata Directional Technology, Inc. (In re Rand Energy Co.)*, 259 B.R. 274 (Bankr. N.D. Tex. 2001).

2.2.iiiiii. Non-return of avoided preference does not require disallowance of administrative expense claim. The debtor in possession avoided preferences to a prepetition creditor who had also provided postpetition services. The debtor sought to disallow the creditor's administrative expense claim under section 502(d), which requires disallowance of a claim by an entity that has received and not returned a voidable transfer. The bankruptcy court rules that section 506(d) does not apply to the allowance or disallowance of administrative expense claims, which are creatures of the bankruptcy law that are unique and differ from prepetition claims dealt with by section 502. *Camelot Music, Inc. v. MHW Advertising and Public Relations, Inc. (In re CM Holdings, Inc.)*, 264 B.R. 141 (Bankr. D. Del. 2001).

2.2.jjjjjj. Rule 9006(a) does not apply to 90-day preference period. A transfer was made on a Friday, 91 days before the date of the filing of the petition. The trustee argued that, applying Bankruptcy Rule 9006(a), the 90-day period ended on a Saturday, so the counting should continue to the next [preceding] business day, the Friday on which the transfer was made. The Ninth Circuit rejected the argument, ruling that the 90-day rule of section 547(b)(4)(A) was not an "applicable statute" to which Rule 9006(a) applied, and that the 90-day period was substantive, not procedural. As a result, under the Rules Enabling Act, the rules could not extend the 90-day period. *MBNA America v. Locke (In re Greene)*, 223 F.3d 1064 (9th Cir. 2000).

2.2.kkkkkk. Late-perfected security interest may meet "substantially contemporaneous" preference exceptions. The debtor granted the creditor a security interest in exchange for a new loan. Because of a service bureau's error, the financing statement was not filed until 16 days after the date of the loan. The court agrees that the transfer, which occurred for purposes of section 547 upon the filing of the financing statement, was substantially contemporaneous with the creditor's giving of new value to the debtor. The court rejects the trustee's argument that the automatic 10-day relation back rule of section 547(e)(2)(A) should be read into the substantially contemporaneous requirement of section 547(c)(1). *Lindquist v. Dorholt (In re Dorholt, Inc.)*, 224 F.3d 871 (8th Cir. 2000).

2.2.llllll. Earmarking doctrine expanded. At the debtor's request, the bank advanced funds to the debtor specifically to pay a particular creditor. The Ninth Circuit finds all of the elements of the earmarking defense present. Although the debtor had the power to break its agreement with the bank and use the money for other purposes, it did not have the right to do so, and it actually complied with the agreement in this case. Moreover, it did not matter that the debtor requested the loan for the specific purpose of paying off the creditor rather than the bank proposing the loan for the benefit of the creditor. *Adams v. Anderson (In re Superior Stamp & Coin Co., Inc.)*, 223 F.3d 1004 (9th Cir. 2000).

2.2.mmmmmm. State court determination of mortgage validity does not bind the trustee. In a foreclosure proceeding, the state court had determined that a mortgage was valid as between the mortgagee and the debtor, but not as to third parties. In his action to set aside the foreclosure as a preference, the trustee was not bound by the state court's ruling, because the trustee, acting on behalf of creditors, was not in privity with the debtor in the state court action. *Boberschmidt v. Society National Bank (In re Jones)*, 226 F.3d 917 (7th Cir. 2000).

2.2.nnnnnn. A foreclosure cannot result in a preference. Affirming the Bankruptcy Court's decision, the District Court holds that for preference purposes, solvency is measured immediately before the time of the transfer and, relying on *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994), that the amount the creditor bids at the foreclosure sale is "reasonably equivalent value," negating the possibility of the creditor

receiving more than it would receive in a chapter 7 liquidation case. *In re Fibsa Forwarding, Inc.*, 244 B.R. 94 (S.D. Tex. 1999).

2.2.oooooo. "Earmarking" doctrine does not apply to redirected funds. The debtor instructed its principal customer to make payments to a bank escrow account for the benefit of one of its suppliers. The Eighth Circuit B.A.P. rejected the application of the earmarking doctrine as a defense to preference recovery on these facts, because the debtor retained full control over the redirected funds and there was no real substitution of a new lender for a former lender. *Stingley v. AlliedSignal, Inc. (In re Libbey Int'l, Inc.)*, 247 B.R. 463 (8th Cir. B.A.P. 2000).

2.2.pppppp. Administrative expenses are included in calculation of "greater percentage" test. In determining what a creditor would have received in a hypothetical chapter 7 liquidation case for the purpose of applying the "greater percentage" test in a preference action, the court should take into account the actual expenses of administration incurred in the chapter 7 case, at least up to the point of judgment in the preference action. *Dakmak v. United States (In re Lutz)*, 241 B.R. 172 (E.D. Mich. 1998); 241 B.R. 179 (E.D. Mich. 1999).

2.2.qqqqqq. New value preference exception measured from date of tender of check. Where a debtor makes a preference by tender of a check to the creditor, the measurement of the creditor's subsequent new value defense under section 547(c)(4) runs from the date of tender of the check, not the date the check is honored. *Brandt v. Sprint Corp. (In re Sonicraft, Inc.)*, 238 B.R. 409 (Bankr. N.D. Ill. 1999).

2.2.rrrrrr. Use of post-dated checks does not defeat subsequent advance rule. The debtor paid for each of 54 shipments during the 90-day preference period with a post-dated check. The trustee and the creditor stipulated that each payment was made when the check cleared. Nevertheless, the creditor could take advantage of the subsequent advance defense under section 547(c)(4) based on the dates of the shipments and the date the checks were honored. *Williams v. Agama Systems, Inc. (In re Micro Innovations Corp.)*, 185 F.3d 329 (5th Cir. 1999).

2.2.ssssss. An extinguished unperfected security interest does not defeat a subsequent new value defense. The creditor retained a security interest in goods sold to the debtor during the preference period, but did not perfect the security interest. The security interest was extinguished by subsequent payment. Nevertheless, the security interest was not an "otherwise unavoidable security interest" so as to defeat the application of the subsequent new value exception of section 547(c)(4). *Williams v. Agama Systems, Inc. (In re Micro Innovations Corp.)*, 185 F.3d 329 (5th Cir. 1999).

2.2.tttttt. Subsequent new value may be applied to all prior preferences. Adopting the majority rule, the Fifth Circuit holds that a subsequent advance of new value may be applied against all prior preference payments under the subsequent new value defense of section 547(c)(4) to reduce preference liability. *Williams v. Agama Systems, Inc. (In re Micro Innovations Corp.)*, 185 F.3d 329 (5th Cir. 1999).

2.2.uuuuuu. A prepetition foreclosure is not a preference. The creditor foreclosed on real property worth $50,000 by bidding in its claim of $20,000 and soon resold the property for $28,000. *BFP v. RTC*, 511 U.S. 531 (1994), prohibits the foreclosure sale from being treated as a fraudulent transfer, but the debtor challenged the foreclosure as a preference. The court rules that, even though the loss in value to the debtor rendered the debtor insolvent, the transfer was not made "while" the debtor was insolvent, as required by section 547. Although the creditor received more than it would have in a liquidation, the court applied the rationale of *BFP* to rule that the policy of protecting regularly-conducted non-collusive real property foreclosure sales outweighs the policy of the preference section and validated the transfer. *Newman v. Fibsa Forwarding, Inc. (In re Fibsa Forwarding Inc.)*, 230 B.R. 334 (Bankr. S.D. Tex. 1999).

2.2.vvvvvv. Payment of a debt secured by a letter of credit may be preferential. The debtor paid a supplier's invoices, which were backed by a letter of credit from a bank whose reimbursement obligation was fully secured by the debtor's assets. The payments nevertheless could be preferential, even though

the payments "release" the collateral securing the bank's letter of credit reimbursement claim. *Krafsur v. Scurlock Permian Corporation (In re El Paso Refinery, LP)*, 171 F.3d 249 (5th Cir. 1999).

2.2.wwwwww. Intercreditor lien subordination agreement does not affect preference analysis. The supplier had a first lien on inventory and receivables; the bank had a second. Their intercreditor agreement provided for pro rata sharing but stated that the agreement was not for the benefit of the debtor. The supplier defended a preference claim on the ground that the payments were proceeds of its collateral. The Court of Appeals agreed, overruling the trustee's argument that the supplier's collateral sharing agreement with the bank did not make the payments proceeds of the banks collateral, ruling that the agreement was a subordination rather an assignment agreement and that the third party beneficiary clause in the agreement prevented the trustee from taking advantage of it during the litigation. *Krafsur v. Scurlock Permian Corporation (In re El Paso Refinery, LP)*, 171 F.3d 249 (5th Cir. 1999).

2.2.xxxxxx. Imposition of a constructive trust may constitute a preference. The debtor was enjoined to transfer a patent to the plaintiff in pre-bankruptcy district court litigation. Finding that the order imposed a constructive trust on the patent in favor of the plaintiff, the bankruptcy court concluded that under applicable Illinois law, the constructive trust arose only upon the district court's order, which was entered within 90 days before bankruptcy, transferring the debtor's interest in the property. In addition, in a detailed and thoughtful analysis of constructive trust claims in bankruptcy, the court concludes that the plaintiff would have had only a general unsecured claim in the bankruptcy case if the transfer had not occurred. *CRS Steam, Inc. v. Engineering Resources, Inc. (In re CRS Steam, Inc.)*, 225 B.R. 833 (Bankr. D. Mass. 1998).

2.2.yyyyyy. Late payments were not in the ordinary course of business. Although the debtor regularly made payments to the creditor approximately 30 days later than invoice terms required, the payment terms extended significantly in the 90 days before bankruptcy. The payments that were later than normal were not in the ordinary course of business for preference exception purposes under section 547(c)(2)(B) and were avoidable. *Official Plan Committee v. Expediters Int'l of Washington, Inc. (In re Gateway Pacific Corp.)*, 153 F.3d 915 (8th Cir. 1998).

2.2.zzzzzz. Wire transfers were not in the ordinary course of business. On the eve of bankruptcy, the debtor contacted the creditor to inquire whether checks had been cashed. When the debtor learned they had not, the debtor wire transferred the payment to the creditor. The payment was not in the ordinary course of business for preference exception purposes under section 547(c)(2)(B) even though the creditor had no part in any aggressive collection action. *Central Hardware Co., Inc. v. Sherwin-Williams Co. (In re Spirit Holding Co., Inc.)*, 153 F.3d 902 (8th Cir. 1998).

2.2.aaaaaaa. Transferred collateral is valued at the transfer, not the petition date. If a partially secured creditor receives a transfer of collateral in satisfaction of a portion of its claim, the collateral is valued as of the transfer date, rather than as of the petition date. Otherwise, the court states, a prepetition transfer of depreciating collateral would always result in a preference. *Telesphere Liquidating Trust v. Galesi (In re Telesphere Communications, Inc.)*, 229 B.R. 173 (Bankr. M.D. Ill. 1999).

2.2.bbbbbbb. Same day reimbursement payments under a letter of credit are preferences. The bank issued a letter of credit to the debtor's supplier and entered into an agreement with the debtor that the debtor would pay the bank the amount of any L/C draw at or before presentation of the draw. The supplier drew, and, on the same day, the debtor transferred funds to the bank, which wired funds to the supplier under the draw. Because the bank became obligated directly to the supplier upon the draw and the debtor became indebted to the bank at the same time, and based on the principle of independence governing letters of credit, the debtor's transfer to the bank of the amount needed to pay the letter of credit was a transfer of property of the debtor for or on account of an antecedent debt, even though the transfers were all made on the same day. *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.)*, 140 F.3d 1111 (7th Cir. 1998).

2.2.ccccccc. A merger after a preference does not affect preference liability. The debtor corporation made preferences and then, before bankruptcy, merged into another corporation. The

successor filed bankruptcy. For purposes of section 547(b), the property transferred was "property of the debtor," based on *Begier v. IRS*, 496 U.S. 53, 58 (1990) ("'property of the debtor' subject to the preferential transfer provision is best understood as that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings."). However, insolvency is determined by the transferor's assets and liabilities, not the assets and liabilities of the merged companies. *Payne v. Clarendon National Ins. Co. (In re Sunset Sales, Inc.)*, 1998 Bankr. Lexis 683 (10th Cir. B.A.P. 1998).

2.2.ddddddd. Preference earmarking doctrine protects unperfected lien. The bank paid certain mechanics lienors directly but did not record its mortgage until three days before bankruptcy. The court overrules the trustee's preference attack against the bank, holding that the earmarking doctrine permits the bank to step into the shoes of the mechanics lienors, who could have perfected their liens even after bankruptcy. *Kaler v. Community First National Bank (In re Heitkamp)*, 137 F.3d 1087 (8th Cir. 1998).

2.2.eeeeeee. How to value a going concern for preference insolvency purposes. The assets of a going concern must be valued based on their liquidation over a hypothetical reasonable time, balancing "not so short a period that the value of goods is substantially impaired via a forced sale," against "not so long a time that a typical creditor would receive less satisfaction of its claim, as a result of the time value of money and typical business needs." In this case, 12 to 18 months was held reasonable. Liabilities are valued at face amount, not their market trading value, although the court reaches this conclusion to a degree based on its "going concern" assumption about the business rather than the language of section 101(32)(B). Because the valuation was of a going concern, the contingent costs of dissolution and wind-down plus contingent liabilities that would arise upon going out of business should not be included as liabilities. *Travelers International AG v. TransWorld Airlines, Inc. (In re TransWorld Airlines, Inc.)*, 134 F.3d 188 (3d Cir. 1998).

2.2.fffffff. Bankruptcy preference grace period for enabling loans preempts state law. Section 547(c)(3)(b) provides a 20-day grace period to perfect a security interest that secures an enabling loan. This grace period trumps any otherwise applicable state law grace period under which a perfection relates back an earlier date. *Fidelity Financial Services, Inc. v. Fink*, 522 U.S. 211 (1998).

2.2.ggggggg. Levy on trust fund taxes avoided. In *Begier v. IRS*, 496 U.S. 53 (1990), the Supreme Court held that a voluntary payment of trust fund taxes would establish a reasonable nexus between funds withheld and funds paid. In this case, however, where the IRS levied on the debtor's bank account, the transfer was involuntarily and no such reasonable nexus could be made, therefore, the levy 20 days before bankruptcy constituted an avoidable preference. *United States v. Borock (In re Ruggeri Electrical Contracting, Inc.)*, 214 B.R. 481 (E.D. Mich. 1997).

2.2.hhhhhhh. Payments to an employee benefit fund are held non-preferential. Five months before bankruptcy, the debtor switched from monthly employee benefit fund payments to a weekly. The benefit fund was given the benefit of the contemporaneous exchange and subsequent new value exceptions to preference recovery. The payments were held to be intended as contemporaneous and in fact, substantially contemporaneous, and the new value to the debtor was not required to come directly from the creditor (the benefit plan). Alternatively, each weekly payment (except the last) was followed by new value to the debtor in that the employees continued working for that following week. However, Section 1113(f), which prohibits a trustee from altering a collective bargaining, does not prevent preference recovery. *Jones Truck Lines, Inc. v. Central States, Southeast and Southwest Areas Pension Fund (In re Jones Truck Lines, Inc.)*, 130 F.3d 323 (8th Cir. 1997).

2.2.iiiiiii. Bank account withdrawal as a transfer. An individual debtor withdrew funds from a bank account to hinder an attaching creditor and stash the cash under the mattress. Departing from the ruling of the Seventh Circuit in *In re Agnew*, 818 F.2d 1284 (7th Cir. 1987), the Ninth Circuit holds that the withdrawal from the account was a "transfer" for purposes of the fraudulent transfer grounds for denial of discharge under section 727(a)(2). *Bernard v. Sheaffer (In re Bernard)*, 96 F.3d 1279 (9th Cir. 1996).

2.2.jjjjjjj. Provisional credits on uncollected checks do not create antecedent debt. The Eighth Circuit rules that the withdrawal by a depositor/debtor of funds represented by uncollected checks/provisional credits do not create a debt from the depositor to the bank, except that in a check-kiting scheme of which the bank becomes aware and which does not discontinue, an inference might be drawn that the bank agreed to extend credit. The court also rules that the bank retains a security interest in the checks and their proceeds, based on section 4-210(a)(1) of the Uniform Commercial Code. Thus, the trustee's preference attack on the repayment of the provisional credit (ledger overdraft) fails, because the bank did not receive more than it would have received in a liquidation, as required for preference avoidance under section 547(b)(5). *Laws v. United Missouri Bank of Kansas City, N.A.*, 98 F.3d 1047 (8th Cir. 1996).

2.2.kkkkkkk. Late payments qualify for "ordinary business terms" preference exception. The debtor, a commercial customer of the gas company, routinely made late payments on its gas bills, as did approximately ten percent of other commercial gas customers. The Sixth Circuit, joining a clear consensus among other Circuits, holds that "ordinary business terms" in section 547(c)(2)(C) "means that the transaction was not so unusual as to render it an aberration in the relevant industry," that the transactions, therefore, qualify under the objective test of section 547(c)(2)(C), and that the transfers are "made according to ordinary business terms." *Luper v. Columbia Gas of Ohio, Inc. (In re Carled, Inc.)*, 91 F.3d 811 (6th Cir. 1996).

2.2.lllllll. Bankruptcy Code perfection period preempts state law relation back period. Section 547(c)(3)(B) exempts from preference attack a security interest that is perfected within twenty days after the granting of an enabling loan. State law provides that perfection of a purchase money security interest within a longer specified time relates back to the date of the purchase. Nevertheless, the twenty-day provision in the Bankruptcy Code preempts State law, preventing relationback of the later perfection, and rendering the subsequent perfection subject to preference attack. *Pongetti v. General Motors Acceptance Corp. (In re Locklin)*, 101 F.3d 435 (5th Cir. 1996); *Fink v. Fidelity Financial Service, Inc. (In re Beasley)*, 102 F.2d 334 (8th Cir. 1996).

2.2.mmmmmmm. Payments to a brokerage account are not avoidable. Adopting an extremely broad construction of "margin payment" and "settlement payment" under section 546(e), the bankruptcy court rules that virtually any payment into a brokerage account at a stock broker constitutes a margin payment or a settlement payment and therefore falls within the exception to avoidance of a preference contained in section 546(e). *Biggs v. Smith Barney, Inc. (In re David)*, 193 B.R. 935 (Bankr. C.D. Calif. 1996).

2.3 Postpetition Transfers

2.3.a. Sections 549(a) and 542(a) are not mutually exclusive. The debtor was engaged in the business of buying, rehabilitating and selling houses through sham business entities. Typically, she transferred house sale proceeds to a different entity, which would then use the proceeds to repeat the process. She filed a chapter 11 case. A trustee was appointed about four months later, and the case was soon converted to chapter 7. While the debtor remained in possession, she sold 10 properties titled in the name of sham entities. A law firm and a title company that it owned handled the closings. Both knew that the debtor was in bankruptcy. Four years later, the trustee brought an action against the law firm, the title company and their principal for turnover or an accounting of property of the estate that was in their possession, custody or control. Section 542(a) provides that "an entity … in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease … shall deliver to the trustee, and account for, such property or [its] value." Section 549(a) provides "the trustee may avoid a transfer of property of the estate … that occurs after the commencement of the case … [and] is not authorized under this title or by the court," but the action must be brought within two years after the transfer. The two sections are not mutually exclusive. The trustee's ability to avoid a postpetition transfer does not affect the obligation of an entity that is in possession, custody or control of property of the estate to turnover or account for property of the estate that it held at any time during the case, and the trustee need not move only under section 549 when it is available. In this case, the law firm and title company possessed the proceeds of the 10 houses that the debtor in possession sold. They are liable to the trustee to account,

and the two-year statute of limitations applicable to avoiding a postpetition transfer does not apply. Although they disposed of the proceeds in accordance with the debtor in possession's instructions, they knew of the bankruptcy and therefore knew or should have known, especially in light of the debtor's criminal activities, that disposition required compliance with bankruptcy law. Therefore, the court denies the motion to dismiss, noting that the defendants may assert the affirmative defense relating to disposition in accordance with the debtor in possession's instructions at a later time during the proceeding. *Rosen v. Gemini Title & Escrow, LLC (In re Hoang)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 38478 (D. Md. March 15, 2013).

2.3.b. 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).

2.3.c. Recipient of an avoidable transfer is not a mere conduit if it has previously paid the purported initial transferee. The debtor engaged a law firm to register its trademark in Europe. The law firm retained a French firm to file the registration. The French firm billed the law firm for its services. The law firm billed the debtor, including the French firm's bill as a "disbursement". The law firm then paid the French firm, and the debtor later filed a chapter 11 case. Around the plan's effective date, the debtor in possession paid the law firm its entire invoice amount, including the "disbursement" amount. The confirmed plan provided for a liquidation trust. The liquidation trustee sued the law firm to avoid and recover the postpetition transfer. A recipient of an avoidable transfer is not liable if it was a mere conduit, rather than a transferee. A conduit does not have dominion or control over the transferred asset and must not be able to redirect the transfer to its own use. Here, the transfer did not flow through the law firm. Rather, the law firm met its obligation to the French firm before bankruptcy and was free to use the debtor in possession's payment in any way it chose. Therefore, it was not a mere conduit but was a transferee who was liable to the liquidating trustee. *Dembsky v. Frommer, Lawrence & Haug, LLP (In re Lambertson Truex, LLC)*, 458 B.R. 155 (Bankr. D. Del. 2011).

2.3.d. Automatic stay does not apply to a postpetition transfer unless the transfer is avoidable under section 549. An indirect equity owner of the debtor transferred an interest of the estate in property while the chapter 11 case was pending. Section 362(a)(3) stays any act to exercise control over property of the estate, but section 362(b)(24) excepts "any transfer that is not avoidable … under section 549". Section 362(b)(24) is not limited to transfers by the debtor nor to transfers to which section 549 does not apply in the first instance, but includes transfers to which section 549 does not apply at all, whether due to an exception to avoidance under section 549(c) or otherwise. Therefore, if the transfer is avoidable under section 549, the automatic stay does not apply; otherwise, it does. *Morton v. Kievit (In re Vallecito Gas, LLC)*, 440 B.R. 460 (Bankr. N.D. Tex. 2010).

2.3.e. Section 549 allows trustee to avoid the debtor's postpetition mortgage on property of the estate. Shortly after filing bankruptcy, the debtors refinanced their house, granting a lien to the lender, without notice to the trustee or the court or court approval. Section 549(a) permits the trustee to avoid a postpetition transfer of property of the estate that is not authorized by the Code or the court. Prior caselaw held that the debtor's creation of a lien was not a transfer for purposes of section 549(a). However, the 2005 Amendments specifically overruled that caselaw by expanding the definition of transfer. Now, "transfer" includes creation of a lien. Section 362(a)(4) stays any act to create a lien on property of the estate. An action in violation of the stay is void. Therefore, section 549 is not necessary to avoid a

creditor-created lien, because it is void under section 362. Section 549 allows a trustee to avoid the debtor's creation of a lien, which the trustee here may do. *Hopkins v. Suntrust Mortgage, Inc. (In re Ellis)*, 441 B.R. 656 (Bankr. D. Idaho 2010).

2.3.f. Trustee may recover cash collateral that was used without authorization. The debtor in possession operated for three weeks after the petition date without court authorization or secured creditor approval under section 363(c)(2) to use cash collateral. During its operation, the debtor in possession purchased and paid for petroleum products with cash that was subject to a secured creditor's security interest. Section 549(a) permits a trustee to avoid a postpetition transfer of property of the estate "that is not authorized under this title or by the court". The debtor in possession's payment of the cash collateral was not authorized by either. Therefore, even though the supplier to whom the debtor in possession paid the cash provided present value to the estate, the trustee may avoid the cash transfers to the supplier. *Marathon Petroleum Co., LLC v. Cohen (In re Delco Oil, Inc.)*, 599 F.3d 1255 (11th Cir. 2010).

2.3.g. Trustee may recover from the debtor postpetition payments from the debtor's bank account. After bankruptcy, the debtor's bank honored several prepetition checks. The funds in the bank account on the petition date were property of the estate. Section 542(a) requires an entity (including the debtor) that is in possession, custody or control of property of the estate to turn over the property to the trustee. Section 542(c) permits a bank that does not have notice or knowledge of the case to honor checks presented after bankruptcy. Section 549(a) authorizes the trustee to avoid a transfer that is authorized only under section 303(f) or 542(c). Section 362(b)(11) excepts from the automatic stay the presentment of a negotiable instrument but does not except or authorize the honoring of a negotiable instrument. Therefore, the honoring of the checks was not authorized under section 362(b)(11) but only under section 542(c), so the bank's transfers of property of the estate to the checks' payees were avoidable. However, the amounts were small, so the trustee sought recovery from the debtor instead. Because the debtor had an obligation to turnover the funds in the account at the petition date, the trustee may recover the amounts from the debtor. *Yoon v. Minter-Higgins*, 399 B.R. 34 (N.D. Ind. 2008).

2.3.h. Bankruptcy Code does not preempt real property race notice recording statute. The debtors sold their house after bankruptcy without notifying the trustee and without advising the buyer that they were in bankruptcy. The buyer promptly recorded the deed and the new lender promptly recorded the new mortgage. The trustee had not recorded a copy of the petition in the land records office. Under California's race notice statute, the buyer and new mortgagee, as bona fide purchasers, took priority over the trustee. The Bankruptcy Code preempts state law if its essential goals and purposes are inconsistent with the state law. The Code's essential goals and purposes are to provide the debtor with protection from creditors and a fresh start and to promote equality of treatment among creditors. California's recording statute does not conflict with either of those goals. The payoff in the sale of the prior mortgage is consistent with the Code's treatment of secured claims, and trustee may still obtain the balance of house's value from the debtor. In addition, section 549 contains a similar rule, providing protection to a bona fide purchaser without knowledge of the bankruptcy. Therefore, the Code does not preempt the recording statute, and the buyer and new mortgagee may retain their interests in the house. *Burkhart v. Coleman (In re Tippett)*, 338 B.R. 82 (9th Cir. 2008).

2.3.i. Postpetition transferee who acted inequitably is liable for property transferred, even though he had paid for it. The debtor in possession sought authority for DIP financing, which the court granted in only a limited amount. The DIP then separately sold (factored) accounts receivable to the DIP lender for cash at a 7% discount to face amount. The lender collected about 81% of the receivables' face amount. After the case was converted to chapter 7, the trustee sought recovery from the lender of an unauthorized postpetition transfer. Section 549 permits avoidance of an unauthorized postpetition transfer without regard to whether the estate was diminished or depleted. Section 550 permits the court to determine the measure of recovery: the property transferred or its value. Neither section 549 nor section 550 authorizes a transferee to offset against any recovery liability any amount he may already have paid to the estate. Here, the equities favored the estate, because the lender factored the receivables with full knowledge of the bankruptcy case and of the court's denial of the DIP's request to borrow more. Therefore, the trustee may recover from the lender the full amount of collections on the accounts, despite

the lender's earlier payment to the estate of the purchase price for the accounts. *Aalfs v. Wirum (In re Straightline Invs., Inc.)*, 525 F.3d 870 (9th Cir. 2008).

2.3.j. Transfer made between case dismissal and order vacating the dismissal order may be avoidable. Under a settlement agreement with a major creditor, the debtor sought ex parte dismissal of its chapter 11 case, which the court granted. When the creditor learned of the dismissal, it promptly moved to vacate the dismissal order on the ground that the debtor had not complied with the settlement agreement and had not given notice of the motion to the creditor. The court vacated the dismissal order. While the case was dismissed, but after the debtor and its counsel had notice of the motion to vacate, the debtor, with counsel's assistance, sold a valuable asset. A dismissal order is subject to reconsideration under Rule 9024 (F.R. Civ. P. 60(b)). A Rule 60(b) order may be conditioned on "such terms as are just", which imports equitable considerations such as whether prejudice would result from granting the relief. Here, the debtor and its counsel had notice of the motion to vacate and proceeded with the sale anyway. Under the circumstances, equitable considerations did not require the court to protect the transfer. The court could vacate the dismissal retroactively, with the effect that the asset was property of the estate when sold and the sale was avoidable under section 549 as an unauthorized postpetition transfer. *Woods & Erickson, LLP v. Leonard (In re AVI, Inc.)*, 389 B.R. 721 (9th Cir. B.A.P. 2008).

2.3.k. Transfer of the debtor's disputed assets that were ultimately disallowed is not a postpetition transfer of property of the estate. The debtor had a disputed partnership interest. After bankruptcy, the other partners sued him in state court to declare the interest invalid, and the debtor counterclaimed for the interest and related claims. To fund the litigation, the debtor transferred one-third of the interest and of any other claims to Rabe in exchange for his agreement to pay the debtor's attorney's fees in cash. The debtor then amended his schedules to disclose the disputed interest. The state court determined that the debtor had no partnership interest and no valid claims. The debtor's chapter 7 trustee sued Rabe and the debtor's attorney on the theory that the partnership interest and claims were property of the estate, the cash that Rabe paid was proceeds of that property, and that Rabe's payments were therefore unauthorized and voidable postpetition transfers of property of the estate. However, because the state court determined that the debtor did not have any partnership interest or claims at all, the cash that Rabe paid could not have been proceeds of the non-existent interest. Therefore, there was no improper postpetition transfer of property of the estate. *Reed v. Rabe (In re Grotjohn)*, 376 B.R. 496 (N.D. Tex. 2007).

2.3.l. *BFP* foreclosure sale value rule does not apply to a sale that violates section 549(a). The debtor failed to list his homeowners' association as a creditor and did not file a copy of his bankruptcy petition in the real property records office. The association foreclosed on the debtor's home. The purchaser paid only the amount of the debtor's past due dues to purchase the home. Section 549(c) permits a trustee to avoid a postpetition sale of estate property, such as the foreclosure sale here, "to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value." *BFP, Inc. v. Resolution Trust Corp.*, 511 U.S. 531 (1994), held that a regularly conducted, non-collusive mortgage foreclosure sale establishes the value of real property for purposes of the fraudulent transfer statute's "reasonably equivalent value" requirement. By contrast, section 549(c) requires "present fair equivalent value," not "reasonably equivalent value," which is a lower standard. *BFP* applies only to mortgage foreclosures, not other kinds of foreclosures, such as tax sales. Therefore, the foreclosure sale here does not establish the value of the property for purposes of section 549(c). In determining that value, the court should deduct the amount of any prior existing liens. Although the purchaser may not be bound by prior liens that he does not assume, they reduce the equity value of the property that the purchaser acquires. *Miller v. NLVK, LLC (In re Miller)*, 454 F.3d 899 (8th Cir. 2006).

2.3.m. Section 549 applies to property transferred in violation of the automatic stay. The debtor owned a partial interest in real property, which passed to her trustee. While the trustee still held the interest in the real property, the sheriff conducted a tax sale of the entire parcel. Although the sale violated the automatic stay, the remedy lies in section 549, which authorizes the trustee to avoid a postpetition transfer that is not authorized by the Code, not in section 362, which contains no provision for avoiding a transfer. The court does not address whether the violation of section 362 renders the sale void. *Herrington v. Grant (In re Paxton)*, 440 F.3d 233 (5th Cir. 2006).

2.3.n. Debtors' postpetition sale of their residence does not violate the automatic stay. The debtors claimed their house as exempt, having placed an artificially low value on it in their schedules. While the trustee was considering selling the property, the debtors consummated a sale without notifying the trustee and without advising the buyer that they were in bankruptcy. The trustee sought to set aside the sale by arguing that the sale violated the automatic stay and was therefore void. Such a reading, however, would render section 549(a) meaningless: section 549 permits avoidance of a transfer that is not authorized. If the debtor's transfer violated the stay and was void, there would be no need for section 549(a). In the course of reaching this conclusion, the Bankruptcy Appellate Panel reviews prior Ninth Circuit case law discussing the issue, but not deciding it in the context of a case that presented facts that required the issue's resolution. Relying on other Ninth Circuit case law, the Bankruptcy Appellate Panel concludes that where a court of appeals has fully considered an issue and made a pronouncement on it, even though it was not directly necessary for the court's conclusion, the pronouncement would be considered binding circuit precedent. *Irwin Mortgage Co. v. Tippett (In re Tippett)*, 338 B.R. 82 (9th Cir. B.A.P. 2006).

2.3.o. A policy loan is not a "transfer"; an interest payment is. The debtor maintained whole life insurance policies on its executives to fund their supplemental retirement benefits. After bankruptcy, without court approval, the debtor in possession borrowed the entire loan values under the policies and thereafter paid interest to the insurance company on the loan amounts. The trustee sued the insurer for recovery of both transfers as unauthorized postpetition transfers. The policy loan was not a "transfer," because it was only an advance to the policyholder of the reserve value to which the policyholder was absolutely entitled. The interest payments, however, were transfers, because they decreased the value of the estate and disposed of the estate's property in favor of the insurer and allowed the insurer to earn a return on the policy's cash value. The court did not consider whether the insurer had a valid defense or offset to the recovery to the extent that the interest payment increased the cash surrender value of the policy. *Devan v. Phoenix Am. Life Ins. Co. (In re Merry-Go-Round Enters., Inc.)*, 400 F.3d 219 (4th Cir. 2005).

2.3.p. Section 549(c) is not an exception to the automatic stay. The Ninth Circuit brushes aside dicta in several prior decisions to rule that section 549(c), which protects a good faith purchaser of real estate in a post-petition transaction, is not an exception to the automatic stay. The court rules that section 549(c) applies only to transfers by the debtor, not to a foreclosure sale that violates the automatic stay, because a transfer in violation of the automatic stay is void, not merely voidable. The effect is that the property interests remain the same as if no transfer had been attempted. The court follows the recent decision of the Ninth Circuit Bankruptcy Appellate Panel reaching the same conclusion. *In re Mitchell*, 279 B.R. 839 (9th Cir. B.A.P. 2002). *40235 Washington Street, Corporation v. Lusardi*, 329 F.3d 1076 (9th Cir. 2003).

2.3.q. Shareholders' post-petition use of Subchapter S corporation's NOL is not recoverable. The debtor was originally formed as a Subchapter S corporation. In the taxable year before bankruptcy, it incurred substantial losses, which the shareholders applied to obtain refunds of the taxes that they had paid for the two prior taxable years. They did not, as the IRC permits, waive the right to carry back the losses and instead apply them to future years. The trustee sought recovery as an invalid postpetition transfer of the shareholders election not to waive the loss carry backs. The court rules that the NOL of a subchapter S corporation is not property of the debtor's estate and that the failure of the shareholders to waive the loss carry back did not constitute a transfer that could be recovered. The court distinguishes *In re Bakersfield Westar, Inc.*, 226 B.R. 227 (9th Cir. B.A.P. 1998), on the ground that it dealt only with the right to revoke subchapter S corporation status, not with the use of an NOL. The court also rejects an unjust enrichment argument that the trustee asserted against the shareholders. *Official Committee v. Forman (In re Forman Enterprises, Inc.)*, 281 B.R. 600 (Bankr. W.D. Pa. 2002).

2.3.r. Post-petition increase in pre-petition lien on debtor- guarantor's asset does not require court approval. Before bankruptcy, the debtors guaranteed the credit line of their wholly owned corporation and secured it with a lien on their personal assets. After bankruptcy, the lender continued making advances, thereby increasing the amount of the lien on the debtors' assets. The Court of Appeals, over a vigorous dissent, rules that the advances and consequent increase in the amount of the lien against the debtors' property do not violate the automatic stay, because the lien was created and perfected before bankruptcy.

Similarly, the advances do not require court approval under section 364(c), because the debtors incurred the secured debt before bankruptcy, and the additional advances did not constitute additional secured debt. Although the court notes that the priority of the post-petition advances is an open question for the bankruptcy court on remand, the court does not mention the trustee's strong-arm power under section 544(a), under which the trustee has the rights of a bona fide purchaser of real property as of the petition date and of a judicial lien creditor as of the petition date, nor does it consider that the increase in debt constitutes non-recourse debt, which is allowable as a claim against the debtor under section 102(2). *Beeler v. Jewell (In re Stanton)*, 303 F.3d 939 (9th Cir. 2002) (285 F.3d 888 *superseded*).

2.3.s. Debtor golfer loses hole-in-one prize to trustee. Shortly before bankruptcy, the debtor agreed with the other members of his foursome that if any one of them won the hole-in-one prize at the tournament, they would share it equally. Naturally, the debtor won the $43,000 car, but the prize was not awarded until after bankruptcy. When he received it, he sold it and divided the proceeds among the four players, claiming his share as exempt. The trustee sued his golf partners for recovery of an invalid post-petition transfer. The court rules that the oral agreement, though enforceable, did not give his golfing partners any interest in the prize winnings. It created only unsecured claims. Therefore the court would not impose either a constructive trust or an equitable lien. *Allard v. Ackhoff (In re Ackhoff)*, 281 B.R. 889 (Bankr. E.D. Mich. 2001).

2.3.t. Advances to a non-debtor secured by a lien on a debtor's property are not avoidable. A factor entered into a lending agreement with a corporation. The corporate shareholders guaranteed the loans and secured the guaranty by a lien on their house. The shareholders filed chapter 11, and the factor continued advances to the non-debtor corporation. After the case converted to chapter 7, the trustee sought to avoid the factor's lien on the house to the extent of post-petition advances. The Ninth Circuit rejects the trustee's claim, on the ground that the debtor did not incur new debt under 364 that would have required prior court approval. In addition, the automatic stay did not apply, because the lien existed and was perfected before the shareholders' chapter 11 case. However, because the subsequent advances were optional, as a matter of state law, the priority of the lien to secure those subsequent advances was junior to any intervening liens on the property (such as the trustee's hypothetical petition date judicial lien under section 544(a)(1)). The Ninth Circuit remand for resolution of that issue. Importantly, the court stresses that approval under section 364 of the advances was not required, so as not to require "the bankruptcy of a corporation's shareholder to clog the going business of the corporation and its creditors." *Beeler v. Jewell (In re Stanton)*, 285 F.3d 888 (9th Cir. 2002).

2.3.u. Trustee may recover only debtor's equity in property transferred in a voidable post-petition transfer. After bankruptcy, the debtor in possession sold his residence, which was subject to a mortgage, and turned over the equity value to the chapter 7 trustee. The purchaser knew of the pendency of the chapter 11 case and did not obtain bankruptcy court approval of the sale. The trustee sued the purchaser (actually, its title insurance company) to recover the property or its value. The Second Circuit rules that the property of the estate that the trustee can recover includes only the debtor's equity in the property, which the trustee already received by turnover from the debtor. Therefore the trustee could not recover anything from the purchaser. *McCord v. Agard (In re Bean)*, 252 F.3d 113 (2d Cir. 2001).

2.3.v. Court permits post-petition perfection of security interest in chattel paper proceeds. The bank perfected its interest in the debtor's chattel paper by possession, and gave notice to the trustee under section 546(b) of a claim to the post-petition payments that the trustee received under the chattel paper. The notice was adequate to perfect the security interest under section 9-306(3) of the UCC, which provides that a creditor maintains a continuously perfected security interest in proceeds of collateral of which the creditor takes possession within ten days after the debtor receives it. *Marine Midland Bank v. Breeden (In re The Bennett Funding Group, Inc.)*, 255 B.R. 616 (N.D.N.Y. 2000).

2.3.w. Punitive avoiding power action is dismissed. If the trustee brings an otherwise valid avoiding power action but the action would not result in any benefit to the estate and its purpose is only to punish either the debtor or the transferee, the action should be dismissed. Here, the debtor in possession sold his house for fair market value after the petition date and turned over the cash proceeds to the

subsequently appointed trustee. The trustee's action to set aside the transfer was dismissed for abuse of discretion. *McCord v. Agard (In re Bean)*, 251 B.R. 196 (E.D.N.Y. 2000).

2.3.x. Mailing of a cashier's check does not constitute delivery. The Ninth Circuit rules that the mailing of a cashier's check does not constitute delivery, because the check is not irretrievably out of the sender's control. Therefore, the trustee may avoid as a post-petition transfer under section 549 a payment made by a cashier's check that was mailed before the petition date but received by the creditor after the petition date. *Mora v. Vasquez (In re Mora)*, 199 F.3d 1024 (9th Cir. 1999).

2.3.y. "Date of honor" rule applies to post-petition transfers. The debtor's lessor received a check for current rent the day before an involuntary petition was filed. The debtor's bank honored the check the day after the involuntary was filed. For purposes of section 549(a), the transfer occurred on the date of honor, following the rule for preferences in *Barnhill v. Johnson*, 503 U.S. 393 (1992). *Guinn v. Oakwood Properties, Inc. (Oakwood Markets, Inc.)*, 203 F.3d 206 (6th Cir. 2000).

2.3.z. Whether post-petition value is "given" is viewed from the perspective of the creditor. The debtor paid post-petition rent under a long term lease immediately after the filing of the petition. The debtor's assets were all sold under an execution sale (stay relief had been granted) within days after that. Nevertheless, the landlord gave post-petition value by allowing the debtor to stay in the premises for the month following the involuntary. The value was given post-petition, not at the time the lease was signed, and even though the debtor did not benefit from the use of the premises for the entire month, the question of whether value was given must be viewed from the prospective of the giver. *Guinn v. Oakwood Properties, Inc. (Oakwood Markets, Inc.*), 203 F.3d 206 (6th Cir. 2000).

2.3.aa. Lien securing post-petition advances is not avoidable. The individual debtors guaranteed the debt of their non-debtor corporation and secured the guarantee by a lien on their house. After they filed bankruptcy, the corporate lender made subsequent advances to the corporation, which increased the amount of guarantee secured by the lien on the house. The B.A.P. rules that the post-petition increase in the amount of the lender's claim secured by the lien on the debtor's house in not avoidable because it is not a post-petition transfer of the debtor's property, relying on *Thompson v. Margen (In re McConville)*, 110 F.3d 47 (9th Cir. 1997). The B.A.P. also rules that authorization under section 364 is not required for the creditor to increase the amount of its lien against the debtors, distinguishing *TransAmerica Commercial Fin. Corp. v. Citibank, N.A. (In re Sun Runner Marine, Inc.)*, 945 F.2d 1089 (9th Cir. 1991), on the ground that the loan was not made to the debtors does. The B.A.P. suggests that the lien might be limited by section 506(b), which operates as of the date of the filing of the petition. *Jewell v. Beeler (In re Stanton)*, 248 B.R. 823 (9th Cir. B.A.P. 2000).

2.3.bb. Cashier's check is delivered when received. Before bankruptcy, the debtor mailed a cashier's check to the creditor. The creditor received the check after bankruptcy and credited it to the debtor's account. The trustee sought return of the funds from the creditor, on the ground that the payment was an avoidable post-petition transfer under section 549(a). The B.A.P. orders of the return of the funds, holding that a transfer by delivery of a mailed cashier's check occurs when the check is received, not when it is mailed. *Vasquez v. Mora (In re Mora)*, 218 B.R. 71 (9th Cir. B.A.P. 1998).

2.3.cc. Lender of invalid post-petition loan retains lien to the extent of value given. The lenders advanced funds to the debtor after the filing of a chapter 11 case and received a lien on the real property the debtors purchased at the time of the loan. The loan was not authorized by the court. The subsequent chapter 7 trustee sought to avoid the lien. The Ninth Circuit originally ruled that the granting of a lien was not a transfer of property for purposes of Section 549(a) or (c), which protects a good faith purchaser of real property from the debtor after the filing of the case, 84 F.3d 340 (9th Cir. 1996), but then amended its opinion to limit that holding to transfers of real property, which is all that Section 549(c) protects. 97 F.3d 316 (9th Cir. 1996). The court then withdrew those opinions and ruled that the loan violated section 364(c)(2) but that the lenders could retain a lien to the extent of the value given because they were in good faith. *Thompson v. Morgan (In re McConville)*, 110 F.3d 47 (9th Cir. 1997).

2.3.dd. Involuntary gap employment contracts may be avoided. During the involuntary gap, the corporate debtor entered into long-term employment contracts with its officers at their then-existing salaries, plus significant bonuses in the event of termination without cause. Because the contracts were entered on the eve of the consent to an order for relief, the bankruptcy judge "collapsed the gap" to find that the contracts were effectively entered into after the order for relief. The Ninth Circuit reversed, but held that the agreements were enforceable only to the extent of the salaries earned for services performed before the officers' termination some months after the order for relief. *Hamilton v. Lumsden (In re Geothermal Resources International, Inc.)*, 93 F.3d 648 (9th Cir. 1996).

2.4 Setoff

2.4.a. Recoupment is not subject to equitable limitations. The debtor collected under his disability policy, which permitted the disability insurer to recover from the debtor any payments that the debtor later recovered in Social Security disability payments. Shortly before bankruptcy, the debtor received a Social Security disability payment, which the insurer recovered from the debtor. The trustee asserted a preference avoidance claim against the insurer, which the insurer satisfied. The insurer then reduced the debtor's disability payments, as permitted under the policy, to recoup the preference amount. The debtor challenged the recoupment as violating the discharge injunction. The recoupment doctrine permits a creditor to recoup from the debtor a payment arising out of the same transaction, not just out of the same contract. Recoupment is an equitable doctrine: a creditor may recoup if both debts "arise out of a single integrated transaction so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations." Thus, the equitable analysis applies in determining whether both debts meet the "same transaction" requirement. Once a court determines that they do, the court may not impose further equitable considerations in determining whether recoupment is appropriate. In this case, the debt arose from the same transaction—the disability insurance payments and the Social Security disability payment. Therefore, the insurer was entitled to recoupment. *Terry v. Std. Ins. Co. (In re Terry)*, 687 F.3d 961 (8th Cir. 2012).

2.4.b. Disability insurance carrier may recoup the debtor's prepetition obligation from postpetition payments owing to the debtor. The debtor received disability payments from an insurance carrier. The policy provided that any Social Security disability payments that the debtor received would reduce the insurer's obligation and that the insurer was entitled to reimbursement for any such payments. The debtor received a Social Security disability payment, paid it to the insurer and filed bankruptcy shortly thereafter. Upon the trustee's demand, the insurer turned over the payment to the trustee as a preference. It then sought to reduce the debtor's future monthly disability payments to recoup the amount paid to the trustee. The insurer did not file a claim in the case, and the debtor received a discharge. Section 502(h) provides that a claim arising from avoidance and recovery of a transfer is allowed as a prepetition claim, but it does not limit the creditor's rights to allowance of a general unsecured prepetition claim. Recoupment is an equitable doctrine that applies only where the right asserted arises out of the same contract as the debtor's claim against the creditor. The insurer's right to repayment arises from the same contract as its payment obligation to the debtor. The court must therefore determine whether recoupment would be equitable based on the facts and circumstances of the case. *Terry v. Std. Ins. Co. (In re Terry)*, 443 B.R. 816 (8th Cir. B.A.P. 2011).

2.4.c. Court denies setoff and recoupment against damages arising from rejection of a supply contract. The debtor accepted a purchase order from its customer. The purchase order provided the terms of the debtor's sale of goods to the customer. The customer issued periodic releases specifying quantities. At the time of the debtor's bankruptcy, the debtor had an account receivable from the customer. The debtor in possession sold all of the estate's assets, including the accounts receivable, free and clear of all claims and interests, and rejected the customer's purchase order contract. The customer asserted a damage claim arising from the rejection. The buyer sued the customer to collect the receivable. A sale of receivables free and clear of claims and interests does not defeat the account debtor's recoupment rights or any setoff rights that the account debtor exercised before bankruptcy. Although the damage claim arising from the contract rejection is treated as a prepetition claim, it does not actually arise until postpetition, when the contract is rejected. Therefore, it could not be offset before bankruptcy, and it cannot be used to offset the customer's liability to the asset purchaser. Recoupment is a right arising from

the same transaction that gives rise to the receivable, such as a claim for overpayment, damage-in-transit or late delivery for the same goods. Recoupment should be construed narrowly, because its application to rejection damages would frustrate the purpose of section 365 and permit one creditor to defeat the statutory priorities. Because each release, not the purchase order, was the single transaction, damages arising from rejection against the purchase order could not be recouped against the customer's payable owing for goods shipped under each release. Therefore, the customer could neither offset nor recoup the rejection damages against the receivable. *HHI FormTech, LLC v. Magna Powertrain USA, Inc. (In re FormTech Indus., LLC)*, 439 B.R. 352 (Bankr. D. Del. 2010).

2.4.d. 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), *aff'd Swedbank AB v. Lehman Bros. Holdings Inc. (In re Lehman Bros. Holdings Inc.)*, 445 B.R. 130 (S.D.N.Y. 2011).

2.4.e. Bank may offset guarantor subsidiary's deposit against bank's claim against the parent principal obligor. The bank entered into a loan agreement with a parent holding company but advanced all funds under the loan to the holding company's two subsidiaries. One subsidiary gave the bank a deed of trust on its real property to secure repayment and agreed, in the deed of trust, to pay all indebtedness owing to the bank. All three entities filed bankruptcy. The court ordered substantive consolidation of all three debtors. The subsidiaries had funds on deposit with the bank, which the bank sought leave to offset. Section 553(a) preserves the right of setoff of mutual prepetition debts and claims. The consolidation order occurred postpetition, so any setoff right as to the subsidiaries' funds on deposit with the bank against the parent's debt to the bank did not meet section 553's requirement that both claims and debts arise before bankruptcy. However, the subsidiary's guarantee of the bank's debt arose prepetition and created the requisite mutuality to allow the bank to offset the subsidiary's deposit account against the guarantee claim. *In re England Motor Co.*, 426 B.R. 178 (Bankr. N.D. Miss. 2010).

2.4.f. Financial contract safe harbors do not permit setoff of non-mutual debts. The debtor in possession deposited funds with a bank after bankruptcy. The bank asserted a claim against the debtor under a swap agreement and asserted a right to offset the postpetition deposit against its claim. Section 553 permits setoff of "a mutual debt owing by the creditor to the debtor that arose before the commencement of the case against a mutual claim of the creditors that arose before the commencement of the case". In this case, mutuality is lacking because the deposits were made postpetition. In addition, the debt to the debtor arising from the postpetition deposits does not meet the express requirement of section 553(a) that the debt arise before the commencement of the case. Section 560(a) provides that the exercise of a contractual setoff right "shall not be stayed … or otherwise limited by operation of any provision of this title". Section 560(a) does not directly address section 553's requirements, and its language is narrower than the more commonly used, "notwithstanding any other provision of this title", and is thereby limited to the automatic stay's application. Section 553(a)'s requirements therefore apply to a setoff under a swap agreement, and section 560(a) does not protect the setoff. *In re Lehman Bros. Holdings Inc.*, 2010 Bankr. LEXIS 1260 (Bankr. S.D.N.Y. May 5, 2010).

2.4.g. Setoff is not permitted against an intrabank transfer that was not credited to the debtor's account until postpetition. On Friday afternoon, after the cut-off time for same-day intrabank transfers, one of the debtor's subsidiaries with an account at the bank initiated a transfer to the debtor's account at

the same bank. The bank's terms and conditions for intrabank transfers specified that a transfer after the cut-off time would be credited to the transferee account on the next business day, but that the transferor could revoke the transfer instructions until 10:00 AM on the next business day. The debtor filed bankruptcy Sunday night. The debtor owed the bank under a credit agreement, but the subsidiary did not. Section 553 permits setoff of a mutual debt and credit that each arose prepetition if applicable law permits the setoff. Here, applicable law paralleled section 553. A bank account represents a debt from the bank to the account holder. The debt arises when funds are finally and irrevocably credited to the account. Because the bank's terms and conditions provided for transfer only on the next business day (Monday) and the subsidiary could revoke the instructions until 10:00 AM on Monday, even though it did not, the transfer was not credited to the debtor's account until after the petition was filed Sunday night. Therefore, the debt from the bank to the debtor arose postpetition and could not be offset against the bank's claim against the debtor. *In re Lehman Bros. Holdings Inc.*, 404 B.R. 752 (Bankr. S.D.N.Y. 2009).

2.4.h. Court disallows triangular setoff among substantively consolidated debtors. The debtors owned and operated retail stores. One debtor owned the stores, the management company employed all the officers and employees and the limited partnership operated the stores and paid the management company for the use of the employees. The management company hired a vice president and entered into an employment contract that provided severance pay of $250,000. In connection with the contract's relocation expense reimbursement provisions, the vice president issued a note in the same amount. The management company terminated the vice president before bankruptcy. The debtors confirmed a plan that substantively consolidated the debtors' estates. The Bankruptcy Code permits setoff of mutual debts. The management company's severance debt to the vice president was not mutual with the vice president's debt to the operating company, because the obligations were not owing to and from the same entities in the same capacities. Substantive consolidation does not affect rights arising before consolidation and therefore cannot create mutuality for setoff purposes that did not already exist. *Ferguson v. Garden Ridge Corp. (In re Garden Ridge Corp.)*, 399 B.R. 135 (D. Del. 2008).

2.4.i. Triangular setoff violates the Bankruptcy Code. A supplier had entered into numerous petroleum products trading contracts with three affiliated counterparties, each of which later filed bankruptcy. Bilateral master agreements governed each of the contracts. Each of the master agreements contained a broad version of a cross-affiliate setoff provision permitting the supplier to offset any amounts owing to any one of the debtors against any amounts owing by any of the other debtors. The supplier sought stay relief to effect a "triangular setoff" of the amount owed to one debtor against amounts the other debtors owed to the supplier. Section 553 preserves any setoff right existing under non-bankruptcy law, but it does not create or augment a setoff right, and it imposes restrictions that might not apply under nonbankruptcy law, the most important of which is the requirement that debts to be offset must be "mutual". The Bankruptcy Code does not define "mutual". Case law is clear that debts are "mutual" only when "they are due to and from the same persons in the same capacity". The mutuality requirement thus appears to prohibit triangular setoff. Existing case law has not actually permitted triangular setoff, despite general discussions of a potential exception to the mutuality requirement. Contractual netting provisions do not make debts owing among different parties "mutual", and section 553's mutuality requirement does not contain a contractual exception. This reading is "consistent with the purpose of section 553 and the broader policies of the [Bankruptcy] Code [that] similarly-situated creditors are treated fairly and enjoy an equality of distribution .... By allowing parties to contract around the mutuality requirement of section 553, one creditor or a handful of creditors could unfairly obtain payment from a debtor at the expense of other creditors, thereby upsetting the priority scheme of the Code and reducing the amount available for distribution to all creditors". Therefore, the court disallows stay relief. *In re SemCrude, L.P.*, 399 B.R. 388 (Bankr. D. Del. 2009), *aff'd Chevron Prods. Co. v. SemCrude, L.P. (In re SemCrude, L.P.)*, 428 B.R. 590 (D. Del. 2010).

2.4.j. Debtor may offset a prepetition claim against a supplier's section 503(b)(9) administrative expense claim. The debtor received goods from a supplier within 20 days before bankruptcy, entitling the supplier to an administrative expense priority claim under section 503(b)(9). The debtor asserted various prepetition claims against the supplier. The debtor may offset the claims against the supplier's section 503(b)(9) claim. Even though that section grants the supplier's claim administrative expenses priority, it remains a prepetition claim and thus retains the requisite mutuality for section 553 to permit setoff.

Brown & Cole Stores, Inc. v. Assoc. Grocers, Inc. (In re Brown & Cole Stores, Inc.), 375 B.R. 873 (9th Cir. B.A.P. 2007).

2.4.k. Charges for services are subject to setoff recovery. The debtor communications provider overcharged its customer for toll free telephone number services. The debtor and the customer agreed that the customer could apply the overpayment amount to other telecommunications services that the debtor continued to supply to the customer, including toll free number services. The application of the overcharge credit to the toll free services that the debtor provided after the overcharge agreement was a recoupment that is insulated from avoidance under section 553(b). The application to other services, however, is an avoidable setoff. *Jahn v. U.S. Xpress, Inc. (In re Transcommunications Inc.)*, 355 B.R. 668 (Bankr. E.D. Tenn. 2006).

2.4.l. Creditor may offset subordinated claim against debt to the estate. The debtor's principal borrowed extensively from the debtor. He also guaranteed the debtor's debts and granted a security interest in his property to secure the guarantee. After bankruptcy, the guaranteed creditor foreclosed on the principal's property, giving the principal a claim against the debtor by way of subrogation or reimbursement, both of which are subordinated under section 509. Despite the subordination, the principal may offset the claim against the amount he owed the estate for his borrowings. Although setoff of a subordinated claim might not be permitted where the subordination is contractual, it will be permitted where, as here, the claim was not subordinated immediately before the commencement of the case but is subordinated only by the Bankruptcy Code. *Lambert v. Callahan (In re Lambert Oil Co.)*, 347 B.R. 508 (W.D. Va. 2006).

2.4.m. A creditor may not set off rejection damage claim against prepetition debt to the debtor. The debtor in possession rejected its lease with the creditor. The creditor sought stay relief to set off its rejection damage claim against its prepetition debt to the debtor. The court denies stay relief. Section 553(a) provides that the Bankruptcy Code does not affect any setoff right. Therefore, the creditor may set off mutual debts and claims only if the right exists under applicable nonbankruptcy law. Under section 365(g), "rejection … constitutes a breach … immediately before the date of the filing of the petition." Under section 502(g), a rejection claim "shall be allowed or disallowed the same as if such claim had arisen" prepetition. Neither section actually converts the rejection claim to a prepetition claim for all purposes nor grants a setoff right for such a claim. Besides, section 553(a) would negate any such grant ("this title does not affect any right"). Nonbankruptcy law does not permit setoff of a contingent claim for possible future breach (rejection) of a contract, so as of the petition date, the creditor did not have any setoff right, and stay relief would be denied. *In re Delta Air Lines, Inc.,* 341 B.R. 439 (Bankr. S.D.N.Y. 2006).

2.4.n. Plan provision prohibiting setoff is effective. A mutual insurer insured the debtor in possession during the chapter 11 case. The insured asset was sold during the case, and a plan was confirmed some months later. Shortly after confirmation, the buyer obtained insurance elsewhere and cancelled the insurance policy. As a mutual insurer, the insurer asserted a claim against the estate for a "release" premium, representing potential future retrospective premiums for which the insured would be liable if it remained a member of the mutual society. It failed, however, to file a proof of claim within the administrative bar date. Instead, it attempted to offset its liability to the estate for insured losses against the release premium. The liquidating plan did not discharge the debtor, but the plan enjoined any creditor from asserting a setoff against the debtor or the estate. Although section 553(a) provides that title 11 does not affect any setoff right, these facts did not call into question whether section 1141(d)'s discharge takes precedence over section 553(a) and extinguishes a setoff right, because the plan itself and the administrative claims bar date both prohibited the setoff. Therefore, the insurer was in contempt for asserting the setoff and refusing to pay the insured claim. *In re SunCruz Casinos LLC*, 342 B.R. 370 (Bankr. S.D. Fla. 2006).

2.4.o. Court denies setoff based on creditor's prepetition opportunistic behavior. The debtor had entered into a bond financing under which the indenture trustee held the bond proceeds in trust as collateral for the bonds, to be disbursed to the debtor upon the debtor's certification that it had incurred specified construction expenses. Days before bankruptcy, when the debtor's imminent bankruptcy was

widely reported in the press, the debtor submitted such a certification. The indenture trustee withheld payment, in large part because of the risk of bankruptcy. The debtor in possession submitted another request shortly after bankruptcy for expenses incurred before bankruptcy. The bankruptcy filing defaulted the bonds, and the indenture trustee then claimed a right of setoff as to both requests. The indenture trustee is permitted to offset the funds requested under the debtor's postpetition certification but not the prepetition certification. The court distinguishes the two certifications based on the bankruptcy default on the bonds. It reasons (somewhat questionably) that the debt from the debtor to the indenture trustee was not in default until the bankruptcy filing, so there was no debt that could be offset owing from the debtor to the indenture trustee until bankruptcy. The opposite was true for the postpetition certification. The court stresses the importance of not permitting a counterparty to gain advantage because of an impending bankruptcy by opportunistic behavior such as withholding contractually required payments. It also reasons (also somewhat questionably) that the bondholders did not have a security interest in the funds until the default. Therefore, it rejects the argument that the indenture trustee should be permitted to offset to permit it to fulfill its fiduciary duty to bondholders at the expense of its contractual duty to the debtor. The court does not analyze the obligations in terms of mutuality: once the indenture trustee's payment obligation matured, the funds were no longer subject to the trust in favor of the bondholders, and the indenture trustee no longer owed the construction reimbursement to the debtor in its capacity as trustee, but rather in its capacity as a contract counterparty to the debtor. As such, it could not offset. As to the postpetition certification, the funds remained subject to the trust of the indenture as of the petition date and could be offset. *U.S. Bank Nat'l. Assoc. v. United Air Lines, Inc. (In re United Air Lines, Inc.)*, 438 F.3d 720 (7th Cir. 2006).

2.4.p. Setoff of different kinds of claims permitted. The debtor provided physician services to an HMO, which paid for the services monthly in advance, and the debtor paid the HMO for services provided by third-party specialists arranged by the HMO. When the debtor fell behind in the payments to the HMO, the HMO loaned the debtor cash, repayable over time. Before the debtor had completed repayment, it filed a chapter 11 case. The HMO sought stay relief to offset the loan amounts the debtor owed against amounts that it owed the debtor for physician services. The debtor argued that because the parties were acting as lender and borrower with respect to the HMO's loan and as reimburser and provider with respect to the physician services, the debts were not owed in the same capacity. The court rejects the argument and permits the setoff. "Capacity" does not relate to the nature of the obligation owing but to the legal capacity in which the parties act. *Meyer Med. Physicians Group, Ltd. v. Health Care Serv. Corp.*, 385 F.3d 1039 (7th Cir. 2004).

2.4.q. Chapter 11 plan may not eliminate setoff right. The debtor's chapter 11 plan provided for allowance of the IRS's tax claim and payment over six years, without acknowledging the IRS's claimed setoff right. Despite the plan's language, and recognizing the split in the case law on this issue, the court permits the IRS to offset a tax debt it owes the debtor in partial satisfaction of the allowed claim. Section 553(a) preserves the right of setoff, "except as otherwise provided … in sections 362 and 363." Therefore, the discharge, which is found in section 1141, does not trump the preserved setoff right. *In re Ronnie Dowdy, Inc.*, 314 B.R. 182 (Bankr. E.D. Ark. 2004).

2.4.r. Bank is liable to trustee for setoff of directed deposit. Before bankruptcy, the debtor arrived at the bank with two cashier's checks, with directions to the teller that they be applied to her home equity line of credit. The bank accepted the checks, credited them to the debtor's checking account, and then applied the funds to the equity line. A week later, the bank reversed the entries and applied the funds to two unsecured lines of credit for the debtor's businesses. The trustee sought recovery of the funds as either a preference or an improper setoff. Tracing the history of section 553, the bankruptcy court rules that the bank's application of the funds contrary to the specific purposes for which they were deposited strips the bank of the protections of section 553 and makes the bank liable for a preference. The court does not award the funds to the debtor under section 522(h) (exemption avoiding power) or in equity and expressly leaves open the question of whether the debtor would have a claim against the bank, in addition to the trustee's claim, for damages resulting from the improper application of the funds. *Davis v. Wells Fargo & Co. (In re Haynes)*, 309 B.R. 576 (Bankr. D. Ariz. 2004).

2.4.s. Section 553 applies only to creditor setoffs, not estate setoffs. A Canadian receiver had filed a proof of claim in the U.S. bankruptcy court for an administrative expense. The debtor in possession filed a counter-claim for prepetition amounts owing to the debtor and sought to offset the postpetition administrative claim against the debtor's prepetition claim against the Canadian entity. After reviewing in detail the theoretical underpinnings of the doctrines setoff and recoupment, the court concludes that those concepts are not applicable in this case. Rather, it concludes that because the debtor in possession pursued the counter-claim, section 553 does not apply. By its terms, section 553 applies only where the creditor attempts to assert an offset. Accordingly, even though the estate's claim arose prepetition and the creditor's claim arose postpetition, the two amounts could be offset. *In re ABC-NACO, Inc.*, 294 B.R. 832 (Bankr. N.D. Ill. 2003).

2.4.t. Court disallows set-off of post-petition credit against avoidable transfer. The creditor attempted to reduce the amount for which he was liable to the estate upon avoidance of a fraudulent transfer by the amount of goods that the creditor had shipped to the estate post-petition. The Second Circuit disallows the set-off. First, it concludes that section 553 does not apply to post-petition debts and credits. Second, the set-off would be inappropriate because the transfer was fraudulent and the transferee did not act in good faith. Finally, section 502(d) requires disallowance of a claim of an entity that has not paid over an avoided transfer, and set-off should not be permitted against a claim that has not been allowed. *Glinka v. Murad (In re House Craft Industries U.S.A., Inc.)*, 310 F.3d 64 (2d Cir. 2002).

2.4.u. Account receivable may be sold free of claim of set-off. In a sale of assets free and clear of liens and other interests, the sale of the debtor's accounts receivable were free and clear of any right of set-off by the account debtor, but the account debtor's right of set-off attached to the proceeds of the sale and could be asserted against the estate. In addition, the account debtor could assert its right of recoupment against the estate, but the sale was not free and clear of the right of recoupment, which could be asserted against the buyer. *MBNA America Bank, N.A. v. TransWorld Airlines, Inc. (In re TransWorld Airlines, Inc.)*, 275 B.R. 712 (Bankr. D. Del. 2002).

2.4.v. Reconciliation of accounts may constitute a transfer. Shortly before bankruptcy, after making appropriate adjustment entries, the debtor's affiliates "reconciled" their books and records to show that amounts previously thought to be owing to the debtor were in fact not owing. The reconciliation constitutes a "transfer," as defined in section 101(54). It may have effected a setoff of debts among the debtor and the affiliates or eliminated a debt owed by the affiliates to the debtor. The elimination of the debt was a transfer. Because nearly the same definition of transfer is used under the Uniform Fraudulent Transfer Act, the reconciliation constitutes a transfer for that purpose as well. *Official Committee v. Lozinski (In re High Strength Steel, Inc.)*, 269 B.R. 569 (Bankr. D. Del. 2001).

2.4.w. Sale free and clear of "interests" does not include defenses. The estate sold all of its assets, including accounts receivable, under section 363(f), free and clear of all "interests." In an action to collect a receivable, the account debtor asserted a right of recoupment for breach of contract under which the receivable arose and a right of setoff arising under other contracts with the debtor. The Third Circuit holds that the defense of recoupment is not an "interest" that is extinguished upon a sale free and clear because it is a defense, not an affirmative claim. It suggests, however, that a right of setoff would be extinguished if it had not clearly been exercised before bankruptcy. *Folger Adam Security, Inc. v. DeMatteis/MacGregor*, JV, 209 F.3d 252 (3d Cir. 2000).

2.4.x. Recoupment denied on equitable grounds. The debtor breached the long term supply contract shortly before bankruptcy. The creditor/purchaser under the contract owed the debtor for prepetition deliveries, but asserted a damage claim for the debtor's failure to deliver shortly before and during its chapter 11 case and asserted recoupment, paying over to the debtor only the net amount owing. The court denies the recoupment claim on the grounds that the debtor received no post petition value from the contract and that there was no inequitable benefit or enrichment to the debtor that would allow the purchaser to rely on the equitable doctrine of recoupment. The purchaser, who was a net debtor to the estate, did not file a proof of claim and was therefore excluded from any recovery and required to pay the full amount owing for prepetition purchases. *Herod v. Southwest Gas Corp. (In re Gasmark Ltd.)*, 193 F.3d 371 (5th Cir. 1999).

2.4.y. A non-recourse debt is not subject to set-off. Section 553 permits set-off only of "mutual" debts. The debtor's obligation under a non-recourse mortgage is not mutual with the creditor's obligation to the debtor and therefore may not be offset. *In re Allen v. Main Assocs., L.P.*, 233 B.R. 631 (Bankr. D. Conn. 1999).

2.4.z. Only the creditor may assert a right of setoff. In a case of apparent first impression, the bankruptcy court concludes, based on standing grounds, that only the creditor that owes a debt to the debtor may assert a right of setoff or recoupment. The debtor may not assert it on the creditor's behalf. *In re Gosnell Development Corp.*, 221 B.R. 776 (Bankr. D. Ariz. 1998).

2.4.aa. Bank account withdrawal restrictions do not defeat mutuality for purposes of set off. The debtor deposited funds at the bank. A portion were designated as collateral for the loan, and the debtor was permitted to withdraw from the account only once every three months and not below the collateral amount. The withdrawal restrictions did not automatically defeat mutuality for purposes of set off. Based on the totality of the circumstances, which courts must consider, the account was still sufficiently general and not a trust account. *Official Committee of Unsecured Creditors v. Manufacturers and Traders Trust Co. (In re The Bennett Funding Group, Inc.)*, 146 F.3d 136 (2d Cir. 1998).

2.4.bb. Recoupment defined narrowly. The state labor department attempted to offset prepetition overpayments of unemployment compensation against postpetition liability to the debtor for unemployment compensation. The Second Circuit denied the application of the recoupment doctrine, holding that the attempt was a set off that is stayed under the automatic stay. In doing so, the Second Circuit adopts a narrow definition of "same transaction" so as to qualify for recoupment. *Malinowski v. New York State Department of Labor (In re Malinowski)*, 156 F.3d 131 (2d Cir. 1998).

2.4.cc. Application of a prepetition utility deposit is a recoupment, not a setoff. In a narrow opinion that the court restricts only to the special circumstances of a utility deposit, the Second Circuit rules that application of a prepetition utility deposit against a prepetition utility bill is a recoupment, not a setoff that is subject to the automatic stay. More generally, the court describes the doctrine of recoupment as applying only in the event of "a single contract or transaction or a single set of transactions," which is defined by state law, and says that it should be narrowly construed "in light of the Bankruptcy Code's strong policy favoring equal treatment of creditors and bankruptcy court supervision over even secured creditors." *New York State Electric and Gas Corp. v. McMahon (In re McMahon)*, 129 F.3d 93 (2d Cir. 1997).

2.4.dd. For setoff purposes, a secured creditor does not owe a debt to the debtor. The debtor secured its obligation to the creditor with a cash collateral account on deposit at a bank. The creditor was given a security interest in the account and the right to exercise "sole dominion and control" over the account, although the debtor retained ownership of the funds. Such a relationship does not create a debt from the creditor to the debtor: "a creditor cannot create a right of offset for its claim against the debtor by refusing to reconvey security [and] cannot create the effect of cross-collateralization by refusing to reconvey collateral for a fully paid secured debt and claiming the right of offset against [its] unsecured debt owing from the same debtor." *Biggs v. Stovin (In re Luz Intl., Ltd.)*, 219 B.R. 837 (9th Cir. B.A.P. 1998).

2.4.ee. A right of set-off may not be determined on a motion for relief from stay. The creditor filed a motion for relief from stay to permit setoff. At the hearing, the bankruptcy court granted relief and authorized the setoff. The B.A.P. reverses, holding that a determination of the right of setoff must be brought in a separate proceeding. The B.A.P. suggests an adversary proceeding for the complicated facts of this case, but does not require one. *Biggs v. Stovin (In re Luz Intl., Ltd.)*, 219 B.R. 837 (9th Cir. B.A.P. 1998).

2.4.ff. Set-off right extinguished by plan confirmation. Although a creditor had a right of setoff against the debtor, the chapter 11 plan provided for extinguishment of the right. The creditor did not object to that provision in the plan. In an action brought after confirmation, the creditor was not permitted to offset, because the provisions of the confirmed plan bound the creditor. *United States v. Continental Airlines, Inc. (In re Continental Airlines, Inc.)*, 218 B.R. 324 (D. Del. 1997), *affd.* 134 F.3d 536 (3d Cir. 1997).

2.4.gg. United States is a unitary creditor for set-off purposes. The Tenth Circuit holds that the United States is a unitary creditor for purposes of section 553 (governing set-off) and that mutuality exists between the debtor on the one hand and various agencies and departments of the United States on the other hand (in this case, the SBA and ASCS). As a result, the avoidance power of section 553 applied to the prepetition set-off in this case, rather than the preference avoidance power of section 547. *Turner v. Small Business Administration (In re Turner)*, 84 F.3d 1294 (10th Cir. 1996).

2.5 Statutory Liens

2.5.a. Trustee may not avoid a statutory tax lien perfected within 90 days before bankruptcy. The IRS issued a notice of tax assessment against the debtor about eight months before bankruptcy but did not file the notice that would perfect the lien against later judicial lien creditors until six weeks before bankruptcy. Under section 547, the trustee may avoid certain transfers made within 90 days before bankruptcy as a preference but may not avoid "the fixing of a statutory lien that is not avoidable under section 545". The IRS's tax lien is a statutory lien as defined in section 101(53). Section 545 permits the trustee to avoid only statutory liens that become effective on insolvency or a distressed financial condition. "Fixing" includes all steps in making the lien effective, including perfection. Thus, if the IRS perfects the lien before bankruptcy, it is not avoidable under section 545. A statutory lien that is not avoidable under section 545 is not avoidable as a preference. Therefore, the trustee may not avoid the lien. *Spicer v. U.S. (In re Motion Marketing Solutions, Inc.)*, 403 B.R. 403 (Bankr. N.D. Tex. 2009).

2.5.b. Wage lien under statute that permits retroactive perfection remains subject to avoidance. The state's wage lien statute grants a lien that "takes precedence over all other debts, judgments, decrees, liens or mortgages against the employer … that originate before the lien … takes effect." Section 546(b)(1)(A) makes the trustee's statutory lien avoiding power rights "subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection … ." The wage lien statute does so, but the statutory lien avoiding power of section 545(2) permits avoidance of any lien that "is not perfected or enforceable [upon bankruptcy] against a bona fide purchaser … ." The wage lien statute does not protect the lien against a bona fide purchaser. Therefore, its application against prior perfected liens does not protect it under section 546(b)(1)(A). *In re Globe Bldg. Materials, Inc.*, 463 F.3d 631 (7th Cir. 2006).

2.5.c. A statutory lien may be avoided only under section 545. The trustee challenged the validity of a state statutory tax lien under the bona fide purchaser avoiding power of section 544(a)(3). The court rejected the challenge, ruling that section 545 was the only basis on which a statutory lien could be challenged. *In re Sullivan*, 254 B.R. 661 (D.N.J. 2000).

2.5.d. A trustee is not a bona fide purchaser as against the IRS tax lien. Section 545 of the Bankruptcy Code gives the trustee the status of a bona fide purchaser as against statutory liens, including the federal tax lien. Under section 6323 of the Internal Revenue Code, the tax lien is not valid on certain kinds of property against a purchaser "who, for adequate and full consideration in money or money's worth acquired an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice." The Ninth Circuit rules that section 545 does not give the trustee the status required under IRC section 6323 to defeat the tax lien. *Battley v. United States (In re Berg)*, 121 F.3d 535 (9th Cir. 1997); *Accord, In re Linn*, 212 B.R. 169 (S.D. Fla. 1997).

2.5.e. Trustee's bona fide purchase status under section 545(2) does not defeat IRS lien. Following the Sixth and Ninth Circuits, which are the only two circuits to have addressed the issue, the Eighth Circuit B.A.P. holds that the definition of "purchaser" in section 6323(h)(6) of the Internal Revenue Code prevents the trustee's status as a bona fide purchaser under section 545(2) of the Bankruptcy Code from defeating the IRS' lien on cash and securities. *Janssen v. United States (In re Janssen)*, 213 B.R. 558 (8th Cir. B.A.P. 1997).

2.6 Strong-arm Power

2.6.a. A radiologist's accounts receivable are not proceeds or product of a medical imaging device. The debtor radiologist granted the bank a security interest in a medical imaging camera and the proceeds and product of the camera. In his practice, the debtor used the camera and generated accounts receivable. The record did not indicate whether the receivables were solely for the use of the camera or whether they included amounts owing for the debtor's services. Under Article 9, proceeds includes, among other things, "whatever is collected on, or distributed on account of, collateral." Without a showing of the extent, if any, to which the receivables arose from the use of the camera, the court could not conclude that the receivables were proceeds of the camera. Even to the extent that the receivables were for the use of the camera, they were not "collected on" the camera or "distributed on account of" the camera and so were not proceeds of the camera in any event. Article 9 does not contain a definition of "product." Using a general definition, product is yield, income, receipts or return. The receivables do not meet this definition, because the debtor receives no yield, income, receipts or return on the camera from the receivables themselves, only when he collects the receivables. Therefore, they are not product. *Swope v. Comm'l Sav. Bank (In re Gamma Center, Inc.)*, 489 B.R. 688 (Bankr. N.D. Ohio 2013).

2.6.b. Supplier's retained title in corn that was delivered to the debtor was only a security interest. The debtor ethanol producer contracted with a corn supplier to provide the debtor's entire corn requirements. The contract provided that delivery of the corn was complete when it arrived at the debtor's site. It also provided that it would be stored in bins on the debtor's site that the debtor leased to the supplier and that the supplier would retain ownership until the corn passed from the bins through the weigh station on its way into the ethanol plant. The supplier controlled the electricity to the bins and conveyor belts so that it could prevent the debtor and anyone else from removing the corn from the bins, but until the debtor ceased operations and the supplier locked the bins, the debtor removed corn as needed to feed plant operations. The bins did not exhibit any signs or other evidence that the supplier owned the corn in the bins, and the supplier did not file a UCC-1 financing statement. U.C.C. section 2-401(1) provides, "Any retention or reservation of title (property) by the seller in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest." The section thus makes any title retention after delivery to the buyer subject to Article 9. Despite the parties' intention that ownership not transfer until the corn passed through the weigh station, section 2-401 made title pass, subject to the retention of a security interest, upon delivery, which the contract defined as complete upon arrival at the debtor's site. The supplier did not perfect its security interest by filing. Perfection by possession requires unequivocal, absolute, notorious dominion or control that puts third parties on notice. The supplier's ability to lock down the corn, without more, such as notice on the bins, was insufficient. Therefore, the corn is property of the debtor, and the trustee avoids the unperfected security interest. *Clean Burn Fuels, LLC v. Perdue Bioenergy, LLC (In re Clean Burn Fuels, LLC)*, ___ B.R. ___, 2013 Bankr. LEXIS 2009 (Bankr. M.D.N.C. May 16, 2013).

2.6.c. Postpetition turnover may defeat possessory lien. The bank had a possessory security interest in the debtor's bank account, which held over $900,000 on the petition date. The trustee demanded turnover. The bank agreed, withholding $50,000 to cover returned checks and other chargebacks. The chargebacks ultimately exceeded $500,000. The bank sought repayment from the trustee and adequate protection about six months after turnover. Section 542(a) requires turnover to the trustee of property of the estate but does not automatically provide for adequate protection of a creditor's lien in the property. Just as with setoff, unless the creditor requests adequate protection, it loses its possessory lien when it surrenders possession. Therefore, the trustee may retain the funds. *N. Am. Banking Co. v. Leonard (In re WEB2B Payment Solutions, Inc.)*, 488 B.R. 387 (8th Cir. B.A.P. 2013).

2.6.d. UCC-3 termination statement is effective only if authorized. A lender syndicate financed a series of synthetic leases for the debtor. The agent for the syndicate filed UCC-1 financing statements to perfect the lenders' security interests in the underlying property. Separately, another lender syndicate, using the same agent, issued a secured loan to the debtor secured by substantially all of its assets. The agent also filed a UCC-1 financing statement. When the leases expired, the debtor and the agent prepared documentation, including UCC-3 termination statements, to reflect the final payoff and release of security interests in the leased property. One of the UCC-3 termination statements referenced the UCC file number

for the secured loan financing statement, without either the debtor or the counsel to the agent for the lease syndicate (which was different from the counsel for the loan syndicate) realizing that the file number related to the loan rather than to the lease. Under UCC section 9-513(d), upon the filing of a termination statement, the related financing statement ceases to be effective but, under UCC section 9-510(d), only if filed by a person authorized to file it under section 9-509(d). Under that section, a person may file a termination statement only if the secured party authorizes the filing. Ordinary agency principles determine authority. Based on the facts here, the agent for the loan syndicate had not authorized the filing of the termination statement for the loan security interest. Therefore, the erroneous termination statement was not effective. *Official Comm. of Unsecured Creditors v. JPMorgan Chase Bank, N.A. (In re Motors Liquidations Co.)*, 486 B.R. 596 (Bankr. S.D.N.Y. 2013).

2.6.e. Arbitration clause between debtor and creditor does not bind trustee in avoiding power litigation. An art owner consigned artwork to the debtor. The owner did not file a financing statement. The consignment agreement provided for arbitration of any disputes. The owner filed a proof of claim. The liquidating trustee challenged the owner's ownership of the artwork and objected to the claim on the ground, among others, that the owner's interest in the artwork was avoidable under the trustee's strong-arm power, section 544(a). The owner sought stay relief to pursue arbitration of the dispute. Whether a court must order arbitration under the Federal Arbitration Act depends first on whether the parties agreed to arbitrate. The arbitration agreement between the owner and the debtor does not bind the trustee when the trustee is asserting creditors' rights, such as under the strong-arm power, rather than the debtor's rights under section 541(a). In addition, if the arbitration agreement is binding, the bankruptcy court has discretion not to order arbitration in a core proceeding if arbitration would inherently conflict with Bankruptcy Code provisions or necessarily jeopardize the Bankruptcy Code's objectives. The determination of what constitutes property of the estate, the allowance of a proof of claim and the adjudication of a strong-arm power challenge to a lien are all core proceedings. The Bankruptcy Code's policy of centralizing resolution of disputes relating to such matters to promote efficient estate administration overcomes the Arbitration Act's policy favoring arbitration. Therefore, the bankruptcy court properly denied stay relief to pursue arbitration. *Kraken Invs. Ltd. v. Jacobs (In re Salander-O'Reilly Galleries, LLC)*, 475 B.R. 9 (S.D.N.Y. 2012).

2.6.f. Section 544(a) does not permit the trustee to bring claims on behalf of creditors for aiding and abetting the debtor's fraud. The trustee brought an action against a third party for aiding and abetting the debtor's fraud. The debtor could not have brought such an action, because the *in pari delicto* doctrine would have barred it. So the trustee sued on behalf of all creditors, asserting that section 544(a) gave him authority to do so. Section 544(a) provides that the trustee "shall have, as of the commencement of the case … the rights and powers of, or may avoid any transfer of property … that is voidable by (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien". A creditor that extends credit to the debtor at the time of the commencement of the case could not assert any claim, such as one for prepetition fraud, that accrued before then, nor could such a creditor bring claims on behalf of other creditors. Moreover, such a reading would obviate any need for section 544(b), because it would give the trustee all rights to avoid transfers under state fraudulent transfer laws, and would effectively overrule *Caplin v. Marine Midland Grace Trust Co*., 406 U.S. 416 (1972), which prohibited a trustee from asserting claims belonging solely to creditors. Therefore, the court dismisses the trustee's action. *Picard v. JPMorgan Chase & Co. (In re Bernard L. Madoff Inv. Secs.)*, 460 B.R. 84 (S.D.N.Y. 2011).

2.6.g. Section 544(a) does not apply to a postpetition transfer. An indirect equity owner of the debtor transferred an interest of the estate in property while the chapter 11 case was pending. Section 544(a) permits a trustee to "avoid any transfer of property of the debtor". By contrast, section 549(a) permits a trustee to "avoid a transfer of property of the estate". The distinction is critical. Property of the debtor becomes property of the estate under section 541(a) upon the filing of the petition. Therefore, section 544(a) does not apply to a postpetition transfer, which is a transfer of property of the estate. *Morton v. Kievit (In re Vallecito Gas, LLC)*, 440 B.R. 460 (Bankr. N.D. Tex. 2010).

2.6.h. Trustee may avoid consignors' interests in consigned goods. The debtor antique dealer dealt in consigned goods but did not mark the goods as such in his shop. Other antique dealers delivered goods worth more than $1,000 to the debtor for sale. Under U.C.C. section 9–391, goods received on consignment are treated as the debtor's property for purposes of determining creditors' and purchasers' rights. Section 9–102(a)(20) defines "consignment" as a transaction in which a person delivers non-consumer goods worth less than $1,000 per delivery for sale to a merchant who deals in goods of that kind, is not an auctioneer and is not generally known by its creditors to deal substantially in others' goods. Here, the consignors were all dealers, so the goods were inventory in their hands, not consumer goods. The debtor was not known to deal substantially in others' goods, because there was no indication that the goods were delivered by others. Section 544(a) gives the trustee the rights of a hypothetical ideal judicial lien creditor. With such rights, the trustee may avoid the consignment interests and recover the consigned goods for the estate. *In re Niblett*, 441 B.R. 490 (Bankr. E.D. Va. 2009).

2.6.i. Trustee may disregard the debtor's funding affiliate for purposes of section 544(a) if the affiliate is not sufficiently separate. The debtor established a funding affiliate to whom it transferred its accounts receivable for no apparent consideration, except that the affiliate took a small percentage of each collection to fund its minimal operating expenses. The affiliate borrowed against the receivables and gave the lender a security interest. The affiliate operated as if it were a department of the debtor. It had no office, phone number or checking account. All its correspondence was on the debtor's stationery. It did not prepare financial statements or file tax returns. The debtor continued to carry the receivables on its own books and told other creditors that the lender had a security interest in the receivables. Under section 544(a), a trustee may avoid a transfer that a hypothetical judicial lien creditor could avoid. For this purpose, the trustee may disregard the affiliate as a separate entity. *Paloian v. LaSalle Nat'l Bank Assoc.*, 619 F.3d 688 (7th Cir. 2010).

2.6.j. Trustee avoids unrecorded real property equitable interest asserted by trustee in prior bankruptcy case. Parents bought real property for their daughter, while she was struggling financially, with the apparent intent that she be the owner once she could take out a mortgage on it. Seven years later, still struggling, she filed bankruptcy. She did not list the real property in her schedules, she received her discharge and her case was closed quickly. One year later, the father filed bankruptcy. By then, the father and his ex-wife had separated and divided their property, and the father owned a 50% interest in the real property. The daughter's trustee learned of her claim of an equitable interest in the real property and moved to reopen the daughter's case to claim her equitable interest in the property. Section 544(a)(3) gives a trustee the rights of a hypothetical bona fide purchaser of real property, without regard to the trustee's knowledge. Under state law, a bona fide purchaser of real property without knowledge of an equitable interest defeats the interest if it is unrecorded. Therefore, the father's trustee avoids the interest in the real property asserted by the daughter's trustee. *Collins v. Duda (In re Duda)*, 422 B.R. 339 (Bankr. D. Mass. 2010).

2.6.k. Filing with the petition of schedules that list an unrecorded mortgage does not defeat the trustee's strong-arm power. The creditor refinanced the debtor's home mortgage and filed a release of the prior mortgage, but failed to record the new mortgage. The debtor filed bankruptcy two years later and filed her schedules, which listed the mortgage, with the petition. Section 544(a)(3) permits the trustee to avoid a transfer of real property that is avoidable by "a bona fide purchaser of real property … from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case" and "without regard to any knowledge of the trustee". The trustee is charged with knowledge of the schedules. However, the schedules cannot be filed until the case is filed, and the avoiding power operates as of the filing of the petition. At that instant, the trustee does not have knowledge of the schedule's contents. Moreover, the trustee's avoiding power operates "without regard to any knowledge of the trustee". Therefore, the trustee may avoid the mortgage. *Chase Manhattan Bank, N.A. v. Taxel (In re Deuel)*, 594 F.3d 1073 (9th Cir. 2010).

2.6.l. Suppliers failed to prove that deliveries of goods were not consignments. Several suppliers provided the debtor jewelry for resale at "trunk shows" but did not file UCC-1 financing statements. After the order for relief, the suppliers sought to recover the goods as common law bailments, rather than consignments. The U.C.C. defines "consignment" in section 1-201(a)(20) as "a transaction, regardless of

its form, in which a person delivers goods to a merchant for the purpose of sale and … the merchant … is not generally known by its creditors to be substantially engaged in selling the goods of others …". If the transaction is a consignment, that is, if the merchant's creditors do not generally know it to sell others' goods, then the transaction creates a security interest that must be perfected under the U.C.C. to withstand the trustee's strong-arm power under section 544(a)(1). The consignor has the burden of proof of showing that creditors generally know that the merchant's creditors generally know that it is selling others' goods and therefore that the consignor need not file a financing statement to perfect its interest, because it creates an incentive for the consignor to file a financing statement simply out of an abundance of caution. To meet the "generally known" requirement, the alleged consignor must show that a majority in number of the consignee's creditors know. General industry practice or knowledge does not suffice. Because the suppliers here did not provide the necessary evidence, the court grants judgment avoiding the suppliers' interests in the goods. *French Design Jewelry, Inc. v. Downey Creations, LLC (In re Downey Creations, LLC)*, 414 B.R. 463 (Bankr. S.D. Ind. 2009).

2.6.m. "Perfection" means effective against a later interest. The creditors sued the debtor before bankruptcy, obtained an order for attachment of real and personal property and levied the attachments on real property and intangible personal property. Before the creditor obtained a judgment, the debtor filed bankruptcy. Applicable nonbankruptcy law in this state grants priority to a creditor levying on real property against later purchasers, but the judicial lien on the real property is not enforceable unless the creditor obtains a judgment in the underlying action. The state law does not similarly grant retroactive priority to an attachment of intangible personal property. The trustee's strong-arm power under section 544(a) permits the trustee to avoid an interest in real property that is not perfected against a bona fide purchaser of the real property as of the petition date. The applicable nonbankruptcy law here does not use the term "perfected" to describe the priority of the attaching creditor over a later purchaser. However, the strong-arm power should be so construed, so that the trustee could not here use the strong-arm power to avoid the creditor's judicial lien. *Ivester v. Miller*, 398 B.R. 408 (M.D.N.C. 2008).

2.6.n. Perfection by possession requires actual possession, not through the debtor as agent; a surety bond is not an instrument. The debtor leased equipment to various lessees. The debtor obtained surety bonds to guarantee the lessees' payments. The debtor granted the bank a security interest in the lease receivables and in the underlying leases and equipment, in the surety bonds and in the lease files and other related documents. The bank did not file a financing statement, relying on perfection of its interest in the receivables as payment intangibles that the debtor sold to the bank. In addition, the bank appointed the surety as servicer for the obligations, and the servicer appointed the debtor as sub-servicer. The servicing agreements required the surety to hold the documents, including the leases, as servicer and the debtor to hold the documents as sub-servicer. However, the bank held direct possession of the surety bonds. In an earlier decision, the court determined that the debtor did not sell the lease receivables but granted a security interest. The bank argues in this case that it has perfected its security interest in the lease payments by perfection in the underlying leases by possession. A secured party or its agent must have actual possession of the collateral to perfect. However, the agent may not be the debtor, because the purpose of possession is to put third parties on notice that the debtor does not have unfettered control of the collateral. Therefore, the bank did not have sufficient possession to perfect its security interest in the leases or in the lease receivables. The bank also did not perfect its security interest in the surety bond, despite actual possession. A secured party may perfect a security interest in an instrument by possession. Under U.C.C. §9-102(1)(tt), an instrument is a "writing that evidences a right to payment of a monetary obligation … and is of a type that in ordinary course of business is transferred by delivery with any necessary endorsement or assignment." Although the surety bond is assignable, a surety bond is not of a type transferred in the ordinary course of business, because there is no market for surety bonds. In addition, it does not evidence a monetary obligation, because it acts only as a guarantee, not as a fixed right to payment, and does not stand independent of the underlying obligation. *F.D.I.C. v. Kipperman (In re Comm'l Money Ctr., Inc.)*, 392 B.R. 814 (9th Cir. B.A.P. 2008).

2.6.o. Strong-arm power does not apply to sold mortgage loans. The debtor originated mortgage loans and sold them to a buyer. The buyer took possession of the loans and the mortgages but did not record its interest in the land records office and did not file a UCC-1 against the debtor. The trustee sought to avoid the buyer's interest in the mortgages under the strong-arm power, which gives the trustee the rights and powers, as of the petition date, of a hypothetical judicial lien creditor. The strong-arm power does not apply, however, to a sale. In addition, section 541(d) insulates the buyer's interest in the

purchased loans and prevails over the strong-arm power. *Stalford v. Lion Fin., LLC (In re Lancaster Mortgage Bankers, LLC)*, 388 B.R. 106 (Bankr. D.N.J. 2008).

2.6.p. Trustee may rely on triggering creditor who has different claims as of the petition date than as of the transfer date. The debtor transferred property nearly four years before bankruptcy, while it was insolvent, had unreasonably small capital and had incurred debts beyond its ability to pay as they matured. At the time of the transfer, the debtor had several specified creditors with open account trade claims, who were paid in full shortly after the transfer. The same creditors had open account trade claims as of the petition date based on later sales to the debtor. The trustee sued as successor to these creditors to recover the transfer as fraudulent under the New York Uniform Fraudulent Conveyance Act. Section 544(b) authorizes the trustee to avoid any transfer that is avoidable by a creditor holding an allowable unsecured claim. These creditors hold allowable unsecured claims, though different claims than they held at the time of the transfer. Section 544(b) requires only that the triggering creditor be able to avoid the transfer, not that the triggering claim be the same. Therefore, the trustee may use these creditors as triggering creditors to avoid the claim. The court does not discuss the provision of the New York UFCA that makes a transfer made without fair consideration by a debtor with unreasonably small capital or that has incurred debts beyond its ability to pay voidable as to both present and future creditors. *Silverman v. Sound Around, Inc. (In re Allou Distributors, Inc.)*, 392 B.R 24 (Bankr. E.D.N.Y. 2008).

2.6.q. Strong-arm power is ineffective against a security interest in an asset on which a judicial lien creditor could not obtain a lien. The FCC sold C-block and F-block spectrum licenses for the buyer's promissory note secured by the licenses. The FCC perfected its security interest by a UCC-1 filing, but the filing lapsed before the petition date. The federal statute authorizing the licenses and the installment payments for their purchase, as well as the FCC regulations, provide that the licenses do not create any right beyond their terms and conditions, are "conditioned upon the full and timely payment of all monies due", and are not transferable without FCC approval. Section 544(a)(1)'s strong-arm power gives the trustee the rights and powers of a hypothetical judicial lien creditor as of the petition date. Under the U.C.C., such a creditor's lien would take priority over an unperfected security interest. But if federal law governs the FCC's rights as a secured creditor, then the U.C.C. priority rules do not apply. Here, unlike state-created property rights on which a debtor grants a federal lien under a general federal lending programs, the license is created under federal law, which therefore defines the extent of the debtor's interest. That interest is conditioned upon full payment of the purchase price, and the license is not transferable without FCC approval. Therefore, a hypothetical judicial lien creditor could not obtain a lien on the licenses that is superior to the FCC's lien, so the trustee's strong-arm power is ineffective to avoid the FCC's lien. *Airadigm Comm'ns, Inc. v. Fed. Comm'ns Comm'n (In re Airadigm Comm'ns, Inc.)*, 519 F.3d 640 (7th Cir. 2008).

2.6.r. LLC agreement requiring prior consent to transfer is enforceable against a secured creditor. The debtor agreed to grant a security interest in his interests in various LLC's to his secured creditor. The LLC agreements prohibited assignment or transfer of all or any part of the LLC interests without the LLC manager's prior consent. The debtor signed a security agreement and a UCC-1 financing statement but did not obtain the LLC manager's prior consent. The security interests are invalid, because the anti-assignment provisions in the LLC agreements are enforceable under applicable nonbankruptcy (here, Illinois) law, because "a business's organizational agreement may control the procedure for creating a valid assignment of an interest in that business." *In re Weiss*, 376 B.R. 867 (Bankr. N.D. Ill. 2007).

2.6.s. Schedules do not impart constructive notice to trustee. The debtor financed and then later refinanced her house with the same lender. The lender recorded the mortgage for the first financing, but failed to record the second mortgage. The first mortgage did not remain of record. The debtor filed a voluntary petition. Her schedules, filed with the petition, listed the debt secured by her house. The listing did not give the trustee constructive notice of the lien so as to defeat his status as a hypothetical ideal bona fide real estate purchaser under section 544(a)(3). Section 544(a)(3) gives the trustee that status "as of the commencement of the case." Under section 301, a voluntary petition commences the case. The schedules are filed after the petition, even when they are filed in the same package with the petition, because they are separate documents, filed on separate Official Forms, and they cannot be filed until there is a case in which to file them. Notice of a lien in the text of an involuntary petition might provide

constructive notice, because the notice there is in the petition itself, not in a later-filed document. But in a voluntary case, the schedules (as distinguished from the petition) cannot give the trustee constructive notice of the lien "as of the commencement of the case" to defeat his hypothetical bona fide purchaser status. *Taxel v. Chase Manhattan Bank, USA, N.A. (In re Deuel)*, 361 B.R. 509 (9th Cir. B.A.P. 2006).

2.6.t. Preference section's relation-back provisions do not apply to the strong-arm power. The creditor loaned the debtor money the day before an involuntary bankruptcy petition was filed but did not file its financing statement until five days later. The trustee may avoid the security interest under the strong-arm power of section 544(a). The relation-back provisions of section 547(e) by their own terms apply only to preferences, and the relation-back exceptions to avoidance in section 546(b) encompass only "generally applicable [relation-back] law," which does not include bankruptcy relation-back provisions. Finally, the involuntary case was "commenced" under section 303(a) on the date of the filing of the petition, not on the date of the entry of the order for relief. *Ostrander v. Gardner (In re Millivision, Inc.)*, 474 F.3d 4 (1st Cir. 2007).

2.6.u. Debtor may separate payment streams from chattel paper in granting a security interest. The debtor leased equipment to subprime lessees. To enhance creditworthiness, the debtor obtained surety bonds that guaranteed the lessees' payments to the debtor. The debtor financed the equipment and leases by borrowing from a bank, to whom it granted a security interest in the leases, the payment streams due under the leases, and the surety bonds, but it separated the security interest in the payment streams from the security interest in the leases. The payment streams are payment intangibles, not chattel paper. The leases are chattel paper, which evidence a payment obligation and a security interest. The debtor may strip the payment streams from the leases and grant a separate security interest in them. Revised Article 9's definitions and other provisions make the distinction between chattel paper and payment intangibles. The court acknowledges but does not address the difficult perfection and priority issues that arise when the payment streams and chattel paper are separated in this manner but concludes that Revised Article 9's direct language controls, despite the difficulty in implementing the effects of the ruling. *Netbank, FSB v. Kipperman (In re Commercial Money Ctr., Inc.)*, 350 B.R 465 (9th Cir. B.A.P. 2006).

2.6.v. Creditor may re-perfect its security interest by filing continuation financing statement. The bank loaned the debtor money in January 1999. It took a security interest and filed a financing statement signed by the debtor. Under the security agreement, the debtor "irrevocably appoints Lender as its attorney-in-fact for the purpose of executing any documents necessary to perfect or to continue the security interest." In January 2004, the security interest filing lapsed. The bank filed a continuation statement in October 2004. The bank was authorized to do so by the security agreement and by Old Article 9, § 9-402(b)(3). After Revised Article 9 became effective, it was equally authorized to do so by new section 9-509 and because Revised Article 9 eliminated the requirement of the debtor's signature on a financing statement. *Bank One v. Bononi (In re Aliquippa Mach. Co.)*, 343 B.R. 145 (Bankr. W.D. Pa. 2006).

2.6.w. Landlord has a perfected security interest in a CD deposited with its predecessor. The debtor leased office space from a bank. The lease required the debtor, "as security and collateral for Tenant's performance under this Lease [to] deposit [funds] with the Landlord which will be held by Landlord in an interest bearing certificate of deposit account …. Upon any material default … Landlord … may use, apply, or retain all or any portion of such deposit for the payment of any Rent …." The language, although missing words of grant, is sufficient to create a security interest, because it evidences the parties' intent to create a security interest by giving the landlord an interest in the CD to secure the debtor's performance and describes the CD as security for that performance. The CD was not evidenced by a transferable certificate. Therefore, the deposit is not an instrument that requires perfection by filing but a deposit account that requires perfection by control. The bank here, as both landlord/secured party and the depository bank, had control as defined in U.C.C. § 9-104. The bank later sold the real property and assigned its security interest in the CD to the buyer. U.C.C. § 9-310(C) provides that a filing is not required to perfect an assignee's security interest to continue the assignor's perfection against the debtor's creditors. Because the original landlord's security interest was perfected, it remained perfected in the hands of the assignee, even though the assignee did not have control over the CD, as the bank did. *In re Verus Inv. Mgmt., LLC*, 344 B.R. 537 (Bankr. N.D. Ohio 2006).

2.6.x. "One year" does not necessarily mean 365 days. Section 546(a)(1)(A) requires that certain avoiding power actions be brought within "2 years after the entry of the order for relief." In this case, the order for relief was entered on July 22, 2003. The trustee filed the avoiding power action on July 22, 2005. The two-year period included a leap-year, that is, a year with 366 days. Under the "anniversary date rule," which the court adopts, a year is measured as 12 calendar months, not 365 days, so the complaint was timely. *Callahan v. Moore (In re Gen. Creations, Inc.)*, 343 B.R. 548 (Bankr. W.D. Va. 2006).

2.6.y. The Archbishop of Portland in Oregon (defined under Oregon law as a corporation sole) held record title to all of the real property on which the churches and schools of the Archdiocese were located but claimed that it held title in trust for the parishes and schools. The court had previously determined that the parishes and schools were not legal entities separate from the Archdiocese. The Tort Claimants Committee, moving on behalf of the estate, sought to avoid the beneficial interests in the real property that the parishes and schools claimed, using the powers under section 544(a)(3) of a hypothetical bona fide purchaser of real estate from the debtor as of the commencement of the case. Section 541(d) excludes from the estate property in which the debtor holds only legal title and not an equitable interest. It does not, however, supersede the avoiding power in section 544(a)(3). The Committee could therefore use section 544(a)(3) to avoid the unrecorded beneficial interests. A hypothetical bona fide purchaser is subject, under applicable nonbankruptcy law, to inquiry notice as well as to recorded notice of an adverse interest. The listing of the adverse interest on the debtor's bankruptcy schedules that were not filed with the petition does not give notice sufficient to put a hypothetical purchaser on inquiry notice as of the commencement of the case of the adverse interest, although the listing on schedules filed with the petition might. *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Oregon (In re Roman Catholic Archbishop of Portland in Oregon)*, 335 B.R. 868 (Bankr. D. Ore. 2005).

2.6.z. Reclaiming creditors takes priority over unperfected secured creditor. The debtor, a used car dealer, bought three cars and financed them with a secured creditor, who failed to perfect its security interest by properly recording the certificate of title. The debtor's check to the seller failed to clear. Before bankruptcy, the seller properly and timely demanded reclamation, and the debtor returned the cars. UCC section 2-702 makes a seller's reclamation rights subject to the claims of a good faith purchaser, which the courts have construed to include a secured creditor. However, to qualify, the secured creditor must observe "reasonable commercial standards of fair dealing in the trade." Failure to perfect is not consistent with reasonable commercial standards. Therefore, the unperfected secured creditor did not qualify as a good faith purchaser, and the reclaiming seller's rights were superior. *Davis v. Par Wholesale Auto, Inc. (In re Tucker)*, 329 B.R. 291 (Bankr. D. Ariz. 2005).

2.6.aa. Lender is not liable for not warning take-out lender of debtor's fraud. When the lender suspected that the debtor was engaged in fraudulent accounting practices, inflating sales, receivables and inventory, and that the principals were looting the company, it did not call a default or accelerate the loan, but it put pressure on the debtor to refinance. The debtor did so, but ultimately failed. Although the new lenders asked the old lender for information about the debtor, the old lender did not respond. After bankruptcy, the new lenders sued the old lender for aiding and abetting the fraud and sought recovery of the amount of their new loan plus the amount that the principals had looted after the new loan was made. A claim for aiding and abetting under New York law requires that the defendant had actual knowledge of a fiduciary's breach of obligations and actively induced or participated in the breach. Here, the mere knowledge or suspicion of the breach, even coupled with the pressure to refinance the old loan, did not amount to active inducement or participation in the breach. The breach had existed before old lender learned of it and continued thereafter. The old lender therefore did not induce. In addition, the old lender had no duty to the new lenders, and it did not make any misrepresentations to the new lenders. It merely refused to reveal what it knew. It was fully entitled to protect its own interests in seeing its loan repaid and is not liable for aiding and abetting. *Sharp Int'l Corp. v. State St. Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43 (2d Cir. 2005).

2.6.bb. Lender is not liable for not warning the banking regulator or other creditors of the debtor's fraud. The debtor's principal embezzled substantial funds from the debtor. Its bank lender suspected a problem, stopped advancing, and collected all of its outstanding loans, without advising either its banking regulators or the debtor's other lenders of its suspicions of the crimes afoot or of the potential

uncollectability of the loans. Because the bank was under no duty to warn other lenders and neither participated in the borrower's embezzlement nor made any fraudulent statements to its regulators or to any of the other lenders, it is not liable to the other lenders for their losses. It received a preference, no more, which is not recoverable outside of bankruptcy. *B.E.L.T. Inc. v. Wachovia Corp.*, 403 F.3d 474 (7th Cir. 2005).

2.6.cc. Settlement proceeds are payment intangibles or, alternatively, proceeds. The debtor's dairy cows were destroyed by a faulty electric fence. The debtor sued and recovered a settlement payment from the fencing company. The bank had a security interest in the cows and in all after-acquired property, including payment intangibles. The debtor argued that that action against the fencing company sounded in tort and therefore was not subject to the bank's security interest. Under UCC Revised Article 9 § 9-204(b)(2), an after-acquired property clause cannot reach a future commercial tort claim, which is not a general intangible under UCC Revised Article 9 § 9-102(a)(42). However, once the action settles and the defendant becomes contractually obligated to pay, the obligation becomes a payment intangible that is subject to the bank's after-acquired property clause. Alternatively, the settlement payment was collateral proceeds, which includes rights arising from loss or damage to collateral, under UCC § 9-102(a)(64)(D). *Wiersma v. O.H. Kruse Grain & Milling (In re Wiersma)*, 324 B.R. 92 (B.A.P. 9th Cir. 2005).

2.6.dd. Trustee does not have rights of hypothetical tax creditor. In *United States v. Craft*, 535 U.S. 274 (2002), the Supreme Court held that under the Internal Revenue Code, the IRS has authority to obtain a lien against property held in tenancy by the entirety, even though only one spouse owed the taxes. Under section 544(a)(2), the trustee has the rights and powers of a hypothetical "creditor that extends credit to the debtor at the time of the commencement of the case." The trustee here argues that he has the rights of the IRS as a hypothetical credit extender, but the court rules that the phrase "extends credit" in section 544(a)(2) does not include an involuntary extension of credit such as taxes. It notes that to rule in the trustee's favor would essentially eliminate the tenancy by the entirety exemption from the Bankruptcy Code, which Congress clearly did not intend. *Schlossberg v. Barney*, 380 F.3d 174 (4th Cir. 2004).

2.6.ee. Only the trustee may pursue an alter ego claim against a corporate parent. Section 544(a)(2) grants a trustee all "the rights and powers of . . . a creditor that . . . obtains . . . an execution against the debtor that is returned unsatisfied . . . ." Because a corporation's creditors may sue its shareholder as the corporation's alter ego, so may the trustee. And because the trustee may sue under an avoiding power, the creditors may not, as that right vests exclusively in the trustee. *Doctors Hosp. of Hyde Park, Inc. v. Desnick (In re Doctors Hosp. of Hyde Park, Inc.)*, 308 B.R. 311 (Bankr. N.D. Ill. 2004).

2.6.ff. Filing a financing statement to perfect a security interest in proceeds of a real estate sale contract must be at the debtor's executive offices. Revised Article 9 of the UCC requires perfection of a security interest in a general intangible by filing a financing statement in the State of the debtor's chief executive office. However, section 9-104(j) excludes interests in real property, leases, or rents from the requirements of Article 9. In this case, the lender took a security interest in a contract for sale of real property and filed its financing statement in the State where the real property was located, not in the State of the debtor's chief executive office. Because the secured creditor's interest was an interest in proceeds of the sale contract, rather than in the real property itself, the filing did not perfect the security interest. The opinion letter from debtor's counsel that the State where the real property is located was the correct place to file did not change the outcome. *Fleet National Bank v. Whippany Venture I, LLC (In re The IT Group, Inc, Co.)*, 307 B.R. 762 (D. Del. 2004).

2.6.gg. Assignment of expected tort recovery creates a security interest. After they had filed an action to recover for injury suffered in an automobile accident, the debtors borrowed money and gave an assignment of the proceeds of the action to the lender to secure repayment of the loan. The transaction is subject to Revised Article 9, because the assignment was intended to secure repayment of the loan, rather than "in full or partial satisfaction of a pre-existing indebtedness." (UCC Section 9-109(4)(g).) Perfection of the security interest required filing, because the asset was a "general intangible" rather than a "payment intangible." Under UCC Section 9-102 and Section 9-109, the obligation was not a monetary obligation until it was reduced to judgment or settled. Therefore, the transaction did not qualify for any of

the automatic perfection provisions of Revised Article 9 applicable to an account or to payment intangibles. *Houston v. Eiler (In re Cohen)*, 305 B.R. 886 (9th Cir. B.A.P. 2004).

2.6.hh. Trustee's rights as bona fide purchaser defeats resulting trust. The bankruptcy court had previously determined that real property of the debtor was subject to a resulting trust in favor of a creditor. The debtor in possession sought to defeat the resulting trust by use of the bona fide purchaser avoiding power of section 544(a)(3). The court avoided the interest because, under state law, an unrecorded interest is not effective "in law or equity" against a subsequent purchaser for value and without notice. *In re Loewen Group Int'l, Inc.*, 292 B.R. 522 (Bankr. D. Del. 2003).

2.6.ii. Statute of limitations does not apply to defensive use of avoiding powers. The bankruptcy court had previously determined that the creditor was the beneficiary of a resulting trust on property of the estate. After the property was sold, the creditors sought recovery of its share of the proceeds. The trustee defended on the grounds that the creditors' resulting trust interest was avoidable under section 544(a)(3), but the defense was asserted after expiration of the statute of limitations of section 546(a). Nevertheless, the court permits avoidance of the transfer to defeat the creditors claim. Although the action was to recover property from the estate, the court characterized the action as a claim and analogized the defense to a defense under section 502(d) under which a claim may not be allowed unless the creditor returns any avoided transfers. *In re Loewen Group Int'l, Inc.*, 292 B.R. 522 (Bankr. D. Del. 2003).

2.6.jj. UCC filing governs perfection of security interest in unregistered copyright. The Copyright Act does not have a mechanism for perfection of a security interest in an unregistered copyright, only in a registered copyright. The UCC steps back to federal law only where federal law provides for a means of perfection, which it does not do for unregistered copyrights. Nor does federal law preempt state law on perfection. Accordingly, UCC filing perfects a security interest in an unregistered copyright. At the same time, the Ninth Circuit recognizes the correctness of *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal 1990), which held that the Copyright Act governs perfection of a security interest in a registered copyright. *Aerocon Engineering, Inc. v. Silicon Valley Bank (In re World Auxiliary Power Co.)*, 303 F.3d 1120 (9th Cir. 2002).

2.6.kk. Bank's security interest in general intangible does not extend to rabbi trust. The debtor's rabbi trust prohibited the debtor from creating a security interest in the assets of the trust. For that reason, and because the debtor did not have legal title to the corpus of the trust, the debtor's grant of a security interest in general intangibles did not encompass the corpus of the trust. (The court reaches this result under the pre-revision version of the anti-assignment provision of Article 9; because of the debtor's lack of legal title to the corpus of the trust, the result might be the same under revised Article 9.) *Bank of America, N.A. v. Moglia (In re Outboard Marine Corp.)*, 278 B.R. 778 (N.D. Ill. 2002).

2.6.ll. Perfection of security interest in a patent requires Article 9 filing. Affirming the decision of the Bankruptcy Appellate Panel, the Ninth Circuit rules that perfection of a security interest in a patent is governed by Article 9, rather than by the Lanham Act, which governs registration of patents. In a lengthy analysis of the language of the Lanham Act, the Ninth Circuit concludes that its registration provisions apply to registration of only a transfer of title to a patent, not of a security interest, and that the provisions of Article 9 do not defer to such a federal statute. *Moldo v. Matsco, Inc. (In re Cybernetic Services, Inc.)*, 252 F.3d 1040 (9th Cir. 2001).

2.6.mm. Unsigned security agreement created a valid security interest. The debtor signed a financing statement and a security agreement, which provided that it did not become effective until accepted by the bank. The bank never signed the agreement. A junior secured creditor challenged the validity of the bank's security agreement in the debtor's chapter 11 case. The debtor-in-possession did not challenge the validity of the agreement. The Seventh Circuit holds that the junior creditor could not challenge the grant of the security interest, because it was not a party to the agreement. Moreover, imputing intent to the parties despite the absence of signature, the court holds that the parties clearly intended that the agreement be binding on both the debtor and the bank. *Falconbridge U.S., Inc. v. Bank One Illinois, N.A. (In re Vic Supply Co., Inc.)*, 227 F.3d 928 (7th Cir. 2000).

2.6.nn. Perfection of a security interest in a trademark requires UCC filing. Unlike the Copyright Act, which expressly applies to the filing of security interests in the Copyright Office, the Lanham Act does not require the filing with the Patent and Trademark Office of any notice of the grant of a security interest in a trademark. Accordingly, the filing rules of the UCC apply to perfection of a security interest in a trademark. *Trimarchi v. Together Development Corp.*, 255 B.R. 606 (D. Mass. 2000).

2.6.oo. UCC governs perfection of unregistered copyright. Finding that *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal. 1990), required perfection by recordation in the Copyright Office only of registered copyrights, the bankruptcy court rules that the UCC governs perfection of a copyright that has not been registered with the Copyright Office. Thus, the trustee could not avoid the banks lien on the copyright where the lien was perfected by the filing of a financing statement under the UCC. *Aerocon Engineering, Inc. v. Silicon Valley Bank (In re World Auxiliary Power Co.)*, 244 B.R. 149 (Bankr. N.D. Cal. 1999)

2.6.pp. Security interest in healthcare receivables upheld. The secured creditor took a security interest in healthcare receivables, including Medicare and Medicaid reimbursement payments, payments from private insurers, and state "insurance claims." The creditor perfected by filing a UCC-1 statement. The court holds the security interest valid, perfected, and unavoidable, ruling that the UCC filing perfects security interests in these assets as the best notice available under the circumstances, even though Article 9 might not literally apply to security interests in these assets. The court also rules that the Federal Medicare and Medicaid anti-assignment statutes do not prohibit the grant of a security interest in Medicare or Medicaid payments. The court notes the possible difficulty the secured creditor might have in collecting, because the anti-assignment statutes prohibit payment to anyone other than the healthcare provider. The court does not address the general Federal anti-assignment statutes, however, which may be broader than the Medicare and Medicaid statutes. *Official Unsecured Creditors' Committee v. Chittenden Trust Co. (In re East Boston Neighborhood Health Center Corp.)*, 242 B.R. 562 (Bankr. D. Mass. 1999).

2.6.qq. Security interest in a patent is perfected by UCC recording. The language of section 261 of the Patent Act, governing an "assignment" of patents and recordation of assignments with the Patent Office, does not cover the grant of a security interest in a patent. Accordingly, perfection of a security interest in a patent is governed by Article 9, and the security interest must be filed in the manner dictated by Article 9 to be perfected. *Moldo v. Matsco, Inc. (In re Cybernetic Services, Inc.)*, 239 B.R. 917 (9th Cir. B.A.P. 1999).

2.6.rr. Perfection of security interest in aircraft does not require refiling after five years. The creditor recorded a security interest in the aircraft with the F.A.A. but did not, under UCC Section 9-403(2), re-record after five years. The Fourth Circuit holds that the re-recording was not necessary, as section 9-403 applies only to a recordation that is required under the UCC. *Blair v. Crestar Bank (In re Brice)*, 188 F.3d 576 (4th Cir. 1999).

2.6.ss. "All debtor's income" is not a sufficient financing statement description. The debtor granted the FmHA a security interest in its contract rights, accounts receivable, and general intangibles, but the financing statement filed with the Secretary of State described the collateral as "all debtor's income." The financing statement was ineffective to perfect the security interests. *Cottage Grove Hospital v. Glickman (In re Cottage Grove Hospital)*, 233 B.R. 493 Bankr. D. Ore. 1999).

2.6.tt. Mortgage avoided because of break in chain of title. The debtor transferred real property to her 50%-owned corporation, who sold it to a third party, who financed the purchase with a mortgage on the property. The corporation did not record a deed (if the debtor indeed ever delivered one) from the debtor, so even after the sale to the third party, record title remained in the debtor. The trustee could avoid the mortgage under section 544(a)(3), holding: (1) whether or not the debtor's bare legal title is impressed with a constructive trust in favor of the mortgagee, section 541(d) is subject to the trustee's avoiding powers; and (2) The trustee's strong-arm avoiding power under § 544(a)(3) gives the trustee the rights and powers of a bona fide purchases, independent of whether there was a transfer by the debtor of the property. However, the trustee's rights are determined by state law, and the rights of a hypothetical bona fide purchaser were subject to the mortgagee's rights of corporation to a prior lien that had not been

released as of the petition date. *Mayer v. United States (In re Reasonover)*, 236 B.R. 219 (Bankr. E.D. Va. 1999).

2.6.uu. Criminal restitution lien does not attach after bankruptcy. 18 U.S.C. § 3613 grants the United States a lien to secure a criminal restitution debt. It provides that the lien is perfected against third parties when recorded, but that "a lien filed as prescribed by this section shall not be voided in a bankruptcy proceeding." The United States recorded the lien against the debtor's real property after bankruptcy. The trustee prevailed against the lien under section 544(a)(3), because the trustee had the rights of a hypothetical bona fide purchaser of the real property. As a result, the trustee did not "void" the lien; the lien simply never attached to the interest at the time it was recorded. *Mayer v. United States (In re Reasonover)*, 236 B.R. 219 (Bankr. E.D. Va. 1999).

2.6.vv. Possession by a bailee may be adequate for attachment of a security interest. UCC section 9-305 permits perfection of a security interest by a bailee of the secured party. UCC section 9-203 permits attachment of a security interest without a written agreement if "the collateral is in the possession of the secured party pursuant to agreement." The Sixth Circuit holds that possession by the bailee is adequate for attachment, as it is for perfection. *Marlow v. Rollins Cotton Company (In re The Julien Co.)*, 146 F.3d 420 (6th Cir. 1998).

2.6.ww. Trustees' strong-arm power is subject to inquiry notice. The rights of a trustee as a bona fide purchaser of real estate under section 544(a)(3) of the Bankruptcy Code are subject to such notice as the trustee would receive under state law inquiry notice requirements. In this case, the purchaser at a foreclosure sale under a mortgage failed to record his deed before the debtor filed bankruptcy. The Fifth Circuit rules that, under Texas law, a bona fide purchaser would be on notice of the existence of the mortgage because the mortgage had been previously recorded, and the purchaser would be required to inquire as to the status of the mortgage. Upon inquiry, the purchaser would have learned of the foreclosure, thereby defeating the purchaser's bona fide purchaser status. *Realty Portfolio, Inc. v. Hamilton (In re Hamilton)*, 125 F.3d 292 (5th Cir. 1997).

2.7 Recovery

2.7.a. Avoiding a transfer as to the initial transferee is not a prerequisite to recovery from the entity for whose benefit the transfer was made. The debtor conducted an insurance franchising business. It managed its franchisees' cash flow, including their operating expenses, by collecting all commissions that they earned, making payments of their operating expenses to their direct suppliers and creditors, deducting franchise fees and payments of franchise loans made by the debtor's affiliate, and remitting the balances to the franchisees. The debtor's affiliate sold participations in some of the franchise loans to a lender. In some instances, where a franchisee did not have sufficient cash flow from commissions to pay its suppliers and creditors currently, the debtor advanced the funds to the suppliers and creditors. After bankruptcy, the trustee sued the participation owner to avoid the debtor's payments to the suppliers and creditors as constructively fraudulent transfers and to recover the amount of the payments from the participation owner as an entity for whose benefit the transfers were made. Section 550(a) permits the trustee, "to the extent that a transfer is avoided," to recover the property transferred or its value from the initial transferee, from "the entity for whose benefit such transfer was made" or from a subsequent transferee. The trustee must avoid the transfer before he may recover it from a subsequent transferee, but prior avoidance as to the initial transferee is not required for recovery from the entity for whose benefit the transfer was made, because such an entity stands in the same relation to the transfer as the initial transferee. Therefore, the trustee may seek recovery from the participation owner without having first avoided the debtor's transfers to the franchisees' suppliers and creditors. *Redmond v. MCMIC Fin. Corp. (In re Brooke Corp.)*, 488 B.R. 459 (Bankr. D. Kan. 2013).

2.7.b. A trustee may recover an avoided transfer from the entity for whose benefit the transfer was made only if the entity actually received a quantifiable and accessible benefit. The debtor conducted an insurance franchising business. It managed its franchisees' cash flow, including their operating expenses, by collecting all commissions they earned, making payments of their operating expenses to their direct suppliers and creditors, deducting franchise fees and payments of franchise loans made by the debtor's

affiliate, and remitting the balances to the franchisees. The debtor's affiliate sold participations in some of the franchise loans to a lender. In some instances, where a franchisee did not have sufficient cash flow from commissions to pay its suppliers and creditors currently, the debtor advanced the funds to the suppliers and creditors. After bankruptcy, the trustee sued the participation owner to avoid the debtor's payments to the suppliers and creditors as constructively fraudulent transfers and to recover the amount of the payments from the participation owner as an entity for whose benefit the payments were made. Section 550(a) permits the trustee, "to the extent that a transfer is avoided," to recover the property transferred or its value from the initial transferee, "the entity for whose benefit such transfer was made" or a subsequent transferee. The "benefit" prong's purpose is to permit disgorgement of property that the debtor transferred before bankruptcy, so that value can be restored to the estate, not to allow the trustee to collect damages nor to impose liability for participation in any such transfers. Therefore, intent is not relevant, and the "benefit" prong applies only where the defendant has actually received a quantifiable and accessible benefit resulting from the transfer. The benefit must flow directly, not secondarily, from the avoided transfer. Here, the sole benefit the participation owner received from the debtor's payments to franchisees' suppliers and creditors was enhancement of the franchisees' ability to continue in business and make payments to the participation owner on the loans. Such a benefit is neither direct, nor quantifiable nor accessible by the participation owner. Therefore, the trustee may not recover the value of the transfers from the participation owner. *Redmond v. MCMIC Fin. Corp. (In re Brooke Corp.)*, 488 B.R. 459 (Bankr. D. Kan. 2013).

2.7.c. A mere conduit may also be an entity for whose benefit a transfer was made. The debtor purchased insurance through an insurance agent. The agent's contract with the insurer required the agent to hold all premiums that it collected in a segregated trust account for the insurer, but if the insured failed to pay, the agent remained liable to the insurer for the premiums. The debtor made several past-due payments to the agent within 90 days before bankruptcy. If the payments are avoidable as preferences, they may be recovered from the initial transferee or from the entity for whose benefit the transfer was made. A mere conduit is not an initial transferee. Because the agent acquired the payments in trust for the insurer, it was a mere conduit. However, because the payments relieved the agent from its contingent liability to the insurer, it was also an entity for whose benefit the transfer was made, and the payments were therefore recoverable from the agent. *Guttman v. Construction Program Group (In re Railworks Corp.)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 95627 (D. Md. July 8, 2013).

2.7.d. Lien preservation allows the estate to succeed to the avoided lien's distribution priority. The trustee avoided an unrecorded first mortgage that was not in default and sought to preserve the mortgage for the benefit of the estate. The debtor asserted that by preserving the mortgage for the benefit of the estate, the trustee stepped into the mortgagee's shoes and had only such rights as the mortgagee had, such as to foreclose only if there were a default. Under section 541(a), the debtor's fee interest in the real property became property of the estate. Preservation of the avoided mortgage allows the trustee to succeed to the mortgagee's claim in the order of distribution priorities that would have applied if the mortgage had not been avoided. *DeGiacomo v. Traverse (In re Traverse)*, 485 B.R. 815 (1st Cir. B.A.P. 2013).

2.7.e. Recovery from subsequent transferee does not require avoidance of transfer against initial transferee. The trustee sued the insolvent initial transferee to avoid and recover a fraudulent transfer. The trustee settled with the initial transferee for a judgment, without reference to the avoiding of any transfer, and a payment of less than the amount sought. Less than one year later, but more than two years after bankruptcy, the trustee sued the subsequent transferee to recover the transfer. Section 550 permits the trustee to recover from a subsequent transfer "to the extent that a transfer is avoided" under the avoiding power sections. Section 550 should be construed flexibly so as not to require the trustee to pursue each initial transferee to judgment, rather than permitting settlement, to preserve a recovery claim against a subsequent transferee. Moreover, the estate should not be prejudiced as to a subsequent transferee where obtaining a judgment against the initial transferee is impossible or impractical, such as where the initial transferee has dissolved or where avoidance would require protracted expensive litigation against an insolvent entity. Therefore, the trustee may pursue a subsequent transferee where the initial transfer was avoidable and the trustee settled, not only where it has been avoided. Where the settlement does not involve a determination of avoidance, the trustee must still show that the transfer was avoidable. Section 550(f)'s statute of limitations is one year after avoidance. Where the initial transfer was not

actually avoided, the one-year period should run from the settlement date. *Picard v. Bureau of Labor Ins. (In re Bernard L. Madoff Inv. Secs.)*, 480 B.R. 501, (Bankr. S.D.N.Y. 2012).

2.7.f. Section 550 applies to an extraterritorial subsequent transferee. An offshore hedge fund, with its principal place of business in the United States, invested substantially all its funds in a U.S. debtor. It solicited investments from foreign investors with materials that made clear that the funds would be invested in the United States. The fund's subscription agreement provided a New York choice of law provision and a submission of the parties to the New York courts' jurisdiction. After bankruptcy, the trustee sued the initial transferee hedge fund to avoid a fraudulent transfer. After settling with the hedge fund for a judgment and a payment of less than the amount sought, the trustee sued a foreign subsequent transferee that had no contacts with the United States other than the investment in the offshore hedge fund. There is a presumption against extraterritorial application of a federal statute unless Congress affirmatively expresses an intention to give the statute extraterritorial effect. However, the presumption does not arise if the acts or objects on which the statute focuses are domestic. Here, the statute's focus is on the improper depletion of the U.S. debtor's assets, rather than on the initial or subsequent transferee, as the statute addresses only the transfers themselves, not the recipients. Therefore, the presumption against extraterritoriality does not apply. Even if it did, it is satisfied here. Section 548 permits the trustee to avoid a transfer of "property of the debtor." "Property of the debtor" is construed as property that would have become property of the estate if the transfer had not been made. Under section 541(a), property of the estate includes all property, "wherever located", evidencing that Congress intended section 541(a) to apply outside the United States. Therefore, section 548's reference to "property of the debtor" also applies to property that is outside the United States. Similarly, section 550 permits recovery of any transfer to the extent it is avoided. Because "transfer" refers to any transfer that the trustee may avoid under the avoiding powers, section 550 should also be read to apply to foreign subsequent transfers. Practical considerations dictate this result as well, to prevent parties from "washing" an otherwise avoidable and recoverable transfer through foreign entities. *Picard v. Bureau of Labor Ins. (In re Bernard L. Madoff Inv. Secs.)*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012).

2.7.g. Direct payee of proceeds of a secured loan to an affiliate is an entity for whose benefit the liens were transferred. The debtor was a housing developer. Its subsidiary had entered into a joint venture to develop houses. The joint venture borrowed heavily and then failed. The debtor had guaranteed the loans. A default on the loans would have cross-defaulted the debtor's bonds and its bank revolving credit line, both of which were guaranteed by its other subsidiaries, who were not liable on the joint venture's obligations. After the joint venture failed, the debtor and its other subsidiaries borrowed from different lenders to pay the joint venture's lenders. The other subsidiaries granted security interests in substantially all their assets to secure the new loans. The new loan agreements required that the loan proceeds be transferred to the joint venture lenders. The borrowed funds, less fees incurred, were disbursed through another of the debtor's (nondebtor) subsidiaries to the joint venture lenders. The debtor and the subsidiaries filed bankruptcy seven months after the transaction. The transfers of security interests to the new lenders and the payment of the borrowed funds to the joint venture lenders were avoided as constructive fraudulent transfers. Section 550 permits recovery of an avoided transfer from the initial transferee or from the entity for whose benefit the transfer was made. The joint venture lenders received the proceeds of the loans. Therefore, they were the entities for whose benefit the initial transfers of security interests to the new lenders were made. They were not beneficiaries of a subsequent transfer of cash from the paying subsidiary, because the new loan agreements required that the paying subsidiary wire the proceeds directly to them, so the subsidiary never had control over the funds. Such a ruling does not put all recipients of payments from a distressed subsidiary at risk or impose a heavy due diligence duty on them. But it is not "a drastic obligation to expect some diligence from a creditor when it is being repaid hundreds of millions of dollars by someone other than its debtor." *Sr. Transeastern Lenders v. Official Comm. of Unsecured Creditors (In re TOUSA, Inc.)*, 680 F.3d 1298 (11th Cir. 2012).

2.7.h. Recovery is not limited to the amount of allowed claims. The debtor was the remains of a larger corporation that had previously spun off substantial assets to its shareholders, in part to shield those assets from liability for environmental and tort claims that were substantially more than other general unsecured claims. The estate asserted a fraudulent transfer claim arising out of the spin-off. The debtor proposed a plan that provided for transferring the fraudulent transfer claim to a liquidating trust for

the benefit of holders of the environmental and tort claims and the distribution of the reorganized debtor's stock to the holders of other general unsecured claims. The holders of the environmental and tort claims were satisfied with that resolution and accepted the plan. Their acceptance of that recovery enabled the holders of other general unsecured claims to receive all of the reorganized debtor's stock under the plan, which those holders also accepted. Section 550(a) provides that to the extent a transfer is avoided, the trustee "may recover for the benefit of the estate, the property transferred, or … the value of such property". Under section 550(a), "benefit of the estate" may be either direct or indirect, including increasing the possibility of a successful reorganization. Thus, the ability to assign an avoiding power action for valuable consideration may provide a benefit to the estate, independent of the actual recovery in the action. The "estate" is created under section 541(a) and consists of assets. The estate is not limited to the allowed claims amount. Benefit to the estate is similarly not limited. Here, the fraudulent transfer action's availability and its transfer to the liquidating trust benefited the estate by making a plan agreement possible and benefited the general unsecured claims holders by removing from their claims pool the environmental and tort claims. Therefore, the amount of environmental and tort claims does not necessarily cap the trust's recovery. However, equitable principles may dictate a cap once the court examines all the facts after trial. *Tronox Inc. v. Anadarko Petro. Corp. (In re Tronox Inc.)*, 464 B.R. 606 (Bankr. S.D.N.Y. 2012)

2.7.i. Lead bank who held a loan for participants was a conduit, not an initial transferee. The lead bank loaned the debtor money and sold participation interests in 95% of the loan to other banks. The participation agreements provided that the transactions were sales of interests in the loan. Each participant agreed to fund its portion of the loan, and the lead bank agreed to hold the loan documents, administer the loan as if it were the holder of the whole loan, hold all payments received from the debtor for the purchasers' benefit (less a small servicing fee) and remit any payments within 10 days after receipt from the debtor. The participation agreements did not establish a trust relationship between the lead bank seller and the purchasers nor a debtor-creditor relationship, because they provided for a sale of interests in the loan. The debtor made a large repayment within 90 days before bankruptcy that the trustee avoided as a preference. The trustee may recover an avoided preference from the initial transferee but not from a recipient who is a mere conduit of the payment. A recipient is not an initial transferee unless it has both control over the transferred property and the legal right to use the property for its own purposes. The lead bank here was not a creditor as to 95% of the payment and was required to transfer the payments attributable to the participants and therefore did not have the legal right to use the funds for its own benefit. The ability of the lead bank to commingle the funds before payment to the participants did not make it an initial transferee. Commingling is part of ordinary banking practice, and the participation agreement did not require segregation of the funds. *Northern Capital, Inc. v. Stockton Nat'l Bank (In re Brooke Corp.)*, 458 B.R. 579 (Bankr. D. Kan. 2011).

2.7.j. Knowledge of voidability depends on transferee's sophistication. The real estate developer debtor paid money to the development's condominium association. The association used part of the payments to pay the unaffiliated management company according to the terms of the management contract. The management company knew of the debtor's financial difficulties and that it had not paid all obligations to the association and was improperly using unit-owner capital contributions for operating expenses, but the management company did not know that the payments to the association might be avoidable. The trustee avoided the payments as preferences. The trustee may recover an avoided transfer from the initial transferee or from an immediate transferee of the initial transferee, unless the immediate transferee took for value, in good faith and without knowledge of the voidability of the transfer. Value need not be given to the debtor. The Code does not define good faith but, in this context, it suggests knowledge that something is awry, that a reasonable person would investigate whether the debtor is transferring assets out of the ordinary course of business. Mere knowledge of financial distress does not negate good faith. Knowledge of voidability requires actual knowledge, not constructive notice, of facts that would lead a reasonable person to believe that the property transferred was recoverable. A sophisticated lender is held to a higher standard of reasonableness than an ordinary trade supplier such as the management company here. In this case, the management company gave value to the association, was in good faith, despite its knowledge of the debtor's financial distress, and did not know sufficient facts for a trade supplier to be deemed to have knowledge of voidability. Therefore, the trustee may not recover from the

management company. *Von Kahle v. Greenacre Props., Inc. (In re Key Developers Groups, LLC)*, 449 B.R. 148 (Bankr. M.D. Fla. 2011).

2.7.k. A transferee that remains willfully ignorant of relevant facts does not take in good faith. Before bankruptcy, the debtor transferred real property to his brother, who transferred it to a friend's company. The deeds recited that the first transfer was for no consideration and the second transfer was for nominal consideration. Two days before it received a deed to the property, the company's principal met with a lender to obtain a loan against the property. In the meeting with the lender, as well as in the later loan documents, the principal was unclear on the correct name of the company. Though the lender obtained a certificate of good standing for the company, it did not update the certificate shortly before funding the loan (as is common practice in the industry), though the company had lost its good standing and was no longer authorized to do business. The lender did not examine the company's deed to the property or any title history. The lender funded the loan and took a mortgage on the property anyway. After bankruptcy, the trustee avoided the first two transfers of the real property and sought to recover from the lender under section 550(a)(2) as a subsequent transferee. Section 550(b) gives a subsequent transferee who takes for value, in good faith and without knowledge of the voidability of a transfer a defense against recovery. "Knowledge of voidability" requires actual, not constructive, notice, but only actual knowledge of facts that would lead a reasonable person to believe that the transfer was voidable. It does not impose a duty to investigate. However, "good faith" imposes an objective standard that examines what the transferee knew or should have known, based on what the transferee actually knew. A transferee who remains willfully ignorant in the face of facts that demand investigation does not take in good faith. Here, the lender did not have knowledge of voidability, because it did not know of the problems with title and with the borrower. However, it did not take in good faith, because the confusion of the principal and the loan documents about the borrower's correct name, the failure to obtain a good standing certificate shortly before closing and the failure to review the deed evidence the lender's willful ignorance of facts that demanded investigation. Therefore, the trustee may recover from the lender. *Goldman v. Cap. City Mortgage Corp. (In re Nieves)*, 648 F.3d 232 (4th Cir. 2011).

2.7.l. Bank that received leveraged buyout loan proceeds was initial transferee. A corporation had guaranteed its parent's debt to the bank without any consideration and had secured the guarantee. The debtor was formed to acquire the corporation's assets in a leveraged buyout. The closing instructions for the transaction required that the proceeds of the loan to the debtor be used to pay the parent's obligation to the bank, which would then release its security interest in the acquired corporation's assets. On the acquisition's closing, the funds from the acquisition loan to the debtor were paid directly to the bank, which released its security interest in the target's assets. The debtor in possession avoided the transaction as a constructively fraudulent transfer. An avoided transfer may be recovered from the initial transferee or a subsequent transferee. A mere conduit of transferred property, that is, one who does not have dominion over the property with the right to put it to its own use, is not an initial transferee. Here, the corporation was not the initial transferee of the loan proceeds, even though the proceeds flowed through the corporation's account and were used to pay off the corporation's guarantee obligation, because the corporation had no right to direct the use of proceeds, which was fully dictated by the transaction's terms. Therefore, the bank was the initial transferee. *CNB Int'l, Inc. v. Lloyds TSB Bank, plc (In re CNB Int'l, Inc.)*, 440 B.R. 31 (W.D.N.Y. 2010).

2.7.m. Section 550s' "benefit" prong applies only where the benefit is the initial transfer's direct result. The debtor's subsidiary had entered into a joint venture that borrowed heavily and then failed. The debtor had guaranteed the loans. The debtor's other subsidiaries were not liable on the joint venture's obligations, but were co-borrowers on the debtor's revolving credit facility and had granted security interests in all their assets to secure their obligations under the facility. If the debtor defaulted on the joint venture loan, it would have cross-defaulted the revolver, which neither the debtor nor the subsidiaries would have been able to pay. After the joint venture failed and the joint venture lenders sued the debtor, the debtor borrowed from different lenders to pay the joint venture's lenders. The debtor's other subsidiaries became co-borrowers on the new loans and granted security interests in substantially all their assets to secure their new obligations. The debtor and the subsidiaries filed bankruptcy seven months after the new loans, due in large part to the collapse of the debtor's markets during the time between the new loans' funding and the bankruptcy. A transfer of the debtor's property is fraudulent and avoidable if the debtor had unreasonably

small capital or was insolvent at the time of or rendered insolvent by the transfer and did not receive reasonably equivalent value in exchange. If the trustee avoids the transfer, the trustee may recover from an initial or (in some cases) a subsequent transferee of the transfer or from the entity for whose benefit the transfer was made. These three categories are mutually exclusive. Further, the "benefit" test applies only where the benefit is the direct result of the initial transfer and not where the benefit is not the immediate and necessary consequence of the initial transfer, such as where the benefit flows from the use to which the transfer is put, rather than from the transfer itself. Because the joint venture lenders were subsequent transferees of the new loan proceeds, which were backed by the subsidiaries' security interests, they were subsequent transferees of the proceeds of the security interests and do not qualify as entities for whose benefit the subsidiaries granted the security interests. *3V Cap. Master Fund Ltd. v. Official Comm. Of Unsecured Creditors (In re TOUSA, Inc.)*, 444 B.R 613 (S.D. Fla. 2011).

2.7.n. REMIC trustee is the initial transferee of avoidable transfers. The debtor's affiliate borrowed against the real estate the debtor leased from the affiliate. The rent was equal to the loan payments and was well above fair market rental value. As security for the debt, the affiliate mortgaged the real property and assigned the lease to the lender. The loan documents provided for the debtor/lessee to pay rent directly to the lender. The rent payments were then applied to the loan. The lender transferred the note and related collateral to a REMIC, which is a trust that holds loans for the trust's beneficial certificate holders. The trustee is fully responsible for administering the trust. The bankruptcy court determined that the debtor's rent payments were fraudulent transfers. The bankruptcy trustee sought recovery under section 550(a) from the REMIC trustee. Section 550(a) permits the bankruptcy trustee to recover an avoided transfer from the initial transferee. An initial transferee is one who has dominion and control over the funds, not one who is a "mere conduit". A transferee may have dominion and control even if it does not have unfettered use of the funds, as long as it has the freedom to use the funds for its own purposes. In this case, the trustee, rather than the REMIC certificate holders, had legal title to the trust assets and therefore to the payments and so was the initial transferee. *Paloian v. LaSalle Nat'l Bank Assoc.*, 619 F.3d 688 (7th Cir. 2010).

2.7.o. Stock broker who does not exercise control over a margin account is not an initial transferee. The debtor operated a Ponzi scheme by offering loans to customers against their stock. In a typical transaction, the customer would transfer his or her stock directly to the debtor's account at a stock brokerage. The debtor then sold the stock and misappropriated the proceeds, using proceeds from future stock sales to purchase and return stock to customers when they repaid their loans. The debtor made cash deposits into its margin account with the broker. The broker never applied the cash to any obligation the debtor owed to the broker, except for deduction for fees, commissions and margin interest payments. After bankruptcy, the trustee sued the broker to avoid and recover the cash transfers. Section 550(a) permits recovery of an avoided transfer from the initial transferee. An initial transferee is one who has and actually exercised dominion and control over the property that was transferred. Because the broker did not exercise control over the margin account to sell securities or offset amounts in the account against deficiencies, and despite the deduction of fees, commissions and interest, the broker does not qualify as an initial transferee of the cash deposits. The court does not address the nature of the deduction of fees, commissions and interest as a setoff, rather than a transfer. *Grayson Consulting, Inc. v. Wachovia Secs., LLC (In re Derivium Cap., LLC)*, 437 B.R. 798 (Bankr. D.S.C. 2010).

2.7.p. 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).

2.7.q. Court may order unperfected secured lender to pay the estate the loan amount only if there is adequate evidence of the value of the unperfected lien. The debtor bought a car within 90 days before bankruptcy. The car lender recorded its security interest 21 days after the purchase. The bankruptcy court avoided the security interest as a preference and ordered the lender to pay the trustee the amount of the loan, allowing the lender to preserve its lien against the car, its claim against the debtor and a general unsecured claim against the estate. Section 550 permits the court to order the recovery of the property transferred or its value at the time of the transfer, even when a lien is preserved under section 551. The court may order recovery of the value of a security interest but should order recovery of the security interest itself when the security interest's value at the time of the transfer is not readily determinable. Because of the time between the transfer and the judgment and the lack of evidence of value of the security interest at the time it was granted, the bankruptcy court abused its discretion in ordering the lender to pay the estate the amount of the loan. *USAA Fed. Sav. Bank v. Thacker (In re Taylor)*, 599 F.3d 880 (9th Cir. 2010).

2.7.r. Trustee may not recover punitive damages for a fraudulent transfer. The trustee avoided transfers as fraudulent under section 544(b) and the Oklahoma Uniform Fraudulent Transfer Act. Section 550 permits a trustee to recover the property transferred or its value from the transferee or the entity for whose benefit the transfer was made, but it does not authorize recovery of punitive damages. Section 550 takes priority over any applicable state fraudulent transfer law under which the trustee brings the action that permits recovery of punitive damages and limits the trustee's recovery. *Miller v. Dow (In re Lexington Oil & Gas Ltd.)*, 423 B.R. 353 (Bankr. E.D. Okla. 2010).

2.7.s. Court orders unwinding to the extent possible of multi-party transaction, with interest, fees and recoupment of decline in property value, as remedy for fraudulent transfer. The debtor's subsidiary had entered into a joint venture that borrowed heavily and then failed. The debtor had guaranteed the loans. After the joint venture failed, the debtor borrowed from different lenders to pay the joint venture's lenders. The debtor's other subsidiaries, who were not liable on the joint venture's obligations, were co-borrowers on the new loans and granted security interests in substantially all their assets to secure their obligations. The borrowed funds, less fees incurred, were disbursed directly to the joint venture lenders. The debtor and the subsidiaries filed bankruptcy seven months after the new loan. The transfers of security interests to the new lenders and the payment of the borrowed funds to the joint venture lenders were avoided as constructive fraudulent transfers. Section 550 permits recovery of an avoided transfer from the initial transferee or from the entity for whose benefit the transfer was made. It is designed to restore the estate to the financial condition in which it would have been if the transfers had not been made. To do so here requires not only avoidance of the liens to the new lenders but also recovery of the payments from the joint venture lenders, as well as recovery of all transaction costs, litigation costs, and decline in value of the collateral from the transfer date until the recovery. However, the estate is entitled to only a single satisfaction, and it would be inequitable to order recovery from only one set of defendants. Therefore, the court determines to unwind the transactions to the extent possible. It orders the joint venture lenders to repay to the subsidiaries' estates the portion of the borrowed funds attributable to the subsidiaries, with interest from date of payment. From those funds, the subsidiaries are to retain an amount required to recover the decline in collateral value between the transaction date and the recovery date and transaction and litigation costs and then remit the balance of the proceeds to the new lenders. Finally, the new lenders must repay the estate all adequate protection and other payments made during the case on account of their claims. *Official Comm. of Unsecured Creditors v. Citicorp N. Am., Inc. (In re TOUSA, Inc.)*, 2009 Bankr. LEXIS 3311 (Bankr. S.D. Fla. Oct. 13, 2009).

2.7.t. Selling LBO shareholders are liable for all consideration received, including interest payments, but may recover any surplus after creditors are paid in full. The shareholders of old Crown agreed to sell its assets to new Crown for $3.1 million in cash and a $2.9 million junior secured note, with 8% contingent interest. New Crown received a $500 investment from its owner plus a $3.1 million senior secured loan from a bank. Just before closing, old Crown dividended $600,000 to its shareholders. At closing, it received the note and the cash, which it promptly paid to its shareholders. New Crown made two annual interest payments on the junior note, which were transferred to the old Crown shareholders. New Crown failed and filed bankruptcy three and one-half years after the sale, in part due to business mistakes the new owner made. In the bankruptcy, the trustee sold new Crown's assets for $3.7

million and successfully sued the old Crown shareholders to avoid the transaction as a fraudulent transfer. A trustee may recover property transferred in an avoided transfer from the immediate transferee or from a subsequent transferee that does not take in good faith, for value or with knowledge of the transfer's voidability. The court does not collapse the transaction steps and determines that old Crown was the initial transferee and the shareholders were the subsequent transferees. They gave no value to old Crown, so they are liable to the trustee for the cash, the dividend and the interest payments, and their note and lien are unenforceable. The resulting surplus money in the estate is paid to the debtor under section 726(a)(6). When the estate is closed, the federal bankruptcy interest in proceeds distribution ceases, so state law governs the distribution of the surplus. The fraudulent transfer avoidance unravels the sale, so any money received from the trustee's sale of the company's assets belongs to the original shareholders. In other words, the trustee may avoid the transfer only as to or for the benefit of creditors, not as to the selling shareholders. *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787 (7th Cir. 2009).

2.7.u. Avoidance and preservation of a lien may prevent recovery of the property or its value. The creditor perfected its security interest in the debtor's vehicle within 90 days before bankruptcy. The trustee successfully sued to avoid the preference and sought recovery of the value of the lien from the creditor. Section 551 automatically preserves an avoided transfer, such as a lien. The lien become property of the estate under section 541(a)(4). The trustee thereby recovers all that was transferred and puts the estate in the same position it would have been in if the transfer had not been made. Section 550(a) is permissive: "the trustee may recover … the property transferred, or, if the court so orders, the value" of the property. Where an avoided lien is preserved, the trustee has recovered the property transferred, and it would be inappropriate for the court to order an additional recovery under section 550(a). *Rodriguez v. Daimlerchrysler Fin. Servs. Americas LLC (In re Bremer)*, 408 B.R. 355 (10th Cir. B.A.P. 2009).

2.7.v. REMIC trustee is the initial transferee of avoidable transfers. The debtor's affiliate borrowed against the real estate the debtor leased from the affiliate. The rent was equal to the loan payments and was well above fair market rental value. As security for the debt, the affiliate mortgaged the real property and assigned the lease to the lender. The loan documents provided for the debtor/lessee to pay rent directly to the lender. The rent payments were then applied to the loan. The lender transferred the note and related collateral to a REMIC, which is a trust that holds loans for the trust's beneficial certificate holders. The trustee is fully responsible for administering the trust. The bankruptcy court determined that the debtor's rent payments were fraudulent transfers. The bankruptcy trustee sought recovery under section 550(a) from the REMIC trustee. Section 550(a) permits the bankruptcy trustee to recover an avoided transfer from the initial transferee. An initial transferee is one who has dominion and control over the funds, not one who is a "mere conduit". A transferee may have dominion and control even if it does not have unfettered use of the funds, as long as it has the freedom to use the funds for its own purposes. In this case, the trustee, rather than the REMIC certificate holders, was the initial transferee because of its powers to administer the trust. *LaSalle Nat'l Bank Assoc. v. Paloian*, 406 B.R. 299 (N.D. Ill. 2009).

2.7.w. Person to whom debtor's principal diverted corporate funds is an "initial transferee". The corporate debtor's principal wrote checks on the corporation's bank accounts to satisfy his obligations to his ex-wife. The corporation was insolvent at the time and received no consideration, so the transfers were fraudulent transfers and recoverable. The trustee's right to recover from an initial transferee of a fraudulent transfer is absolute, but a subsequent transferee has defenses to a recovery action. A recipient of the transfer is an initial transferee if it has "dominion over the money or other asset, the right to put the money to one's own purposes". A corporate debtor's principal does not have such dominion, despite the principal's power to allocate corporate funds, because the principal may not do so as a matter of right. Accordingly, even though the corporation accounted for the transfers as distributions to a shareholder, because the checks were issued directly to the ex-wife, she was the initial transferee and is absolutely liable to the trustee for the fraudulent transfers. *Richardson v. Preston (In re Antex, Inc.)*, 397 B.R. 168 (1st Cir. B.A.P. 2008).

2.7.x. Creditor may file avoiding power action derivatively with trustee's consent and without prior bankruptcy court approval. Five days before the avoiding power statute of limitations expired, a creditor asked the trustee to pursue a preference action and gave the trustee a draft complaint. The trustee declined. The creditor filed the complaint and later sought bankruptcy court approval to prosecute the action on behalf of the estate. The trustee stated no objection as long as the action was pursued for

the benefit of all creditors. The Eighth Circuit joins the other circuits who have ruled on derivative standing to rule that generally, a creditor or committee may bring an action derivatively with the bankruptcy court's approval. To obtain approval, the creditor must show that it asked the trustee to act, the trustee unjustifiably refused and the claim is colorable. Whether a refusal is justifiable is based on the facts and circumstances and may include considerations of the probabilities of financial success, the proposed fee arrangement and any possible delay or expense to the estate. Where the trustee consents to the creditor's derivative standing, the creditor must show that derivative standing is in the best interest of the estate and is necessary and beneficial to the fair and efficient resolution of the case. Such a showing will be rare, because a trustee should ordinarily pursue an action that would be in the best interest of and beneficial to the estate. Finally, the bankruptcy court may authorize derivative standing after the creditor files the action; prior approval is not required. *PW Enterps., Inc. v. N. Dakota Racing Comm'n (In re Racing Servs., Inc.)*, 540 F.3d 892 (8th Cir. 2008).

2.7.y. Trustee may not recover a fraudulent transfer from an entity that did not receive it as an "entity for whose benefit the transfer was made". The debtor had a consolidated cash management system with its parent and grandparent corporations. It issued a dividend note to its parent. Its grandparent took interest payments directly for itself from the consolidated cash account. The payments were fraudulent transfers, because the debtor was insolvent when it issued the note and made the interest payments. A trustee may recover an avoided transfer "from the initial transferee of such transfers or the entity for whose benefit the transfers were made". Fraudulent transfer recovery is a form of disgorgement, so to recover from an entity for whose benefit a transfer is made, the entity must have received an actual benefit. Although the debtor had issued the notes to the parent, the parent did not receive the transfers and therefore was not the entity for whose benefit the transfers were made. *Freeland v. Enodis Corp.*, 540 F.3d 721 (7th Cir. 2008).

2.7.z. Bank that participated in a fraudulent conveyance LBO is not a good faith subsequent transferee. The debtor was formed to acquire the assets of three businesses in the same industry in a leveraged buyout. The debtor in possession avoided the transfer of the purchase price to one of the three businesses. That business had guaranteed its parent's debt to the bank without any consideration and had secured the guarantee. On the acquisition's closing, the debtor paid the guarantor business, which immediately paid the bank on the guarantee. The bank participated in the LBO planning and even funded part of the purchase price, for which it was repaid at the closing. Section 550(a) permits a trustee to recover property transferred in an avoided transfer or its value from the initial transferee or from an immediate transferee from the initial transferee if the immediate transferee took for value, in good faith and without knowledge of the voidability of the transfer. The trustee is limited to a single satisfaction. A transferee can be treated as an initial transferee if the initial recipient of the transfer is a mere conduit. However, the initial recipient becomes a mere conduit only if its transferee exercised dominion and control over the recipient and the conduit structure is established at the transferee's behest. Here, the bank's participation in the transaction, even the bank's expectation of reducing its exposure, did not rise to the level of sufficient dominion and control to make the first recipient a mere conduit and the bank the initial transferee. An immediate transferee does not take "in good faith" if it violates "reasonable standards of fair dealing and with the intent to seek unconscionable advantage over general unsecured creditors". A creditor may properly seek advantage over other creditors. However, because the bank actively participated in planning and funding the transaction with the purpose of transferring risk from the bank, which was not a creditor of the debtor, to the debtor's unsecured creditors, it did not act in good faith. A transferee has knowledge of the voidability of a transfer if it knows sufficient facts to put it on actual or inquiry notice of a basis of voidability. The bank's internal analysis showed the price the debtor would pay exceeded the value of the acquired assets and that the debtor would therefore be insolvent, giving it knowledge of voidability. In a multi-party fraudulent transfer, allocation of liability may be difficult. Here, however, the debtor overpaid for only one of the three businesses' assets. The transfer was avoidable only to the extent the debtor overpaid for the assets. The debtor in possession may therefore recover only that amount from the bank, minus what the debtor in possession recovered from other defendants, so that it is limited to a single satisfaction. Finally, the UFCA by its terms does not permit recovery of a money judgment. A creditor may set aside the conveyance or disregard it and attach or levy execution on the transferred property. However, judicial decisions under the UFCA permit a money judgment. Under section 544(b), a trustee acquires only a creditor's right to avoid a transfer, not to obtain a money judgment.

Section 550(a) gives the trustee the right to recover the property or its value. Value includes time value of money for the time the estate was deprived of the property. Therefore, the debtor in possession may recover prejudgment interest on the judgment from the date of the filing of the complaint. *CNB Int'l, Inc. v. Kelleher (In re CNB Int'l, Inc.)*, 393 B.R. 306 (Bankr. N.D.N.Y. 2008).

2.7.aa. Stockbroker is initial transferee of margin payments. The debtor operated a Ponzi scheme. It maintained securities accounts with a stockbroker, which issued numerous margin calls in the year before bankruptcy on short positions that the debtor maintained. The stockbroker deposited the margin payments into a segregated account under SEC Rule 15c3-3, which requires a stockbroker to maintain customer funds, such as margin, in segregation from the stockbroker's own assets and is limited in how the stockbroker may use or apply the funds. However, the stockbroker took a security interest in margin funds and could apply them to the customer's obligations in connection with the customer's securities transactions, for which the stockbroker would be liable to the customer's counterparty if the customer did not provide adequate funds. The court had separately determined that payment of the margin calls were transfers made with actual intent to defraud creditors and are therefore recoverable as fraudulent transfers under section 548(a)(1)(A). Under section 550(a), the trustee may recover only from the "initial transferee", that is, one who has dominion and control of the transferred property, and not from a mere conduit. "Dominion" is a technical test that determines whether the transferee is able to put the transferred property to its own purposes, while the "control" test looks to which entity in fact controlled the property and permits equitable considerations. The dominion test does not require that the recipient have full discretion over the funds, and regulatory or contractual restrictions on the recipient's use of the property does not deprive it of dominion if the property is ultimately for the recipient's benefit. A mere conduit simply facilitates the transfer of funds from the debtor to a third party, such as a financial intermediary does. An entity may be more than a mere conduit and yet not have dominion or control over the transferred property, and there are situations in which there is not a conduit at all, where the debtor transfers directly to the initial transferee. Rule 15c3-3's segregation limitation on the stockbroker's use of the funds does not deprive the stockbroker of sufficient dominion or control to qualify it as the initial transferee because the funds were placed for the stockbroker's benefit. Therefore, the trustee may recover the transfers from the stockbroker. *Bear, Stearns Sec. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1 (S.D.N.Y. 2007).

2.7.bb. The trustee need not avoid a transfer to recover from a subsequent transferee. The trustee sued a buyer to avoid an unauthorized postpetition sale. The trustee and the buyer settled, but the buyer did not admit liability. The trustee also sued the debtor's law firm, to whom the debtor paid a portion of the sale proceeds, under section 550, which permits recovery from the initial or a subsequent transferee "to the extent a transfer is avoided". Although the present tense phrasing of the introductory clause suggests that the transfer must be avoided as a condition to recovery, the "to the extent that" phrase suggests that the introductory clause is intended only to limit recovery where a transfer can be avoided only in part. Avoidance and recovery are separate concepts. Requiring the trustee to avoid a transfer before permitting recovery might foster unnecessary litigation to determine avoidability and discourage settlement such as occurred in this case or to attempt to prevent a subsequent transferee from litigating avoidability once the trustee has an avoidability judgment against the initial transferee. Therefore, section 550 requires only that the trustee show avoidability, not avoidance. The B.A.P. notes the split between the 10th and 11th Circuits on this issue. *Woods & Erickson, LLP v. Leonard (In re AVI, Inc.)*, 389 B.R. 721 (9th Cir. B.A.P. 2008).

2.7.cc. Bankruptcy court may reduce fraudulent transfer recovery by amount repaid to the debtor before bankruptcy. The debtors made an actual fraudulent transfer to a relative, who repaid some of the funds before bankruptcy and some of the funds after. Bankruptcy courts must do equity. Although a court may refuse to credit repayments of money that has been transferred with actual fraudulent intent, it is not required to do so. Granting a credit only for prepetition payments and not for postpetition repayments is within the bankruptcy court's equitable discretion. *Bakst v. Wetzel (In re Kingsley)*, 518 F.3d 874 (11th Cir. 2008).

2.7.dd. A chapter 7 trustee may not bring avoidance actions reserved solely to a chapter 11 creditors committee. In the DIP financing order, the court barred the debtor in possession from bringing

actions against a secured creditor but permitted the creditors committee to do so. After conversion to chapter 7, the trustee sought to bring the action. The committee's rights to bring the actions were derivative from the estate, but the debtor in possession could no longer assert the rights. The trustee succeeds only to the rights that the DIP had. When the committee dissolved upon conversion to chapter 7, the trustee did not succeed to the rights, because they were not rights that the DIP had. *Hill v. Akamai Techs., Inc. (In re MS55, Inc.)*, 477 F.3d 1131 (9th Cir. 2007).

2.7.ee. State fraudulent transfer law does not limit the amount of the trustee's recovery. The debtor transferred real property more than two years before bankruptcy. The trustee sought recovery under section 544(b) and the state's Uniform Fraudulent Transfer Act. The state's Act limits a creditor's avoidance and recovery to the lesser of the amount of the creditor's claim and the debtor's nonexempt unencumbered interest in the property at the time of the transfer. The Bankruptcy Code separates recovery from avoidance. Section 544(b) authorizes avoidance. Once the trustee demonstrates the right to avoid a transfer, section 550 authorizes recovery, which limits recovery only to the extent that the recovery be "for the benefit of the estate." Section 550 permits the trustee to recover the property transferred or its value. The trustee therefore may recover the value of the property at the time of the recovery action, as that gives the estate the benefit of the amount that it would have had if the debtor had not transferred the property. *Joseph v. Madray (In re Brun)*, 360 B.R. 669 (Bankr. C.D. Cal. 2007).

2.7.ff. Federal allocation rule governs application of section 550(d)'s "single satisfaction" limitation. The trustee settled a fraudulent transfer action against initial transferees to avoid and recover 377 transfers. The trustee brought a recovery action against a subsequent transferee to recover 11 of the transfers. Under section 550(d), "the trustee is entitled to only a single satisfaction." In determining how to allocate the recovery under the initial settlement among the transfers so as to limit the trustee to only a single satisfaction, a federal rule for allocating the settlement proceeds among the 377 transfers applies. Settlement allocation is a rule of judicial process, which state law may not govern in federal courts. The single satisfaction rule is a federal rule, which state law should not be permitted to frustrate. Finally, application of a federal rule will not disturb any pre-bankruptcy commercial relations or expectations, because the rule applies only to recovery of transfers that are avoided as a result of bankruptcy. Under the federal rule, the court should make allocation decisions only if the trustee pursues an additional defendant after settlement with other defendants, rather than at the time of the settlement, to conserve judicial resources. The court should not simply adopt the allocation on which the settling parties agree in the settlement agreement, as the settling defendants typically do not care how the proceeds are allocated, and the plaintiff has an interest in preserving claims against future potential defendants who are not present and therefore cannot be heard on the fairness of the allocation. *Dzikowski v. N. Trust Bank of Fla., N.A. (In re Prudential of Fla. Leasing, Inc.)*, 478 F.3d 1291 (11th Cir. 2007).

2.7.gg. Interim trustee appointment does not extend section 546(a) statute of limitations. Section 546(a) imposes a statute of limitations on an avoiding power action of two years after the order for relief, but the statute may be extended to one year "after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302" if the election or appointment occurs before the expiration of the two-year period. In this case, the chapter 11 case was converted to chapter 7 shortly before the two-year period expired. The U.S. trustee immediately appointed an interim chapter 7 trustee under section 701, and the creditors elected a permanent trustee under section 702, but only after the two-year period had expired. Neither the appointment of the interim trustee nor the election of the permanent trustee extends the statute of limitation. The extension applies only to a trustee appointed or elected under section 702, not to an interim trustee appointed under section 701, and the permanent trustee's election occurred after the two-year period had expired. Therefore, the trustee's avoiding power actions are barred. *Singer v. Frontier Commc'ns. of Am. Inc. (In re Am. Pad & Paper Co.)*, 478 F.3d 546 (3d Cir. 2007).

2.7.hh. Trustee may pursue a separate recovery action after avoiding and preserving a lien. The trustee brought an action to avoid a mortgage as a preference and for recovery of a money judgment. The defendant mortgagee defaulted, and the trustee took a default judgment avoiding the mortgage and preserving it for the benefit of the estate. The trustee then brought another action against the same mortgagee for recovery of the value of the avoided transfer. The requisites for claim preclusion—identity of

the parties and causes of action and a final judgment on the merits—are present here, but an exception to the doctrine permits a second action if the statutory scheme permits a plaintiff to split the cause of action. Section 550 permits recovery separate from avoidance and imposes a separate statute of limitations for the recovery action. Indeed, an action for avoidance does not necessarily result in a recovery judgment, which must be requested separately, even if in the same action. Therefore, the statutory scheme permits splitting of the cause, and the trustee may pursue the recovery action. The court does not address the effect of either of preservation of the lien in the first action on section 550's "single satisfaction" rule or of the inclusion of the claim for recovery of a money judgment that was pleaded but not pursued in the first action. *Maxwell v. Mich. Fid. Acceptance Corp. (In re Maestas)*, 354 B.R. 844 (Bankr. E.D. Wis. 2006).

2.7.ii. Recovery from funds transferred to a minor's UTMA account is limited to the amount in the account. A corporation owned by a husband and wife received an insurance payment, which they deposited into custodial accounts for their children. The wife, who was the custodian, then transferred the proceeds to two other corporations that the husband and wife formed and controlled. The initial corporation's bankruptcy trustee sought recovery of the insurance payment from the husband, the wife, the children, and the other two corporations as a fraudulent transfer. A custodian under the Uniform Transfers to Minors Act, unlike a true trustee, does not have title to the account assets but simply controls them. Therefore, the custodian is not the "initial transferee." But the custodian wife exercised dominion over the funds by transferring them to the other two corporations, so she is liable as an initial transferee for whose benefit the transfer was made. The children did not have any control over the assets, but they were the transferees for whose benefit the transfer initially was made. However, UTMA § 17 provides that the minor's personal liability for obligations for which the minor is not personally at fault is limited to the amount in the custodial account. The limitation shelters the children's personal liability to the trustee for the fraudulent transfer. *Boyer v. Belavilas*, 474 F.3d 375 (7th Cir. 2007).

2.7.jj. Payee whose use of preference payments is heavily regulated and restricted is still an "initial transferee." Federal law requires telecommunications providers to collect a "Universal Service Fund (USF) Fee" from its customers, which they must pay to the Universal Service Administrative Company (USAC), a Delaware non-profit corporation. USAC, under strict FCC regulatory supervision, pays the USF collections to other telecommunications providers to provide support for schools, libraries, and rural hospitals. A chapter 11 creditors' committee sued USAC to recover as a preference the USF fees that the debtor had paid to it within 90 days before bankruptcy. USAC claimed it was a mere conduit, not a transferee of the funds. Under the "dominion test," a payee is not a transferee unless the payee has the legal right to use the funds for its own purposes or as it sees fit. The "dominion test" differs from the "control test," which focuses more broadly on the transaction as a whole to determine who actually controls the funds. Under the more restrictive "dominion test," USAC had dominion over the funds. Even though its use of the funds was severely restricted by tight FCC regulation, it actually received and took legal title to the funds, had the legal right to determine how to use them (though subject to regulation), and disposed of them in accordance with its budgets and management decisions. It was not a mere conduit for the debtor's payments to the other telecommunications providers. Therefore, it was the initial transferee of the payments. *Universal Serv. Admin. Co. v. Post-Confirmation Comm. of Unsecured Creditors (In re Incomnet, Inc.)*, 463 F.3d 1064 (9th Cir. 2006).

2.7.kk. Recovery requires prior avoidance. The debtor in possession brought an action against a mediate transferee alleging a constructively fraudulent transfer and seeking recovery from the transferee. The debtor in possession had not previously avoided the transfer, nor did it seek avoidance in this action. The court dismisses the recovery action, because section 550(a) permits recovery only "to the extent that a transfer is avoided" under one of the avoiding power sections. Unlike section 502(d), section 550(a) does not depend only on whether the transfer is "avoidable." In addition, the statute of limitations in section 550(f) runs from "avoidance of the transfer on account of which recovery under this section is sought." Thus, without a prior avoidance requirement, there would be no effective statute of limitations on a recovery action, and a trustee could circumvent section 546(a)'s two-year statute of limitations on avoiding power actions simply by not bringing such an action and suing only for recovery. To conserve judicial resources, a trustee may seek avoidance and recovery in the same action, as long as avoidance is

determined before recovery. *Enron Corp. v. Int'l Fin. Corp. (In re Enron Corp.)*, 343 B.R. 75 (Bankr. S.D.N.Y. 2006); rev'd, 388 R.R 489 (S.D.N.Y. 2008).

2.7.ll. Trustee is not limited to avoiding a lien but may recover its value. The debtor transferred the assets of one of its operating divisions to a subsidiary. Five years later, it issued bonds and granted a lien on the assets to secure the bonds. Shortly thereafter, it filed bankruptcy. The trustee brought an action to avoid the transfer to the subsidiary as a fraudulent transfer and sought recovery of the property or its value from the bondholders as the mediate transferees of the avoidable transfer. The court denies the bondholders' motion to dismiss the claim for recovery of the value of the lien. Once a transfer is avoided, a court has discretion whether to order return of the property transferred or its value. The court is not limited as a matter of law to avoiding the lien, even though the value of the lien may be difficult to determine. Although the bondholders do not establish a mediate transferee's good faith defense under section 550(b), the trustee may proceed to trial on the recovery issue. *Official Comm. of Asbestos Claimants v. Bldg. Materials Corp. (In re G-I Holdings, Inc.)*, 338 B.R. 232 (Bankr. D.N.J. 2006).

2.7.mm. Insurance agent's trust account was not initial transferee of an avoidable preference. To be an initial transferee for purposes of section 550, a transferee must be able to exercise legal control over transferred funds and may use the funds for its own purposes. In this case, the debtor sent the agent a check for insurance premiums. State law required the agent to keep all client funds for insurance premiums in a client trust account. The agent deposited the check in the trust account and immediately wrote a check from the trust account to the insurance company. The debtor's check bounced. The debtor later wired funds to the trust account to replace the bounced check. The trustee avoided the wire as a preference but could not recover from the agent as the initial transferee. Even though the agent became the debtor's creditor when it wrote a check on the trust account against the debtor's bounced check, the agent did not have full control over replacement funds wired into its trust account. The agent did not intend to become the debtor's creditor, had every expectation that the check would clear when it deposited it, and charged no interest or fees for the "loan." In addition, the replacement funds were "earmarked" for the client trust account, not as payment of a debt. Finally, as the funds were wired into the trust account, the agent did not have full control over them, but held them in trust subject to the limitations and requirements of state law. *Andreini & Co. v. Pony Express Delivery Servs. Inc. (In re Pony Express Delivery Servs. Inc.)*, 440 F.3d 1296 (11th Cir. 2006).

2.7.nn. Section 546(a)(1) does not extend the statute of limitations for a plan liquidating trustee. Section 546(a)(1) requires that an avoiding power claim be brought within the later of two years after the order for relief or one year after the appointment of a trustee under section 702, 1104, 1163, 1202, or 1303 if the appointment occurs before the expiration of the two-year period. A plan liquidating trustee is appointed under section 1123(b), which authorizes a plan to provide for the appointment of an estate representative to pursue claims belonging to the estate. Therefore, the statute of limitations extension to a trustee does not apply to a plan liquidating trustee. *Alberts v. Arthur J. Gallagher & Co. (In re Greater SE. Cmty. Hosp. Corp.)*, 341 B.R. 91 (Bankr. D.D.C. 2006).

2.7.oo. Section 546(a)(1) does not extend the statute of limitations for an interim chapter 7 trustee. Section 546(a)(1) requires that an avoiding power claim be brought within the later of two years after the order for relief or one year after the appointment of a trustee under section 702, 1104, 1163, 1202, or 1303 if the appointment occurs before the expiration of the two-year period. An interim chapter 7 trustee is appointed under section 701. Therefore, despite the appointment of an interim trustee before the expiration of the two-year period, and even though the interim trustee may become the permanent trustee under section 702, the statute of limitations expires two years after the order for relief if the appointment of the permanent trustee occurs more than two years after the order for relief. *Georgia-Pacific Corp. v. Burtch (In re Allied Digital Techs. Corp.)*, 341 B.R. 171 (D. Del. 2006).

2.7.pp. Trustee is entitled to recover the value to the debtor, not to the creditor, of preferentially returned goods. After the debtor ceased operations, it returned yarn to its yarn supplier. An involuntary case was filed within 90 days thereafter, and after the order for relief, the debtor in possession sued to avoid the transfer as a preference and to recover its value under section 550. It could recover only its value in the hands of the debtor, that is, liquidation value, not the amount for which the creditor could

resell the yarn. That value includes the creditor's expertise, time, goodwill, and selling expense, which do not reflect the amount that the preference harmed the debtor's estate. *Active Wear, Inc. v. Parkdale Mills, Inc.*, 331 B.R. 669 (W.D. Va. 2005).

2.7.qq. A trustee may bring an action to recover a transfer before it is avoided. Section 550(a) permits a trustee to recover property transferred "to the extent that a transfer is avoided." The language does not require the trustee to have avoided the transfer before bringing the action to recover; the actions can be brought together. The quoted phrase serves the purpose of limiting the extent to which the trustee may recover property, for example, if the transfer is avoided only in part, not the time in which the trustee may bring the action. *Leonard v. Optimal Payments Ltd. (In re Nat'l Audit Defense Network)*, 332 B.R. 896 (Bankr. D. Nev. 2005).

2.7.rr. Avoidance is not a prerequisite to recovery. The debtor and its principal engaged in an intricate, international money laundering scheme to remove assets from the debtor for the benefit of the principal when the debtor was under litigation attack for its business activities. The trustee sued to recover some of the transferred funds from the ultimate (mediate) transferee, but did not first seek avoidance of the transfers. Avoidance under section 544(b) is not required for recovery under section 550, despite the language of section 550 that permits recovery "to the extent a transfer is avoided." The phrase is sufficiently ambiguous, and the policy considerations in permitting the last in a chain of fraudulent transferees to rely on that defense are sufficiently compelling, that the court concludes that the phrase applies only to limit recovery when a transfer is avoidable in part and not avoidable in part. Therefore, the trustee may recover from the subsequent transferee alone. *IBT Int'l, Inc. v. Northern (In re Int'l Admin. Servs., Inc.)*, 408 F.3d 689 (11th Cir. 2005).

2.7.ss. Recovery liability may not be offset against resulting section 502(h) claim. The creditor received a transfer that the debtor in possession avoided under section 549. The debtor obtained a judgment under section 550 for the value of the property transferred. Upon paying the judgment, the creditor would have had a claim under section 502(h) that would have been treated as a prepetition claim. The creditor was not entitled to equitable recoupment of that claim against its liability to the estate for recovery of the postpetition transfer. Even though the two claims arose out of the same transaction and therefore might be appropriate for recoupment, the nondebtor party must have a present claim against the debtor. The creditor's claim here is a future claim that does not exist during and accrues only after the avoidance action. What's more, to permit recoupment in these circumstances would effectively nullify any avoiding and recovery power. *Rochez Bros. v. Sears Ecological Applications Co.. (In re Rochez Bros.)*, 326 B.R. 579 (Bankr. W.D. Pa. 2005).

2.7.tt. Section 550(a)(1) requires direct benefit for liability. The debtors sold their assets to a financing entity. The proceeds were used to pay off existing loans and to buy out one of the shareholders for $100,000. A new entity, 100% owned by the other shareholder, leased the assets back from the financing entity. After the debtors later filed bankruptcy, the trustee sought recovery of the $100,000 as a fraudulent transfer from the new entity's shareholder on the ground that by becoming the sole shareholder of the new entity, which controlled the debtor's former assets and business, the sole shareholder had received a benefit from the debtor's $100,000 transfer to the selling shareholder. The benefit was, however, indirect, incidental, and unquantifiable, unlike the paradigm case of the benefit to a guarantor when a debtor pays a guaranteed loan. The transfer could not be recovered from the sole shareholder, because it was not direct, ascertainable, and quantifiable. *Reily v. Kapila*, 399 F.3d 1288 (11th Cir. 2005).

2.7.uu. A trustee may recover an LLC's payment of estimated taxes for individual members. Before bankruptcy, the LLC debtor made estimated income tax payments to the taxing authorities on behalf of the LLC's individual members. The trustee may recover the payments, which were made from property of the LLC, because the LLC was a separate entity, and its funds were not the funds of the individual members. (It was not clear whether the trustee sought turnover of the funds or recovery under one of the avoiding powers.) *Gilliam v. Speier (In re KRSM Props., LLC)*, 318 B.R. 712 (B.A.P. 9th Cir. 2004).

2.7.vv. Mediate transferee protection does not require that value be given to the debtor. The debtor fraudulently transferred machinery and equipment to an affiliate. The affiliate failed and left the

machinery and equipment with its landlord. The landlord transferred the machinery and equipment to a former employee of the affiliate, who agreed to remove from the landlord's premises the equipment with hazardous waste and to dispose of it properly. The landlord was the immediate transferee of the initial transfer, and the former employee was the mediate transferee. A mediate transferee is protected against recovery under section 550(a)(2) if he takes for value, in good faith, and without knowledge of the voidability of the transfer. In this case, the mediate transferee gave value to the landlord by agreeing to remove and treat the hazardous waste that the affiliate had left on the landlord's premises. The value need not be given to the debtor for this protection to apply. *Williams v. Mortillaro (In re Resource, Recycling & Remediation, Inc.)*, 314 B.R. 62 (Bankr. W.D. Pa. 2004).

2.7.ww. Lender gets credit against postpetition avoidance action for unauthorized postpetition loans. Prepetition, the debtor had an accounts receivable financing agreement with a lender. The debtor did not notify the lender of the chapter 11 case. Postpetition, the lender advanced $192,000 against new receivables and collected $163,000 in receivables against which it had previously advanced. After the case converted to chapter 7, the trustee sought recovery under section 549(a) of $163,000 from the lender. Although the court finds the transfers of $163,000 avoidable, it denies the trustee recovery under sections 550(d) and 105(a). Section 550(d) limits a trustee to a single satisfaction. Because the lender had advanced more fresh cash to the estate than it had collected, any further recovery would constitute a double recovery. The court also supported its ruling under section 105(a), reasoning that it would be inequitable to require the lender to pay over the collections when it had already advanced funds to the estate in excess of what it had received and that such an order was consistent with the Code, particularly section 550(d). *Dobin v. Presidential Fin. Corp. (In re Cybridge Corp.)*, 312 B.R. 262 (D.N.J. 2004).

2.7.xx. Recovery from a secured creditor revives the creditor's secured claim. During the involuntary gap, the alleged debtor paid the fully secured creditor a portion owing on its loan. After the order for relief, the debtor confirmed a plan that provided for a revesting of assets free and clear of all liens. After confirmation, the liquidating agent prevailed in an action against the creditor for recovery of the gap transfers under section 549(a). The creditor asserted a secured claim under section 502(h), which would fully cancel the trustee's recovery. Because section 502(h) requires allowance and determination of the claim the same as if the claim had arisen before the date of the filing of the petition, the section 502(h) claim was secured, just as the original claim had been secured. *Fleet Nat'l Bank v. Gray*, 375 F.3d 52 (1st Cir. 2004).

2.7.yy. Creditor may not bring derivative avoiding power action. Refusing to follow the decision of the Third Circuit in *Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548 (3d Cir. 2003) (*en banc*), the Tenth Circuit B.A.P. instead relies on the literal reading of *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000), to rule that a creditor does not have and may not be granted derivative standing to bring an avoiding power action in the name of the trustee. Because the Tenth Circuit has not yet ruled on this issue, the B.A.P. concludes that it must select between the *Cybergenics* and the *Hartford Underwriters'* approaches and chooses the latter. *United Phosphorous, Ltd. v. Fox (In re Fox)*, 305 B.R. 912 (10th Cir. B.A.P. 2004).

2.7.zz. Secured creditor may pursue preference actions. As part of its adequate protection agreement, the debtor in possession transferred to its secured lenders up to $30 million of recoveries under preference claims. Two preference defendants argued that the secured creditors' preference litigation was not "for the benefit of the estate," as required under section 550(a) and so should be dismissed. The Seventh Circuit rules that using the prospect of preference recovery before the commencement of preference litigation to secure a benefit for the estate (here, debtor in possession financing) was sufficiently "for the benefit of the estate" to qualify under section 550(a). Moreover, *Hartford Underwriters v. Union Planters Bank*, 530 U.S. 1 (2000), does not prevent a direct assignment of claims that belong to the estate. *Mellon Bank, N.A. v. Dick Corp.*, 351 F.3d 290 (7th Cir. 2003).

2.7.aaa. "Knowledge of voidability" requires more than inquiry notice. After the case was converted to chapter 7, the debtor's wife paid fees to the debtor's bankruptcy lawyer and the debtor's criminal lawyer. Before the fees were paid, the trustee advised the attorneys that he was investigating whether the source of the funds might be recoverable under one of the avoiding powers. After the fees were paid and the trustee

completed his investigation, the trustee sought recovery from the attorneys of the fees paid on the grounds that they came from property of the estate. He claimed that they were paid by a Cook Islands asset protection trust, which the debtor had established more than one year before bankruptcy, to the wife, who paid them to the attorneys. Despite the advice from the trustee that he was investigating the source of the funds used to pay the fees, the Third Circuit rules that the attorneys did not have "knowledge of the voidability of the transfers." Reading "knowledge" narrowly, the court rules that notice or inquiry notice is not the same as knowledge. *Wasserman v. Bressman (In re Bressman)*, 327 F.3d 229 (3d Cir. 2003).

2.7.bbb. Collateral escrow agent is not an "initial transferee." The debtor issued preferred stock to a special purpose subsidiary of an investment bank, which had borrowed from Dow Chemical. The subsidiary pledged the preferred shares to an escrow agent, to whom the debtor paid preferred stock dividend payments and who then paid them on to Dow as interest payments on the subsidiary's note. The escrow agent was not the "initial transferee" for purposes of section 550. What is more, the court looks through the transaction to determine that Dow may have had a direct equity interest in the debtor and therefore denies summary judgment to Dow on the underlying fraudulent transfer action. *Pereira v. Dow Chemical Co. (In re Trace International Holdings, Inc.)*, 287 B.R. 98 (Bankr. S.D.N.Y. 2002).

2.7.ccc. Trustee need not recover avoided mortgage. The trustee sued to avoid a mortgage on the debtor's property on the grounds that it was invalidly executed under Ohio law. Upon avoidance, the trustee preserved the mortgage for the benefit of the estate under sections 551 and 541(a)(4) and did not need to recover the property transferred. As a result, the transferee did not have the defenses of section 550(b) and section 550(e) available. The court also suggests that preservation of the transfer was not necessary, because upon avoidance of the mortgage the property automatically became property of the estate. *Suhar v. Burns (In re Burns)*, 322 F.3d 421 (6th Cir. 2003).

2.7.ddd. Person who does not have dominion over a cashier's check is not an initial transferee. The husband settled litigation. The wife purchased a cashiers check with her separate property, identifying the husband as the "remitter" on the cashier's check. The husband delivered it to the creditor. The wife filed bankruptcy within a year, and her trustee sought recovery of the funds from the creditor as a fraudulent transfer. On a very close reading of Article 3 of the U.C.C., the Ninth Circuit rules that the identification of the husband as the remitter on the cashier's check was irrelevant. He had only such rights as the wife could transfer. Only the bank, as drawer and drawee of the check, and the creditor as payee, could enforce the check. Therefore the husband did not have dominion over the funds. Affirming that it followed the "dominion" rather than "control" test for identifying who is the initial transferee, the Ninth Circuit concludes that the creditor was the initial transferee and is therefore liable for the fraudulent transfer, even though it accepted the check in good faith and without knowledge of the voidability of the transfer. For these purposes, "dominion" means legal dominion and control, rather than mere control in fact. *Abele v. Modern Financial Plans Services, Inc. (In re Cohen)*, 300 F.3d 1097 (9th Cir. 2002).

2.7.eee. By transferring claim, creditor loses right to reinstated claim after transfer avoidance. The debtor made transfers to its secured lender during the involuntary gap period. The trustee later avoided the transfers under section 549, and the lender asserted a claim under section 502(h), which it claimed was secured by its original collateral. However, the lender had sold its claim to a third party. Because of the sale, the lender could not assert a reinstated claim after the avoidance of the transfer. *Bankvest Capital Corp. v. Fleet Boston (In re Bankvest Capital Corp.)*, 276 B.R. 12 (Bankr. D. Mass. 2002).

2.7.fff. Preference recovery is not subject to PACA trust. The trustee sought preference recovery from PACA suppliers who were paid before bankruptcy. The suppliers settled. The settlement proceeds were not subject to the PACA trust, even though the payments to suppliers may have come from PACA trust funds, because the funds paid to settle the preference actions were not traceable to PACA proceeds. *In re Churchfield*, 277 B.R. 769 (Bankr. E.D. Cal.).

2.7.ggg. The trustee need not "recover" an avoided transfer. The trustee avoided a mortgage under the strong-arm power of section 544(a)(3). The avoided mortgage is automatically preserved for the benefit of the estate under section 551, and the preserved mortgage becomes property of the estate under section 541(a)(4). Once it does, the mortgage and the fee merge, and the trustee effectively owns the

property free and clear of the mortgage. As such, the trustee does not need to invoke the recovery powers under section 550, which are independent of the avoiding power sections of the Bankruptcy Code, and the transferee does not have any of the benefits of the "takes for value" protection of section 550(b)(1), the "good faith immediate or mediate transferee" protection of section 550(b)(2), or the "improvements" lien of section 550(e). *Suhar v. Burns (In re Burns)*, 369 B.R. 20 (6th Cir. B.A.P. 2001).

2.7.hhh. Proceeds of preference recovery are not subject to prepetition liens against the debtor. The taxing agency filed a statutory tax lien for unemployment taxes against the debtor before the petition. In the debtor's chapter 7 case, the trustee recovered substantial funds from preference actions. The state taxing agency sought to impose its lien on the recovery. The Sixth Circuit rules that the proceeds recovered are property of the estate, not of the debtor, so that the state taxing lien never attached to the recovered property. *Frank v. Michigan State Unemployment Agency (In re Thompson Boat Co.)*, 252 F.3d 852 (6th Cir. 2001).

2.7.iii. Avoidance, preservation, and recovery of transfers are separate and independent concepts. The debtor sought to avoid an unrecorded lease under section 544(a) and to preserve the lease for the benefit of the estate under section 551. The debtor did not, however, seek recovery of the leasehold interest under section 550(a), because avoidance and preservation would merge the leasehold and fee interest, resulting in the estate recovering unencumbered title to the real property. The court rules that the debtor may avoid the transfer even though it does not seek recovery under section 550(a), because the two concepts are separate and independent. Moreover, the section 550(a) requirement of a "benefit to the estate" as a condition to recovery does not apply to the avoiding powers. *Dunes Hotel Assocs. v. Hyatt Corp.*, 245 B.R. 492 (D.S.C. 2000).

2.7.jjj. Court denies avoidance of transfer on equitable grounds. Characterizing the case as unique, the court denies the use of the avoiding powers against a clearly avoidable transfer where the transferee was the debtor's sole creditor and the avoidance would benefit only the debtor and its equity holder. The court found that such a course of conduct would violate the debtor in possession's fiduciary duty of loyalty by favoring the debtor's interest rather than the interest of creditors and would be contrary to the purposes of the avoiding powers. *Dunes Hotel Assocs. v. Hyatt Corp.*, 245 B.R. 492 (D.S.C. 2000).

2.7.kkk. Subsequent transferee is liable for funds flowing through bank accounts. In settlement of a proxy contest, Southmark paid a dissident shareholder $3.3 million. The shareholder paid a portion of it to another member of its group, who paid the amount to the group's lawyer. Apparently ignoring the nature of the bank account, the court holds that the flow of funds through each of the three bank accounts rendered the law firm a "subsequent transferee" under section 550(a) of the property transferred by Southmark to the initial shareholder. *Southmark Corp. v. Schulte, Roth & Zabel, L.L.P.*, 242 B.R. 330 (N.D. Tex. 1999).

2.7.lll. Unsuspecting payee of cashiers check is "initial transferee" for avoidance purposes. The corporate debtor's principal drew a cashiers check on the debtor's bank account, naming a car dealership as the payee and the principal's son as the remitter. The son used the check to buy a car. Although the car dealership had no idea of the source of the funds, it was the initial transferee under section 550(a)(1) for purposes of avoiding the fraudulent transfer of the debtor's funds. The court conducts a thorough analysis of UCC Article 3 in reaching its conclusion that only the car dealership had the sufficient dominion over the funds to qualify as the initial transferee of the debtor's property. *Perrino v. Salem, Inc.*, 243 B.R. 550 (D. Me. 1999).

2.7.mmm. Subsequent transferee is denied a good faith defense. Because the subsequent transferee of a preference knew of the source of the funds and "knew facts that would lead a reasonable person to believe that the transfer could be avoided as a preferential transfer if [the debtor] filed bankruptcy," the subsequent transferee had "knowledge of the voidability of the transfer" as required under section 550(b) and was liable. *Southmark Corp. v. Schulte, Roth & Zabel, L.L.P.*, 242 B.R. 330 (N.D. Tex. 1999).

2.7.nnn. An avoided lien on sold property is preserved for the benefit of the estate. The bankruptcy court holds that the automatic lien preservation provision of section 551 operates even on liened property that is sold before the petition. In this case, the debtor sold receivables that were subject to the unperfected lien. The recovery of the receivables upon the avoidance of the lien brought them back into the estate, despite the subsequent sale, subject to the avoided lien that was preserved for the benefit of the estate. *In re Greater Southeast Community Hospital Foundation, Inc.*, 237 B.R. 518 (Bankr. D.D.C. 1999).

2.7.ooo. Postconfirmation avoidance action must benefit the estate. The successor to the debtor under the plan issued a note to creditors that was not contingent on the successor's recovery under avoiding power actions. Accordingly, the successor corporation could not proceed to recover transfers under section 550, which requires that the recovery be "for the benefit of the estate." *Burlington Motor Carriers, Inc., v. MCI Telecommunications (In re Burlington Motor Holdings, Inc.)*, 231 B.R. 874 (Bankr. D. Del. 1999).

2.7.ppp. Chapter 7 trustee may transfer avoiding power rights. The Ninth Circuit affirms the bankruptcy court's approval of the trustee's sale of avoiding power actions. *Duckor Stradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.)*, 177 F.3d 774 (9th Cir. 1999).

2.7.qqq. Indirect benefit to creditors will support an avoiding power action. Case law has required that a post-confirmation avoiding power action benefit the estate or creditors. In this case, the recovery in the action would accrue solely to the reorganized debtor, but the equity of the reorganized debtor was owned solely by prepetition unsecured creditors. Thus, the court holds, the recovery benefits creditors adequately to satisfy the requirement of section 550. *P.A. Bergner & Co. v. Bank One, Milwaukee, N.A. (In re P.A. Bergner & Co.)*, 140 F.3d 1111 (7th Cir. 1998).

2.7.rrr. A recipient of funds from the debtor is not necessarily a "transferee." The debtor paid its insurance broker a premium that was to be transferred to the insurance company to purchase coverage. Following other circuits, the Second Circuit rules that the broker was merely a recipient or a conduit of the payment, not a transferee, because the broker passed the funds to the insurance company. To qualify as a transferee, the recipient must have dominion over the asset. *Christy v. Alexander and Alexander of New York, Inc. (In re Finley, Kumble, Wagner, Heinie, Underberg, Manley, Myerson & K.C. Casey)*, 130 F.3d 52 (2d Cir. 1997).

3. BANKRUPTCY RULES

3.1.a. Rule 2019 statements are judicial records subject to public access. In several asbestos chapter 11 cases, the court ordered that Rule 2019 statement exhibits that listed plaintiff law firm clients be filed only with the clerk, under seal, and not placed on the electronic docket. An asbestos debtor in an unrelated chapter 11 case sought access to the exhibits for use in the proceeding in its case to determine aggregate asbestos liability. A Rule 2019 statement is a judicial record because it is filed with the court. Filing with the clerk is the same as filing with the court, as all judicial records are filed with the clerk. There is a presumptive right of public access to judicial records. A party opposing access has the burden of proof to show that disclosure will work a clearly defined and serious injury. Neither the availability of an alternative means of obtaining the information, nor the fact that the purpose for which the information is sought differs from the purpose for which it was filed with the court, nor the fact that the party seeking access is not a member of the press affects the application of any of these principles. Any member of the public who faces an obstacle to obtaining a judicial record has standing to challenge a protective order, and, for the same reason, has standing to appeal. Therefore, the other asbestos debtor may have access to the information. *In re Motions for Access of Garlock Sealing Techs.*, 488 B.R. 281 (D. Del. 2013).

3.1.b. Court rejects "no seal-no deal" request to seal settlement agreement. The trustee and the defendants settled an adversary proceeding. The settlement agreement provided that the defendants would proceed with the settlement only if the court authorized the settlement agreement and any related documents to be filed under seal. Section 107 provides that all papers filed in a bankruptcy case are open to public inspection, except that the court must protect a party with respect to a trade secret, confidential commercial information or scandalous or defamatory matter. Confidential commercial information is

limited to information that would harm a party's competitive position. Material is scandalous only if it is grossly offensive, irrelevant and submitted for an improper purpose, unnecessarily reflects on moral character, is in repulsive language or detracts from the court's dignity and is irrelevant. Mere embarrassment is not sufficient. Material is defamatory only if it is untrue. Here, neither the complaint nor the settlement agreement met these high bars. Section 107 expresses Congress's policy of open access; no other public policy arguments take precedence over section 107, including the interest of the estate in securing a favorable settlement under a "no seal-no deal" provision in the agreement. Otherwise, such provisions would become self-fulfilling, without regard to section 107. Therefore, the court denies the motion to seal but leaves open the possibility of redaction of particular information that might meet one or more of the requirements of section 107(b). *Togut v. Deutsche Bank AG, Cayman Islands Branch (In re Anthracite Capital, Inc.)*, 492 B.R. 162 (Bankr. S.D.N.Y. 2013).

3.1.c. Fifth Circuit states standards for class certification under Rule 7023. A creditor filed a WARN Act class action adversary proceeding and a class proof of claim on behalf of 130 former employees, none of whom filed proofs of claim. The trustee objected to class certification in the adversary proceeding. Bankruptcy Rule 7023, which incorporates Fed. R. Civ. Proc. 23, establishes the requirements for class certification in an adversary proceeding. Rule 7023 applies in a claim objection proceeding, which is a contested matter, only if the bankruptcy court makes it applicable under Rule 9014. In a class claim, therefore, the bankruptcy court must make a preliminary determination, based on whether the class was certified prepetition, whether members of the class received notice of the bar date and whether class certification may adversely affect case administration, among other factors. But in applying Rule 7023 in an adversary proceeding, only the Rule 23 requirements apply, which are whether the class is too numerous to permit joinder of all members, there are common questions of law or fact, the representative's claims or defenses are typical of the class and the representative will fairly represent and protect the class's interests. In addition, the common questions must predominate over questions affecting only individual members, and the class action must be superior to other available methods. The numerosity determination is not based on numbers alone but on practical factors, such as geographical dispersion, ease of identifying members, the size of members' claims, and judicial economy. A court may consider the bankruptcy claims process as an alternative in considering whether the number of class members favors class certification. However, failure of class members to file proofs of claim is not relevant, because the filing of a class proof of claim suspends the bar date for class members, who may rely on the class claim until the court determines whether to certify a class. Whether a class action is a superior procedure is based in part on members' interests in controlling the prosecution of their own claims, the extent of pre-class action litigation, the desirability of concentrating the litigation and potential difficulties in managing a class action. A bankruptcy court may consider the simple bankruptcy claims process as the alternative as well as the costs to the estate of class certification, which could reduce recoveries for all creditors, including class members. But the court must also consider the nature of the claims and defenses, as they may affect whether the claimants will require attorneys and therefore incur cost. Here, the bankruptcy court did not adequately explain its reasons for denying class certification, so the court of appeals remands for findings consistent with the standards it states. *Teta v. Chow (In re TWL Corp.)*, 712 F.3d 886 (5th Cir. 2013).

3.1.d. Rule 9019 does not apply in a chapter 9 case. The municipal debtor settled a pending lawsuit and sought a court order that the settlement did not require court approval. Bankruptcy Rule 9019 provides, "On motion by the trustee …, the court may approve a compromise or settlement." The Rule derives from pre-Code rules that expressly did not apply in municipal bankruptcy cases. The change in format in the rules under the Code did not change the prior inapplicability of Rule 9019 in a municipal bankruptcy case. In addition, section 904 prohibits the court from interfering with a municipal debtor's property. The power to approve a compromise includes a power to disapprove, which could interfere with the debtor's unfettered ability to use its property. Therefore, the court refuses to rule on the settlement. It notes, however, that the number and amount settlements that the debtor makes before confirmation might affect the court's consideration of whether a plan of adjustment is fair and equitable. *In re City of Stockton*, 486 B.R. 194 (Bankr. E.D. Calif. 2013).

3.1.e. 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).

3.1.f. Rule 9006(a)'s time computation rules do not apply to an order that fixes an exact date. The court issued an order extending the time for filing an objection to discharge to April 30, 2011, which was a Saturday. The trustee filed the complaint the following Monday, May 2, 2011. Rule 9006(a)(1) governs time computation. It provides that when "a period is stated in days … include the last day of the period, but if the last day is a Saturday, Sunday, or legal holiday, the period continues to run until the end of the next day that is not a Saturday, Sunday, or legal holiday." Here, the order did not specify a "period stated in days" but fixed a specific date. Therefore, Rule 9006(a)(1) does not apply, and the complaint is untimely. *Dillworth v. Obregon*, 2012 U.S. Dist. LEXIS 111832 (S.D. Fla. Aug. 9, 2012).

3.1.g. Fourth Circuit establishes procedures for class proofs of claim. Before bankruptcy, the debtor was subject to an uncertified class action on behalf of several hundred former employees for overtime pay. After bankruptcy and before the bar date, the putative class representatives filed a class proof of claim. After the trustee objected, the claimants filed a motion under Rule 9014 to make Rule 7023 (Class Actions) apply. Rule 3001(a) requires a creditor or the creditor's authorized agent to file a proof of claim. In an ordinary class action, before class certification, the class representative is the class members' putative agent. If the court certifies the class, the class representative's agency relates back to the date of the filing of the action. Similarly, when a creditor files a class proof of claim, it acts as putative agent for class members, and a later certification of the class and designation of the representative will relate back to the claim filing date. Therefore, Rule 3001(a) does not prohibit a class proof of claim. The court may certify the class only under rule 7023, which, under Rule 9014, applies in a contested matter only if the court so orders. A proof of claim does not initiate a contested matter, but an objection to claim does. The claimant may move under Rule 9014 to apply Rule 7023 to the contested matter only once an objection is filed. If the court grants the Rule 9014 motion, then Rule 7023 procedures would apply, and the court would then have to determine whether to certify the class. If the court denies the Rule 9014 motion, the court should give class members who did not file a proof of claim a reasonable time to file, because the commencement of a class action, and therefore the filing of a class proof of claim, tolls the statute of limitations, and therefore the bar date, for filing a claim. In determining whether to grant the Rule 9014 motion, the bankruptcy court may consider both systemic concerns and specific facts. In general, the bankruptcy process permits all claims to be consolidated in a single forum, permits filing claims without counsel at almost no cost, provides established mechanisms for notice and for managing large numbers of claims, centralizes proceedings in one court and prevents a race to judgment by competing class members. By contrast, class action procedures are cumbersome and protracted. Therefore, systemic concerns may counsel against applying Rule 7023. In this case, because the class

members numbered only in the hundreds (compared with 15,000 other proof of claims filed), requiring class members to file individual proofs of claim would not unduly complicate the claims resolution process. Therefore, the bankruptcy court properly denied the Rule 9014 motion to apply Rule 7023. *Gentry v. Siegel*, 668 F.3d 83 (4th Cir. 2012).

3.1.h. A retroactive change in the law can prevent effective notice of a claims bar date. A consumer purchased the debtor's product before the debtor filed its chapter 11 case. The product manifested a defect three years after plan confirmation. The debtor in possession mailed notices of the claims bar date, of the disclosure statement hearing and of the confirmation hearing to all known claimants and published the notices widely to reach unknown claimants. When the court confirmed the plan, the applicable law under *In re M. Frenville & Co.*, 744 F.2d 332 (3d Cir. 1984), was that the consumer did not have a claim, because the product defect had not yet become manifest. *In re Grossman's Inc.*, 607 F.3d 114 (3d Cir. 2010), overruled *Frenville* four years after plan confirmation in this case, stating the rule that a claim arises upon prepetition exposure to a product or upon conduct that gives rise to an injury, so the consumer's claim against the debtor would have been a cognizable claim in the chapter 11 case. To discharge a claim requires that the claimant be given due process, which includes adequate notice to permit the claimant to participate meaningfully in the bankruptcy case. Because of *Frenville*, the consumer did not have a cognizable claim during the chapter 11 case. So despite the broad notice, the consumer could not participate meaningfully in the case. Thus, where a claim arises from retroactive application of a change in the law, the claim is not discharged when the notice is given based on the understanding that the claimant does not have a claim. *Wright v. Owens Corning*, 679 F.3d 101 (3d Cir. 2012).

3.1.i. Due process may require the debtor to give notice of the nature of the creditor's claim. Law enforcement raids exposed the debtor's participation in an anti-trust conspiracy shortly after the debtor confirmed its plan. The creditor later brought an anti-trust action against the reorganized debtor, who pleaded the chapter 11 discharge as a defense. The debtor had given the creditor notice of the chapter 11 case but not of any possible anti-trust claims. A chapter 11 discharge operates on all claims that arise before plan confirmation. The Code defines "claim" broadly to include contingent, disputed and unliquidated claims. A claim arises when there is a relationship between the debtor and the creditor that allowed them to contemplate contingencies that might result in a claim. Here, the debtor and the creditor had a pre-confirmation relationship—the creditor was the debtor's customer—but not in a manner that allowed the creditor to contemplate the existence of a claim. Still, the creditor admitted that the discharge by its terms would apply to its claim. However, due process principles limit the discharge's scope. Due process requires reasonable notice of a proceeding in which a creditor's rights will be affected. Given chapter 11's broad discharge and fresh start policy, what is practicable and fairness to claimants affect what notice is reasonable. A debtor need not provide notice of the nature of the creditor's claim if the creditor knew or should have known of its claim once it has notice of the chapter 11 case or if the debtor is unable to discover through reasonably diligent effort the nature of the creditor's claims. Here, the debtor was aware of the alleged conspiracy, and the creditor could not have known of it, because it was secret. Therefore, the debtor did not give the creditor sufficient notice so as to bring the creditor's anti-trust claim within the discharge's scope. *DPWN Holdings (USA), Inc. v. United Air Lines, Inc.*, 2012 U.S. Dist. LEXIS 70026 (E.D.N.Y. May 18, 2012).

3.1.j. The burden of proof of the extent of a secured claim under section 506(a) ultimately lies with the creditor. Section 506(a) allows a claim for which the creditor has collateral as a secured claim to the extent of the collateral's value and as unsecured for the balance. Under Rule 3001(f), a proof of claim is prima facie valid. To challenge a proof of claim, an objector must come forward with sufficient evidence to overcome its prima facie validity. Once the objector does so, the burden of persuasion then shifts to the creditor to establish the validity and amount of the claim. The same process applies in determining the amount of an allowed secured claim under section 506(a). Thus, where the creditors committee (on behalf of the estate) introduced an appraisal that showed the collateral's value was less than the amount of the first lien debt, the second lien creditor bore the burden of producing evidence that the property was worth more. Because it did not, the court properly found that the second lien creditor was wholly unsecured. *In re Heritage Highgate, Inc.*, 679 F.3d 132 (3d Cir. 2012).

3.1.k. Court denies motion to seal settlement agreement as contrary to open access policy. The chapter 11 plan liquidating trust settled a claim that the debtor had against a customer. The settlement agreement required that it be filed with the bankruptcy court under seal. There is a strong federal public policy favoring public access to court records, even more so when one of the parties is acting as a fiduciary. Section 107 implements that policy in a bankruptcy case. Ordinarily, a civil action settlement is a private matter. But where a bankruptcy estate (or its successor) is a party and requires court approval of the settlement, the open access public policy applies. Settlements are not entitled to any greater protection against disclosure than any other court-filed information. Because the parties did not present any reason sufficient to overcome the open access policy, the court denies the motion to seal. *In re Oldco M Corp.*, 466 B.R. 234 (Bankr. S.D.N.Y. 2012).

3.1.l. Information in a document is scandalous if it is disgraceful, offensive or shameful or brings discredit. Claimants in a case involving child sexual abuse sought public disclosure of a report filed under seal in the bankruptcy court that included the identity of two alleged perpetrators who were not parties to the case or any claim or adversary proceeding in the case. Section 107(a) provides for public access to all documents filed in a bankruptcy case, subject only section 107(b)'s exceptions. Section 107(b) requires a court, on request of a party in interest, to "protect a person with respect to scandalous or defamatory matter contained in a" filed document. Section 107 completely displaces the common law rule requiring public access to court proceedings and files, because it addresses the same question as the common law rule in a manner that differs from the common law rule. Therefore, common law precedents are of no assistance in interpreting section 107, and courts must interpret "scandalous" according to its ordinary meaning. Dictionaries define "scandalous" as "bringing discredit" and as "offensive to a sense of decency or shocking to the moral feelings of the community; shameful". Disclosure of information about alleged child sexual abuse, whether or not true and whether or not filed with the court for a purpose unrelated to the litigation, would bring discredit on the individuals. It is therefore scandalous and should not be made public. *Father M v. Various Tort Claimants (In re Roman Catholic Archdiocese of Portland In Oregon)*, 661 F.3d 417 (9th Cir. 2011).

3.1.m. U.S. Trustee may conduct examination related to a proof of claim, but only of matters arising in the case. The bank filed a proof of claim secured by a mortgage, without copies of the promissory note or mortgage, claiming the documents had been lost. In response to a motion from the U.S. Trustee, the bank amended its proof of claim to attach copies of the note and the mortgage and to reduce the amount owing by about 15%. The U.S. Trustee then sought an examination of the bank under Rule 2004 about matters related to the proof of claim, the previously lost documents and the bank's policies and procedures addressing preparation and filing of proofs of claim and lost documents. Rule 2004 permits the court to order an examination on "motion of any party in interest". The Code is ambiguous on whether the U.S. Trustee is a "party in interest". Section 307 provides that the U.S. Trustee "may raise and may appear and be heard on any issues in any case or proceeding" under the Code. This broad language provides the U.S. Trustee standing to request an examination under Rule 2004. In addition, the U.S. Trustee is a party in interest for purposes of protecting bankruptcy rules and procedures, for which the U.S. Trustee is the Congressionally appointed watchdog, and to prevent abuse of the bankruptcy law. However, a Rule 2004 examination may relate only to the particular case and to the debtor-creditor relationship. It does not permit a nationwide examination into a creditor's policies and procedures, and it may not be used as a regulatory tool. Therefore, the U.S. Trustee may take the examination, but only concerning matters relating to this case. *Bank of America, N.A. v. Landis*, 2011 U.S. Dist. LEXIS 140868 (D. Nev. Dec. 7, 2011).

3.1.n. Court may approve settlement that pays the debtor's bankruptcy attorney from non-estate funds. The real property on which the debtor operated its business was titled in the name of one of the debtor's principals, who were in the middle of a divorce during the bankruptcy. To settle disputes about the ownership of the property and its division in the divorce, the trustee and the principals agreed that the estate would receive 50% of the property's sale proceeds, each principal would receive 25% and the two principals would pay debtor's bankruptcy attorney a portion of their shares. An unpaid administrative creditor objected to the settlement as violating the Code priority scheme. The payment to the debtor's bankruptcy attorney came only from the principals' shares, not from the bankruptcy estate, and so did not implicate the distribution of property of the estate. Disapproval of the settlement would not necessarily

bring the portion that was to be paid to the attorney into the estate. Therefore, the priority scheme does not apply, and the bankruptcy court properly approved the settlement. *In re Holly Marine Towing, Inc.*, 669 F.3d 796 (7th Cir. 2011).

3.1.o. Only a note's holder or one entitled to enforce it has standing to seek stay relief or file a proof of claim. The debtors issued a note secured by a mortgage. The holder negotiated the note and assigned the mortgage. The new holder assigned the mortgage but not the note. The new mortgagee appointed a servicing agent for the note and mortgage, and the debtors made payments to the agent. When the debtors filed chapter 13, they scheduled the servicer as a secured creditor holding an undisputed secured claim. The mortgagee sought stay relief to foreclose, and the servicer filed a proof of secured claim as agent for the mortgagee. A party seeking stay relief or claim allowance on a negotiable instrument such as a note must have both constitutional and prudential standing to do so and, under Fed. Rule Civ. Proc. 17, must be the real party in interest. The party may meet the requirements by showing that it is the holder of the note or the party entitled to enforce it. Under U.C.C. Article 3, a person may become a holder by negotiation of the note or by a transfer, which requires delivery for the purpose of giving the transferee the right to enforce the note. Standing to seek stay relief requires only a colorable claim to the underlying obligation, because a stay relief proceeding does not determine rights in the obligation. Here, the mortgagee could not show such a colorable claim. The transfer of a mortgage without the transfer of the underlying note that it secures does not give the mortgagee any rights in the note either as a holder or as a transferee entitled to enforce the note. Therefore, the mortgagee did not have standing to seek stay relief. A party may file a proof of claim only if the party is the holder of the claim or its agent. A proof of claim is prima facie evidence of its validity under Rule 3001(f) only if the claim is executed by the creditor or its authorized agent as required by Rule 3001(b). The debtor's sworn schedules are evidence but not conclusive evidence of the status or right of a listed creditor. In this case, the servicer was the authorized agent of the mortgagee, but the mortgagee was not a creditor, and the debtor's schedules, because they were susceptible to several interpretations, did not change the analysis. Therefore, the servicer did not adequately show that it had standing to file the proof of claim. *Veal v. Am. Home Mortgage Serv., Inc. (In re Veal)*, 449 B.R. 542 (9th Cir. B.A.P. 2011).

3.1.p. Court denies motion to seal transcript that reveals settlement amount for stay violation. The debtor's telephone and internet service provider violated the stay by multiple disconnect notices, despite having received notice of the petition and contact from the debtor's counsel. The debtor moved for sanctions. The debtor and the service provider settled for a payment to the debtor and the debtor's attorney, and the debtor voluntarily dismissed the motion under Rule 41 (incorporated by Rule 9014) without disclosing the settlement amount. The debtor's attorney filed an amended statement of compensation, which also did not include the amount. The court scheduled a hearing on approval of the settlement, at which it insisted upon disclosure of the amount. Upon disclosure, the court concluded that it required no further proceedings and permitted the dismissal to take effect. The court reporter prepared and filed a transcript of the hearing. The service provider moved to redact the settlement amount from the transcript. Section 107 requires that all papers filed in a bankruptcy case be public and open to inspection, with limited exceptions for trade secrets or confidential research, development or commercial information, for scandalous or defamatory information and for information that would create an undue risk of identity theft. None of these exceptions apply to the settlement amount. The court may redact information from the record, however, for cause under Rule 9037(d). In addressing a redaction request, the court must consider a bankruptcy case's multi-party nature and other bankruptcy policies, such as the rules requiring disclosure of the debtor's attorney's compensation and court approval of a settlement and the importance of the automatic stay. Where, as here, the violation was not idiosyncratic but was repeated despite several notices and a sanctions motion, confidentiality of sanctions (or settlement) for the violation is inconsistent with the court's responsibility to maintain the bankruptcy system's integrity. Therefore, the court denies the motion to redact the settlement amount. *In re Blake*, 452 B.R. 1 (Bankr. D. Mass. 2011).

3.1.q. Proceeding to enforce discharge injunction must be brought by motion as a contested matter. The debtor claimed that a creditor had violated the discharge injunction. He filed a complaint initiating an adversary proceeding in the bankruptcy court to impose sanctions for the violation. Rule 7001 lists the kinds of relief that require an adversary proceeding and includes a request for injunctive relief. Other two-party disputes are contested matters that must be initiated by motion under Rule 9014. Rule

9020 requires that a request for an order holding a party in contempt is a contested matter that must be initiated by motion. The list in Rule 7001 is exclusive, even though a court may order that some or all of the adversary proceeding rules apply in a particular contested matter. A proceeding to enforce, and for sanctions for violating, the discharge injunction does not seek a new injunction but only a contempt remedy for violation of an existing order and must be brought as a contested matter under Rule 9014, not as an adversary proceeding. The court therefore dismisses the complaint. *Barrientos v. Wells Fargo Bank, N.A.*, 633 F.3d 1186 (9th Cir. 2011).

3.1.r. Settlement's reasonableness depends on evaluation of each claim settled. The debtor in possession negotiated a complex settlement with several adverse parties of several different claims that the debtor had against the other parties and that they had against the estate. In determining whether the settlement is reasonable, the court must evaluate each part of the settlement by evaluating each claim that is being settled to determine whether the settlement as a whole is reasonable. The settlement's reasonableness, however, is not simply based on the sum of parts. The court may consider the benefits to be gained by a global settlement. In doing so, the debtor in possession need not present legal expert testimony nor even the testimony of the debtor in possession's officers about the legal advice they received. Rather, the debtor in possession must present the facts underlying the disputes and the legal arguments that each side has advanced, and the court may then evaluate that information in determining whether the settlement is reasonable. *In re Wash. Mut., Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011).

3.1.s. Community of interest privilege protects plan co-proponents. In a heavily disputed case, the court ordered mediation among twelve parties. The mediation resulted in a proposed settlement among three of the major parties—the debtor, the prepetition secured lenders and the unsecured creditors committee ("DCL")—but not among all parties. The agreeing DCL parties proposed a plan; the others objected and commenced discovery against the DCL parties. Parties may assert a community of interest (common interest) privilege to protect their communication the same as they may protect an attorney-client communication, if "(1) the communication was made by separate parties in the court on a matter of common interest, (2) the communication was designed to further that effort, and (3) the privilege was not otherwise waived". The DCL parties' common interest in achieving a settlement through confirmation of their plan satisfies the common interest standard, even though the parties' interests were adverse and would return to being so if the plan were not confirmed. The common interest begins once the parties reach agreement in principle on the material terms of the plan. *In re Tribune Co.*, 2011 Bankr. LEXIS 299 (Bankr. D. Del. Feb. 3, 2011).

3.1.t. Creditor did not fail to participate in mediation in good faith; court denies sanctions. The court ordered mediation of a dispute. Disputes arose over the scope of the mediation (that is, whether it would extend beyond the matters in dispute); one party's representative's settlement authority (it was limited to the amount in dispute); and that party's active participation in the mediation, including its inadequate risk analysis (whether the party refused to offer to pay anything because it was being obstinate or because it believed it had no risk). The bankruptcy court imposed sanctions on the party for refusal to participate in mediation in good faith. Mediation is by its nature voluntary and must be entirely confidential. A court may not coerce a party into settling. Requiring good faith participation may amount to coercion. Investigating the nature of a party's participation may breach confidentiality. Thus, the party may properly refuse to make an offer, and the court may not require a party to show that it engaged in risk analysis. In addition, a party's representative need have settlement authority only to the extent of the amount in dispute. It would be unduly burdensome to require broader authority or authority to approve creative solutions that may be developed at the mediation, because there is no way to predict what might arise beyond the scope of the dispute. *In re A.T. Reynolds & Sons, Inc.*, 2011 U.S. Dist. LEXIS 28163 (S.D.N.Y. Mar. 18, 2011).

3.1.u. Settlement between debtor and insurer may not bind additional insureds. The debtor and vendors of its products were defendants in numerous personal injury actions. The debtor's general liability insurance policy insured the vendors as well as the debtor and was a "non-eroding" policy, that is, defense costs did not reduce policy limits. The debtor in possession commenced an adversary proceeding for a stay of all actions against the debtor, the vendors and the insurer, which the court granted, and for a determination that all policy proceeds were property of the estate. The debtor in possession and the

insurer then reached a settlement that provided that the insurer pay policy limits to the estate for the sole benefit of the personal injury claimants and excluded their use for payment of administrative expenses and that any plan must contain provisions that are not inconsistent with the settlement. The settlement excluded the vendors' claims against the policy proceeds that the estate obtained and enjoined the claimants and the vendors from bringing any actions against the insurer. A settlement must be fair and equitable and in the best interest of the estate. By depriving the vendors of their independent direct claims against the insurer without providing for their sharing in the insurance fund, the settlement was not fair and equitable to them as creditors. In addition, the bankruptcy court may not, under the guise of a settlement, affect a third party's claims against a non-debtor. The settlement also was not in the best interest of the estate. By allocating the settlement proceeds to a single creditor class and preventing them from being used to pay administrative expenses, the settlement did not benefit the estate as a whole. It also may have increased the burden on the estate by imposing the costs of administering the settlement fund on the estate's general assets, which would reduce the amount available for other creditors. Finally, the fact that the settlement was made in the context of an adversary proceeding did not save it, because a settlement between some parties to an adversary proceeding cannot bind non-settling parties without their consent. Therefore, the settlement may not be approved. *Overton's, Inc. v. Interstate Fire & Cas. Ins. Co. (In re SportStuff, Inc.)*, 430 B.R. 170 (8th Cir. B.A.P. 2010).

3.1.v. Court sanctions creditor for failure to participate in mediation in good faith. The court ordered mediation of a dispute. The creditor attended with representatives whose authority to settle was questionable and who did not engage in negotiations. Instead, it argued its legal position, refused discussion of any risk to its position and repeated a "mantra" that it was not open to any compromise that "would involve taking a single dollar out of their pocket". Mediation requires active work from each of the parties with the presence of a representative who has settlement authority. Telephone access is not adequate, because the participation in the process affects parties' understanding of their risks and willingness to settle. A court may not force a party to settle, and a party unwilling to compromise does not necessarily act in bad faith. However, failure to engage and participate with a representative with adequate authority is not good faith and warrants sanctions. *In re A.T. Reynolds & Sons, Inc.*, 424 B.R. 76 (Bankr. S.D.N.Y. 2010).

3.1.w. Confirmation order that lacks statutory authority is not void or subject to collateral attack. The debtor proposed a chapter 13 plan that provided for payment in full of only the principal amount of his student loan debt and discharge of any interest or other amounts. The clerk gave notice of the plan to the creditor, who filed a proof of claim for principal and accrued interest. Although section 523(a)(8) permits discharge of a student loan only if the court determines that payment would constitute an undue hardship, Bankruptcy Rule 7001(6) requires such a determination be made in an adversary proceeding and section 1325(a)(1) requires the bankruptcy court to find as a condition to confirmation that the plan complies with the applicable provisions of title 11, the court confirmed the plan. The debtor performed and, at the end of the plan period, received a discharge. Later, the creditor moved under Rule 60(b)(4) (made applicable by Bankruptcy Rule 9024) to set aside the confirmation order. The confirmation order was a final judgment. Rule 60(b)(4) permits the court to set aside a final judgment if the judgment is "void". A judgment is void only if it is affected by a fundamental infirmity such as absence of even an arguable basis for jurisdiction or a due process violation. The creditor did not argue the bankruptcy court lacked jurisdiction to confirm the plan. Even though the creditor did not receive a summons and complaint as it would have in an adversary proceeding, the creditor received actual notice of the plan and the confirmation hearing. Due process does not require any particular form of notice, so confirmation did not violate due process requirements, and the creditor could not ignore the notice. Legal error or even lack of statutory authority, as here, is not sufficient to render a judgment void and subject to Rule 60(b)(4) attack. *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S. Ct. 1367, 176 L. Ed. 2d 158 (2010)

3.1.x. Rule 2019 does not apply to an ad hoc committee in a chapter 11 case. In a chapter 11 case, there was one official committee of unsecured creditors, one self-formed ad hoc committee of holders of over 90% of the more senior bonds and another self-formed ad hoc committee of holders of over 65% of junior bonds. The debtor proposed a plan, which all three committees opposed. The debtor proposed a revised plan based on negotiations with the ad hoc senior bond committee, which the other two committees opposed. The official committee then moved to compel the ad hoc senior bond holder

committee (but not the ad hoc junior bond committee that agreed with the official committee's position on the plan) to comply with Rule 2019. Rule 2019 requires "every entity or committee representing more than one creditor" to file certain disclosures with the bankruptcy court. The Rule does not define "committee". However, the plain meaning of "committee", based on dictionary references, is a body appointed by others, by consent, contract or applicable law, for a particular function. Therefore, a self-appointed group is not a "committee" within the meaning of Rule 2019. The court also thoroughly reviews the history of Rule 2019, reaching back to committee practices in equity receiverships, the Chandler Act reforms enacting Chapter X and the Bankruptcy Act's Rules implementing it through Rule 10-211 to conclude that the abuses by committees that Chapter X and Rule 10-211 were intended to eliminate are not possible under chapter 11 and the Code, so that the Rule should not properly be read to apply to a self-appointed ad hoc committee in a chapter 11 case. *In re Premier Int'l Holdings, Inc.*, 423 B.R. 58 (Bankr. D. Del. 2010).

3.1.y. Rule 2019 does not apply to a bank lenders' steering group. The debtor moved to require a steering group (which had previously referred to itself in the case as a "steering committee") to comply with Rule 2019's disclosure requirements. Rule 2019 requires "every entity or committee representing more than one creditor" to disclose its members and certain information about their holdings. "Entity", as defined in the Bankruptcy Code, does not include a group such as the steering group, and as defined in *Black's Law Dictionary*, means an organization that has a legal identity apart from its members or owners. "Committee", as defined in *Black's*, means a subordinate group to which a group refers business for consideration, investigation, oversight or action. The steering group meets neither of these definitions, because it is not an organization independent of its members, and it has not been appointed by any larger body. "Represent" means to act on behalf of another, as an agent. The steering group members act only for themselves and therefore do not represent any other creditors. Therefore, Rule 2019 does not apply to the steering group. *In re Phila. Newspapers, LLC*, 422 B.R. 553 (Bankr. E.D. Pa. 2010).

3.1.z. Rule 2019 applies to an ad hoc noteholders group, who may owe fiduciary duties to other noteholders. A group of 23 noteholders appeared in a chapter 11 case through one counsel. They did not claim to be an informal committee. They asserted no authority to bind other members of the group and did not purport to speak on behalf of their class of noteholders or anyone other than themselves. They were not bound to remain in the group nor to abide by majority rule. Their counsel could assert positions in the case only on behalf of the individual group members who agreed, although typically the group reached unanimous agreement on each issue. Rule 2019 requires that "every entity or committee representing more than one creditor or equity security holder" must file a statement with the court setting forth information about the claims or interests that its members hold. The loose affiliation of creditors of this group is reflective of an ad hoc committee, and counsel has represented the group as a whole, rather than individual members, in all proceedings in the case. The group is an "entity" under section 101(15) and represents the members. Therefore, Rule 2019 applies to the group. Even though the group does not purport to speak on behalf of noteholders generally, the group is deemed to do so, because it attempts to use its size to wield greater influence than each individual member could wield on its own. In general, members of a class may owe fiduciary duties to other class members in certain circumstances when pressing issues affect the entire class. Therefore, the group here owes fiduciary duties to noteholders. The court does not define the extent of such fiduciary duties, but recognizes "that collective action by creditors in a class implies some obligations to other members of that class." *In re Wash. Mut., Inc.*, 419 B.R. 271 (Bankr. D. Del. 2009).

3.1.aa. Court denies class proof of claim for the debtor's employees and former employees. Before bankruptcy, an employee sued the debtor in a class action for violation of various labor laws. The court had not yet considered class certification. After bankruptcy, the plaintiff filed a class proof of claim. Although a claimant may file a class proof of claim, there is no absolute right to proceed on a class basis. Proceeding with a class claim must be consistent with the goals of bankruptcy, which generally require either that the class has been certified before bankruptcy or there has been no actual or constructive notice to the putative class members. Here, the class had not been certified before bankruptcy, and the debtor in possession had given notice to all current employees and all former employees whose employment had been terminated within five years before bankruptcy. In addition, class certification adds complexity and expense to case administration. Therefore, the court does not permit the plaintiff to

proceed with the class proof of claim. *In re Bally Total Fitness of Greater N.Y.*, 402 B.R. 616 (Bankr. S.D.N.Y. 2009).

3.1.bb. WARN Act claims for prepetition termination are not entitled to class action treatment. The debtor terminated employees five days before bankruptcy without providing WARN Act's 60-day notice. The employees asserted WARN Act damages for 60 days' pay, which would have run 55 days into the postpetition period, by a class action adversary proceeding. In addition, 5,300 of the 5,500 class members filed individual proofs of claim. The bankruptcy court has inherent power to control its own proceedings and broad discretion whether to permit a class action to proceed. The bankruptcy court may dismiss an adversary proceeding if it duplicates the ordinary claims allowance process and the ordinary process is adequate to handle the claims. Here, the filing of proofs of claims by nearly all class members made the ordinary claims allowance process fully capable of handing the claims. Therefore, the bankruptcy court properly dismissed the class action. *Binford v. First Magnus Fin. Corp. (In re First Magnus Fin. Corp.)*, 403 B.R. 659 (D. Ariz. 2008).

3.1.cc. Committee may settle objection to sale for payment solely for the benefit of unsecured creditors. The debtor in possession proposed to auction assets based on a stalking horse bid agreement. The day before the auction, the bidder discovered a defect in the assets to be sold and withdrew its bid. The debtor proceeded with the auction, which the stalking horse bidder won for an amount slightly less than its original bid. The unsecured creditors committee threatened to object to approval. The bidder agreed to settle with the committee by funding a trust for the sole benefit of unsecured creditors; in exchange the committee agreed, subject to court approval of the settlement, not to pursue its objection or attempt to impede the sale. Rule 9019 authorizes the court to approve a trustee's or debtor in possession's settlement. However, it is not limited. Therefore, the committee has standing to seek settlement approval. The absolute priority rule requires, in both chapter 7 and chapter 11 cases, that property of the estate be distributed according to statutory priorities, unless a consensual chapter 11 plan provides otherwise. However, a third party may contribute funds that are not property of the estate for the benefit of a selected group of creditors. Here, there was no evidence that the funds the bidder would contribute would have otherwise gone to the estate. Therefore, the settlement did not violate the absolute priority rule. The committee does not breach its fiduciary duty by negotiating a settlement that benefits only unsecured creditors. It owes its duty to the group it represents, the unsecured creditors, not to the estate as a whole. *In re TSIC, Inc.*, 393 B.R. 71 (Bankr. D. Del. 2008).

3.1.dd. Service by certified mail does not satisfy Rule 7004(b)(9)'s first class mail requirement. The bank served a summons and complaint on the debtor by certified mail, return receipt requested. The Postal Service returned the mail to the bank as undeliverable, because the debtor did not pick up and sign for the envelope. The bank sought entry of a default judgment. Rule 7004(b)(9) requires service by first class mail. The Postal Service delivers first class mail to the addressee's location, and first class mail does not require any additional action by the addressee for delivery. By contrast, certified mail requires the addressee to sign or, if not at the address when the mail is first delivered, to fetch the mail from the post office within a specified time. This additional required action differentiates certified mail, return receipt requested from first class mail and therefore does not comply with Rule 7004(b)(9)'s requirement. As a result, the court denies the motion for entry of a default judgment. *GE Money Bank v. Frazier (In re Frazier)*, 394 B.R. 399 (Bankr. E.D. Va. 2008).

3.1.ee. News media do not have a right of access to a Rule 2004 examination. The trustee obtained authorization to conduct a Rule 2004 examination of the debtor. News organization representatives moved to intervene in the bankruptcy case and for access to the examination transcript. Limited intervention is appropriate to permit challenge to a protective order, so the court permits limited intervention here. There is a common law presumption that all court proceedings are public. Proceedings under Bankruptcy Act section 21a, the predecessor to Rule 2004, were part of the bankruptcy proceeding, were held before the referee and therefore were open to the public. However, the Bankruptcy Code changed the court's role, and current Rule 2004 is only a vehicle to assist in the estate's administration, not a court proceeding. Moreover, to the extent Rule 2004 is discovery, there is no right of access to materials not filed with the court. Therefore, the court denies access. *In re Thow*, 392 B.R. 860 (Bankr. W.D. Wash. 2007).

3.1.ff. A party may not withdraw from a settlement agreement pending bankruptcy court approval. The trustee settled with one of several parties in litigation and sought court approval of the settlement under Rule 9019. Before the settlement approval hearing, a guardian was appointed for the settling party. The guardian objected to the settlement and sought rescission. A settlement is a binding contract, subject to the condition precedent of court approval. Thus, a party may not rescind or repudiate the contract while awaiting fulfillment of the condition. If a party could unilaterally withdraw, it could game the system, for example, by settling to obtain a stay of litigation, and withdrawing later when it was ready to proceed. Therefore, the guardian could not rescind the settlement. *Musselman v. Stanonik (In re Seminole Walls & Ceilings Corp.)*, 388 B.R. 386 (M.D. Fla. 2008).

3.1.gg. Creditor's investors do not have standing to challenge the estate's settlement with the creditor. The Committee, on behalf of the estate, brought a preference action against a creditor, which was an investment fund. The litigation settled. The Committee sought court approval under Rule 9019. Fund investors objected, arguing that the fund acted improperly in agreeing to settle. The investors are not parties in interest in this chapter 11 case that have standing to object to the settlement. Although the concept of "party in interest" in section 1109(b) is broad, it applies only to the entity with a direct interest in or against the estate, not to another who may be affected by the bankruptcy proceedings. The entity with the direct interest may assert its rights directly; another may not assert them on its behalf as a party in interest. Here, the investors' interest is not sufficiently direct to permit them to appear and be heard. In addition, although the bankruptcy court must determine that a settlement is fair and equitable, the court's obligation is to the estate. Any concerns that the investors had about the fund's improper action in settling is for a different forum, in an action between the investors and the fund or its managers, not as part of a settlement approval. *Krys v. Official Comm. of Unsecured Creditors (In re Refco, Inc.)*, 505 F.3d 109 (2d Cir. 2007).

3.1.hh. "Case under title 11" does not include proceedings. The debtor filed the chapter 11 case in 1986. A creditor brought a malpractice action against the estate's accountants in state court in 2004, many years after the case was closed. The accountants removed the action to the bankruptcy court, and the creditors sought abstention. Congress adopted the statute governing the courts of appeals' jurisdiction over decisions not to abstain in 1984 and amended it in 1990, 1994, and 2005. The 1994 amendment provided that it "shall not apply with respect to cases commenced under title 11 … before the date of enactment of this Act." "[C]ases under Title 11 … refers merely to the bankruptcy petition itself, as opposed to proceeding[s], which refers to the steps within the case and to any subaction within the case that may raise a disputed or litigated matter." (internal quotation marks omitted). A court must apply the law in effect at the time of decision, unless the statute's effective date provision dictates otherwise. Therefore, the jurisdictional statute, as amended through 2005, applies to this appeal. *Geruschat v. Ernst Young LLP (In re Seven Fields Dev. Corp.)*, 505 F.3d 237 (3d Cir. 2007).

3.1.ii. Rule 6003 does not prohibit interim employment of counsel. The debtor LLC sought immediate interim approval under section 327 of its employment of counsel, without whom it could not present its first day motions to the court. Rule 6003 prohibits certain orders in a case, including an order approving employment of counsel, without 20 days' notice to parties in interest. It does not, however, prevent interim approval if necessary to prevent irreparable harm to the estate. Interim approval is preferable to retroactive approval (or retroactive interim approval following the court's decision that counsel should not be approved but should be compensated for the work performed until disapproval). Lack of counsel in the first 20 days of the case could result in irreparable harm to the debtor in possession, so the court approves counsel's employment on an interim basis only. *In re First NLC Fin. Servs., LLC*, 382 B.R. 547 (Bankr. S.D. Fla. 2008).

3.1.jj. Local Rule requiring automatic reference withdrawal for a jury trial demand is invalid. The Local Bankruptcy Rule provides that if the bankruptcy court determines that a party has made a valid jury trial demand, the bankruptcy court must certify to the district court that the matter is to be tried before a jury, and, upon the certification, the "reference of the proceeding shall be automatically withdrawn." By contrast, section 157(d) permits the district court to withdraw the reference, "on its own motion or on timely motion of any party, for cause shown." Fed. R. Bankr. Proc. 5011(a) requires that a "motion for withdrawal of a case of proceeding shall be heard by a district judge". The Local Rule is invalid, because it

permits the bankruptcy judge, rather than the district court, to make the withdrawal decision, on a motion for certification, rather than on a motion for withdrawal. *Sigma Micro Corp. v. Healthcentral.com (In re Healthcentral.com)*, 504 F.3d 775 (9th Cir. 2007).

3.1.kk. Debtor seeking to enjoin litigation against non-debtor must meet traditional four-part injunction test. A creditor sued the debtor and the debtor's CEO and sole shareholder before bankruptcy over management control and patent rights. The debtor and the principal both filed bankruptcy, but the principal's case was soon dismissed, and the principal resigned as the debtor's CEO. The creditor resumed the litigation against the principal after his bankruptcy case's dismissal. The debtor sought a TRO and preliminary injunction from its bankruptcy court against continuation of the litigation on the grounds that the principal might argue in the litigation that he acted as the debtor's agent, thereby creating the possibility of debtor liability, would reveal the substance of attorney-client privileged communications with the attorney who previously represented both the debtor and the principal, and would assert indemnification claims against the debtor for any liability to the creditor. The bankruptcy court issued a preliminary injunction under section 105(a) staying the litigation until plan confirmation, on the grounds that the litigation "could conceivably have [an] effect on the administration of the bankruptcy estate" and that the debtor showed a reasonable probability of negative effect on the estate. The injunction was improper. The standard the bankruptcy court used is the standard to determine "related to" jurisdiction, not to determine whether to grant an injunction. Section 105(a) incorporates traditional injunctive powers of a court of equity, which incorporates the traditional four-part injunction standards. Therefore, a section 105 injunction protecting a non-debtor may be granted only on a finding of strong likelihood of success on the merits, possibility of irreparable injury, balance of hardships in favor of the plaintiff, and advancement of the public interest. Under *In re Crown Vantage*, 421 F.3d 963 (9th Cir. 2005), plaintiff need not show irreparable injury when seeking an injunction to enforce an express statutory or common law right, such as the automatic stay, where success on the merits is certain, but must meet this test in seeking to enjoin an action against a non-debtor. "Success on the merits" does not require a finding that the action to be stayed would likely violate the automatic stay, but only that the debtor has a reasonable likelihood of a successful reorganization. Here, the evidence did not support a finding of success on the merits, nor of irreparable injury, because, among other things, the litigation against the principal would not bind the debtor in the bankruptcy court. *Solidus Networks, Inc. v. Excel Innovations, Inc. (In re Excel Innovations, Inc.)*, 502 F.3d 1086 (9th Cir. 2007).

3.1.ll. Court may not approve settlement that releases third party claims against settling defendants. The trustee for a debtor law firm reached a settlement among several bank creditors and settling former partners, which provided for a release of all claims against the settling parties by any person "based upon any fact, circumstances, or occurrence relating to" the firm, the bankruptcy estate or any related proceeding. The bankruptcy court addresses whether to approve the settlement by evaluating its subject matter jurisdiction to bar such claims against third parties, rather than any limits on its statutory power. "Related to" jurisdiction encompasses only matters that could conceivably have an effect on the estate or its assets or claims and reaches to disputes between third parties only when the outcome could have an effect on the estate. The bankruptcy court does not obtain "related to" jurisdiction based solely on the presence of facts in the third party dispute that are in common with facts in a dispute with the debtor or the estate. Facilitating overall resolution of the bankruptcy case also does not confer such jurisdiction. Therefore, the court denies approval. *In re Arter & Hadden, LLP*, 373 B.R. 31 (Bankr. N.D. Ohio 2007).

3.1.mm. Third party release as part of a settlement requires an adversary proceeding. A chapter 11 trustee settled claims against two individuals. The trustee sought a bar order, enjoining "all persons" from pursuing the two individuals, whom the trustee had released, on contribution or indemnification claims arising out of or related to the claims that the trustee could have asserted against them. Such an injunction may not be granted except by an adversary proceeding under Bankruptcy Rule 7001(7). Without one, it "would not be worth the paper it is written on, except to use in an attempt to frighten off entities that might pursue claims for contribution and indemnification, and I will not assist the parties in obtaining a Bar Order, utterly devoid of legal authority, to utilize for that improper purpose." In addition, subject matter jurisdiction is doubtful, absent the trustee's showing that the injunction against claims against the third parties would have an effect on the estate. *In re Stratesec, Inc.*, 375 B.R. 1 (Bankr. D.D.C. 2007).

3.1.nn. Minute entries are sufficient as orders to extend the time to assume a lease. The debtor in possession filed a motion for an order extending the time to assume a lease of nonresidential real

property. After the hearing on the motion, the docket reflected a "Minute-Entry" stating "TIME TO ASSUME OR REJECT LEASE EXTENDED TO 1/27/06" and granted additional extensions through similar docket entries without any formal written order. The docket entries are sufficient to extend the time to assume or reject; a separate "bridge order" is not required. Vermont P'ners, Ltd. v. Thaler (In re Poseidon Pool & Spa Recreational, Inc.), 377 B.R. 52 (E.D.N.Y. 2007).

3.1.oo. Court may approve a settlement between the estate and a revenue bond indenture trustee. The debtor leased airport facilities from a municipality, which had issued nonrecourse revenue bonds through an indenture trustee, secured only by the rent due under the lease. Upon bankruptcy, the debtor in possession moved for approval to reject the lease. The DIP, the municipality, and the indenture trustee (with the participation of holders of 60% of the bonds) negotiated a settlement of the lease rejection and resulting claim issues that provided for a new lease at a substantially reduced amount, allowance of an unsecured claim, and a release of all the debtor's obligations under the old lease, among other things. As a result, the bondholders would recover substantially less on their nonrecourse bond claims against the municipality than if the debtor had fully performed the lease. Some bondholders objected to the court's approval of the settlement, arguing that the bankruptcy court could not bind them to a reduction in the amount of their bond claims because the municipality was not a Bankruptcy Code debtor. The bankruptcy court may, however, authorize the DIP to reject the lease, which would have resulted in an even greater reduction in bondholder recoveries, and the court therefore has authority to approve this settlement and bind not only the estate but also the municipality, its indenture trustee, and the bondholders. Subject matter jurisdiction exists under section 1334(b) because the proceeding is related to the DIP's rejection right and the municipality's resulting claim. The Trust Indenture Act does not prevent adjustment of the amounts owing under the bonds because the TIA is subject to the Bankruptcy Code. *In re Delta Airlines, Inc.*, 370 B.R 537 (Bankr. S.D.N.Y. 2007).

3.1.pp. Court dismisses claim against the debtor asserted as a counterclaim to a preference action. The trustee sued a creditor to recover a preference. The creditor counterclaimed, asserting the prepetition claims against the debtor. Fed. R. Civ. P. 13 permits a defendant to assert counterclaims against an "opposing party". Here, the plaintiff was the trustee, in his capacity as representative of the estate; the creditor's claim was against the debtor, not the trustee either individually or in his representative capacity. Therefore, the trustee is not an "opposing party", and the counterclaim is dismissed. Metcalf v. Golden (In re Adbox, Inc.), 488 F.3d 836 (9th Cir. 2007).

3.1.qq. Absolute priority rule governs preplan settlements, absent clear justification for departure. Rule 9019, as interpreted by *Protective Cmte. for Indep. Shareholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414 (1968), requires that a preplan settlement be "fair and equitable." This requirement incorporates the absolute priority rule. However, before plan confirmation, legal rights may be uncertain, because of disputes and litigation, making precise application of the absolute priority rule difficult. The court may therefore depart from the rule if there is specific justification for departure, so long as the parties have not used the settlement to avoid the rule. Here, a settlement between the estate and the secured lenders provided for recognition of the validity of the lenders' liens in exchange for the lenders' allowing a portion of their collateral to be used to fund a litigation vehicle. Although any litigation proceeds were to accrue to the estate, to pay all claims in their order of priority, any unused portion of the funds were to be paid to general unsecured creditors, skipping administrative claimants. The appeals court remands the case to the bankruptcy court to determine whether there is a reasonable justification for deviation from the absolute priority rule in distribution of the excess funds. *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452 (2d Cir. 2007).

3.1.rr. Secured lenders may not "gift" assets to junior classes in settlement of a dispute over the validity of a secured claim. The creditors' committee objected to the validity of the secured lenders' liens. In settlement, the secured lender agreed to direct a portion of their disputed collateral to unsecured creditors, skipping over priority claims. *In re SPM Mfg. Corp.*, 984 F.2d 1305 (1st Cir. 1993), authorized a secured lender to "gift" its collateral to unsecured creditors, outside of the chapter 7 case and applicable priority rules. That authority does not apply in this case, where there was a dispute between the estate (not just the unsecured creditors) and the secured lender over the rights to the collateral, because until resolution of the dispute, the secured creditor did not have any undisputed rights that it could give to the

specified group of creditors outside of the bankruptcy priority scheme. *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452 (2d Cir. 2007).

3.1.ss. Ad hoc committee members must disclose security acquisition dates and prices. Several stockholders appeared in a chapter 11 case under the name "Ad Hoc Committee of Equity Security Holders" through a single law firm. The notice of appearance identified the committee members and disclosed their aggregate holdings, some of which were acquired before and some after the petition date. The committee members agreed to share payment of the firm's fees pro rata among themselves, based on their relative stock holdings. Rule 2019 requires disclosure by "every entity or committee representing more than one creditor or equity security holder" to file a statement setting forth not only the name and address of the holders and the nature and amount of their claims, but also the "time of acquisition" and "with reference to the time of … the organization or formation of the committee … the amounts of claims or interests owned by … the members of the committee … the times when acquired, [and] the amounts paid therefor …." The law firm filed a statement under Rule 2019 disclosing the engagement, the committee members' names, and fee agreement and asserted that the law firm did not own any claims against or interests in the debtor, but the statement did not disclose the times the committee members' interests were acquired or the amounts paid. The law firm's statement is not sufficient. Although the individual members of the committee do not represent other stockholders, when acting as a committee or group, the Rule applies to them, not just to the law firm that represents them. Indeed, the firm stated that it represented only the committee, not the individual members. It is not just that the stockholders call themselves a "committee." The important fact is that they are acting together, to promote their combined holdings and power of the group, which is more than the sum of the parts. Therefore, the committee must provide the full information required by the Rule. *In re Northwest Airlines Corp.*, 2007 Bankr. LEXIS 557 (Bankr. S.D.N.Y. Feb. 26, 2007).

3.1.tt. Time for appellant to file a brief runs from notice of docketing the appeal. Rule 8009 requires the appellant to "file a brief within 15 days after entry of the appeal on the docket pursuant to Rule 8007." Rule 8007(b) requires the district court clerk, upon receipt of the record from the bankruptcy court, to "enter the appeal in the docket and give notice promptly to all parties." The 15-day time period starts to run only when the clerk has given notice, not when the clerk has entered the appeal on the docket. The reference in Rule 8009 to Rule 8007 encompasses both steps required of the clerk, not just the step (entry) referenced in Rule 8009. *Glatzer v. Enron Corp. (In re Enron Corp.)*, 475 F.3d 131 (2d Cir. 2007).

3.1.uu. "Hearing" might be held on paper. The chapter 13 debtor's attorney sought fees in addition to the "no-look" fees the court allows in routine chapter 13 cases. No one objected, but the court questioned the fees and disallowed a portion of the additional request. The Court of Appeals applies Rule 2017 (dealing with prepetition payments) to the dispute. Rule 2017 permits the court, "after notice and a hearing," to determine certain matters about prepetition fees. "After notice and a hearing" in Rule 2017 has the same meaning as provided in section 102(1), which "authorizes an act without an actual hearing … if such hearing is not requested timely by a party in interest." Although no party in interest here requested a hearing, if the court materially reduces the fee request, it assumes the role of an adverse party and must give the applicant a hearing. However, the required "hearing" need not involve an oral proceeding before the court. The requirement may be satisfied if the court notifies the applicant of its intent to reduce fees and gives the applicant an opportunity to respond in writing. *Law Offices of David A. Boone v. Derham-Burk (In re Eliapo)*, 468 F.3d 592 (9th Cir. 2006).

3.1.vv. Creditor's investors do not have standing to challenge the estate's settlement with the creditor. The debtor in possession brought a preference action against a creditor, which was an investment fund. The litigation settled. The DIP sought court approval under Rule 9019. Fund investors objected, arguing that the fund acted improperly in agreeing to settle. They do not have standing. Their interest is not sufficiently direct to permit them to appear and be heard or to appeal. Although the bankruptcy court must determine that a settlement is fair and equitable, its obligation is to the estate. The bankruptcy court should not consider third-party concerns. *Masonic Hall & Asylum Fund v. Official Comm. of Unsecured Creditors (In re Refco, Inc.)*, 2006 U.S. Dist. LEXIS 85691 (S.D.N.Y. Nov. 26, 2006).

3.1.ww. Creditor list is not "scandalous." The debtor had been a municipal court judge. Many of her creditors were lawyers that had lent her money. She sought to seal her creditor list, claiming that the list of lawyer-lenders was "scandalous" under section 107(b)(2), because the potential ethical violations arising from lending to a judge before whom they appeared would unfairly brand all her lawyer creditors. Only section 107(b) governs sealing of papers in bankruptcy court; common law grounds do not apply. Injury to reputation alone is not sufficient to render information "scandalous." The information, when taken in context, must lead to the alteration of a reasonable person's opinion of the person mentioned. Here, the creditors list was just a list of creditors, was filed for a proper and required purpose, and did not appear to be untrue or inaccurate. Potential scandal lies only "outside the lines," not within the list and is only a secondary consequence of the list. The state bar disciplinary board was investigating the loans and the lawyers. State law required that the disciplinary files be kept secret. Rule 9018(3), which permits the bankruptcy court to seal court filings "to protect governmental matters that are made confidential by statute or regulation," also does not permit sealing the creditor list, because the list is not part of the state bar proceedings. *Neal v. Kansas City Star (In re Neal)*, 461 F.3d 1048 (8th Cir. 2006).

3.1.xx. SOFA question 1 is fundamentally ambiguous. The debtor owned his own law practice. When he filed bankruptcy, he answered SOFA Item 1, "State the gross amount of income the debtor has received from employment, trade or profession," by listing his income after payment of business expenses. The government indicted him under 18 U.S.C. § 152 for knowingly and fraudulently making a false statement. Section 152 imports the standard for a perjury conviction, that the question must not be "fundamentally ambiguous." (If the question is arguably ambiguous, the defendant's perjury or not is a question for the jury.) Here, the question does not ask the gross income *of* the business and instead asks how much "the debtor has received," suggesting something similar to "take-home" pay, which would be the debtor's income after business expenses. Therefore, the court dismisses the indictment. The question on Schedule I, by contrast, asks for "Regular income from the operation of a business." Schedule J asks for expenses from the operation of a business. Therefore, the context of Schedule I makes clear that Schedule I seeks gross business receipts, not income after expenses. Therefore, the court does not dismiss the indictment for a false statement on Schedule I. *United States v. Naegele*, 341 B.R. 349 (D.D.C. 2006).

3.1.yy. Inadequate documentation does not provide grounds for claims disallowance. Rule 3001(a) requires that a proof of claim conform substantially to Official Form 10, which requires the claimant to attach copies of supporting documents or, if not available or too voluminous, to attach a summary. Rule 3001(c) requires the original or a duplicate of a writing on which a claim is based to be filed with the claim. Rule 3001(f) makes "a proof of claim executed and filed in accordance with these rules prima facie evidence of the validity and the amount of the claim." The debtor argued that a claim filed not in accordance with the rules does not have any effect and should be disallowed. However, section 502(b) lists the only grounds for claims disallowance. Failure to comply with the claims filing rules is not one of them. As a result, failure to file in accordance with the Rules deprives the claim of being prima facie evidence of the validity of the claim but does not deprive the claim of any effect at all. *Heath v. Am. Express. Travel Related Servs. Co. (In re Heath)*, 331 B.R. 424 (B.A.P. 9th Cir. 2005).

3.1.zz. Rule 7004 does not govern service of an objection to claim. Rule 9014 provides, "(a) Motion. In a contested matter . . . not otherwise governed by these Rules, relief shall be requested by motion . . .. (b) Service. The motion shall be served in the manner provided . . . by Rule 7004." Rule 3007 provides for objection to claim by the filing of an "objection" and that a "copy of the objection . . . shall be mailed or otherwise delivered to the claimant. . . ." Therefore, an objection to claim is a contested matter "otherwise governed by these Rules," and Rule 3007's procedure applies. The court reasons that an objection is more like an answer to a complaint than an initiation of a new proceeding. More important, the filing of a claim submits the creditor to the court's jurisdiction, and the creditor is under an obligation to keep the court informed of any address change. Application of Rule 7004 would require the trustee to search out the creditor's "dwelling house or usual place of abode or . . . the place where the individual regularly conducts a business or profession." Such a burden is unreasonable, especially where the creditor has already provided in the claim form the address where notices are to be sent. *In re Hawthorne*, 326 B.R. 1 (Bankr. D.D.C. 2005).

3.1.aaa. CM/ECF filing occurred too late to stop foreclosure sale. Debtor's counsel logged on to the electronic filing system at 10:49 a.m., to stop a foreclosure sale scheduled for 11:00 a.m. The system was experiencing difficulties, and the system did not "stamp" the petition as filed until 12:09 p.m., by which time the foreclosure sale had been completed. After logging on, counsel is presented with several introductory screens. Only one screen irrevocably commits a document to the clerk's custody, and the system time stamps the filing at the time counsel clicks the "next" button on that screen. Only when counsel has done so is the petition deemed filed. However, the time stamp creates only a rebuttable presumption. If counsel experiences system problems that delays the "filing" screen, counsel should contact the clerk's office by telephone to make alternative arrangements or otherwise expedite the filing. Otherwise, it may be too late. *In re Sands*, 328 B.R. 614 (Bankr. N.D.N.Y. 2005).

3.1.bbb. Electronic filing date is when document filing is completed, not when it is started. The attorney started the filing of an adversary proceeding cover sheet and complaint electronically, shortly before midnight on the last day to file such a complaint. The complaint was not marked filed by the CM/ECF system until 12:14 a.m. The court dismisses the complaint as late filed. The electronic filing administrative procedures specify that a deadline can be met only by completing the filing before midnight. The cover sheet is not part of the complaint, so neither the earlier filing of the cover sheet nor the beginning of the electronic filing of the complaint rendered the complaint timely. *Mittman v. Casey (In re Casey)*, 329 B.R. 43 (Bankr. S.D. Ohio 2005)

3.1.ccc. Local rule requirement cannot force debtor to waive statutory rights. The chapter 13 debtor filed a plan on the form mandated by the court's local rules. The debtor later sought to modify the plan in a manner inconsistent with a provision in the form plan. The fact that the debtor used the Local Rules form did not waive the debtor's right to modify the plan, which is statutory. The debtor had little choice but to use the mandated language in the original plan, but the debtor does not waive a substantive right by doing so, because local rules cannot modify substantive rights. *Sunahara v. Burchard (In re Sunahara),* 326 B.R 768 (Bankr. 9th Cir. 2005).

3.1.ddd. Order was effective upon announcement in court, before entry. The court had issued an order extending a statute of limitations to the date of a subsequent hearing. At the hearing, the court ordered from the bench that the statute be extended further. The written order extending it was not entered until two weeks later. Nevertheless, the order was complete and effective when made, so there was no gap in the extension, because entry is only a record of the act, not the act itself. The court relies on pre-FRCP cases and does not mention Rule 9021 ("A judgment is effective when entered."). *IBT Int'l, Inc. v. Northern (In re Int'l Admin. Servs., Inc.)*, 408 F.3d 689 (11th Cir. 2005).

3.1.eee. Objection to claim may be served on attorney designated in "notice" box of claim form. A creditor asserted a personal injury claim against the debtor based on an accident that occurred only a month before the bankruptcy. The proof of claim form listed the creditor's attorney in the box on the proof of claim form (Official Form 10B) that asks where notices regarding the claim should be sent. The creditor signed the form and put her own address in the signature block. The debtor in possession objected to the claim but mailed the objection only to the attorney, who claimed not to have received the objection. Service was adequate, because Rule 9014, which governs contested matters "not otherwise provided for by these Rules" and requires service in accordance with Rule 7004, does not apply, because Rule 3007 governs objections to claims. Rule 3007 requires only notice to the claimant, not service. *Jorgenson v. State Line Hotel, Inc. (In re State Line Hotel, Inc.)*, 323 B.R. 703 (B.A.P. 9th Cir. 2005).

3.1.fff. Notice to creditor's attorney is not necessarily adequate notice to the creditor. The debtor sent notice of the claims filing bar date to the creditor's law firm, without identifying the firm's client in the notice. The notice was insufficient, because it was not reasonably calculated to reach the creditor. The law firm is not required to search its client files when it receives such a notice to determine who the creditor might be, if the law firm is not a creditor. *In re Greater Southeast Comty.. Hosp.*, 324 B.R. 162 (Bankr. D.D.C. 2005).

3.1.ggg. Document is filed when presented to the clerk. The debtor presented a chapter 7 petition to the clerk, who required that the debtor scan the petition so that it could be filed electronically. Between

the time the debtor presented the petition to the clerk and the time the clerk received the electronic version about 30 minutes later, the sheriff conducted a foreclose sale. The sale was conducted in violation of the stay and was void, because the petition was filed when it was first placed in the custody or possession of the clerk. *Beal Bank SSB v. Brown (In re Brown)*, 311 B.R. 721 (Bankr. W.D. Pa. 2004).

3.1.hhh. Private Securities Litigation Reform Act does not prevent Bankruptcy Rule 2004 examination. The creditors committee sought authority to examine the former directors and officers of the debtor under Bankruptcy Rule 2004 to determine whether the estate owned any claims against them. A separate securities law action was pending against the same individuals in federal district court. The securities law action was subject to the Private Securities Litigation Reform Act, which stays discovery in such an action pending the determination of any motion to dismiss. The bankruptcy court allows the Rule 2004 examination to go forward. It concludes that the action that the committee is investigating, which is on behalf of the debtor, differs from a securities fraud action, which is brought on behalf of individual shareholders, and that the importance of allowing an examination into causes of action belonging to the estate outweighs the policies of the PSLRA. The court was persuaded in permitting the examination to go forward by the fact that the committee had not yet determined to bring an action against the former directors and officers and had committed not to share the materials obtained in discovery with the plaintiff in the securities fraud action. *In re Recoton Corp.*, 307 B.R. 751 (Bankr. S.D.N.Y. 2004).

3.1.iii. The discharge objection deadline is not jurisdictional. Within the time set by Bankruptcy Rule 4004, a creditor filed a complaint objecting to the debtor's discharge. After the deadline, the creditor amended the complaint to add new allegations. The parties litigated the new allegations, and the bankruptcy court denied the debtor's discharge. On motion for reconsideration, the debtor argued that the complaint was filed late, that the deadline in Rule 4004 was mandatory and jurisdictional, and that the deadline could not be waived. Citing Bankruptcy Rule 9030, which states that the Bankruptcy Rules "shall not be construed to extend or limit the jurisdiction of the courts," the Supreme Court rules that the deadline in Rule 4004 is a claim processing rule that does not affect jurisdiction. Thus, failure to assert the deadline as an affirmative defense until after litigation on the merits constitutes a waiver of the defense. If the debtor does not raise the issue before adjudication on the merits, the deadline is waived. In this case, the court does not reach whether the deadline may be extended on equitable grounds, because this case involves only waiver. *Kontrick v. Ryan*, 540 U.S. 443 (2004).

3.1.jjj. A bar date order does not trump section 1111(a). The court issued a bar date order requiring all creditors to file proofs of claim. Neither the order nor the notice to creditors specifically stated that creditors whose claims were deemed filed under section 1111(a) (listed on the schedules as liquidated, undisputed, and not contingent) also needed to file proofs of claim by the bar date. Because the notice was not clear, the creditors' claims were deemed filed, despite the bar date order. However, the court questions whether such a bar date order, which might be inconsistent with section 1111(a) and with Bankruptcy Rule 3003, would ever be permitted. *ATD Corp. Advantage Packaging, Inc. (In re ATD Corp.)*, 352 F.3d 1062 (6th Cir. 2003).

3.1.kkk. Service on bank must be by certified mail on an officer. The debtor sued its bank lender to avoid liens on property and served the summons and complaint by certified mail on the bank's statutory agent for service of process. Bankruptcy Rule 7004(h) requires service on an insured depository institution to be made by certified mail addressed to an officer of the institution. Accordingly, service was improper, and the bankruptcy court properly set aside the default judgment previously granted to the debtor. *Hamlett v. AmSouth Bank (In re Hamlett)*, 322 F.3d 342 (4th Cir. 2003).

3.1.lll. Rule 2004 subpoena should be issued by home court. The Georgia debtor-in-possession sought an examination under Rule 2004 of a California witness. Based on a close textual reading of Rule 2004(c) and Rule 45(a)(2) of the Federal Rules of Civil Procedure, the bankruptcy court rules that the bankruptcy court where the case is pending is the proper court to issue a subpoena for attendance at an examination, even for a witness who is not located within the home court district. Because the subpoena in this case did not require the witness to appear in the home court district, the issue did not arise of whether a home court subpoena could compel attendance from a distant district. The effect of the

rulings is to require a motion to quash to be filed in the home court. *In re Fred Ayers Co., Inc.*, 266 B.R. 557 (Bankr. M.D. Ga. 2001).

3.1.mmm. Cash collateral stipulation waivers do not bind subsequent adversary proceeding litigants. Preference defendants asserted that the debtor subsidiary was insolvent because its guaranty of its debtor parent's debt was a voidable fraudulent obligation. The trustee countered that the cash collateral stipulation approved at the outset of the case constituted a determination of the validity of the guaranty that bound defendants under the law of the case doctrine and principles of *res judicata*. The court rules that the law of the case doctrine does not apply because the preference defendants were never parties to the cash collateral stipulation and never had an opportunity to litigate the guaranty validity issue. For the same reason, the *res judicata* does not apply. It would be unreasonable to require all potential preference defendants to appear and be heard on a cash collateral stipulation approved in the first days of the case, as that could cause reorganization cases to grind to a halt. *Philip Servs. Corp. v. Luntz (In re Philip Services (Delaware), Inc.)*, 267 B.R. 62 (Bankr. D. Del. 2001).

3.1.nnn. Complaint may relate back to prior motion date. The creditor filed a motion objecting to dischargeability under section 523. Bankruptcy Rule 7001 requires that such an objection be made by complaint and that the proceeding be an adversary proceeding. After the deadline for objecting to dischargeability, the creditor filed and served a complaint and argued that it related back to the date of the filing of the motion. The bankruptcy appellate panel agrees and permits the later-filed complaint to relate back, under a generous reading of F.R. Civ. P. 15(c)(2). *Gschwend v. Markus (In re Markus)*, 268 B.R. 556 (9th Cir. B.A.P. 2001).

3.1.ooo. Nationwide service of process rejected. The Eight Circuit rules that despite Bankruptcy Rule 7004, a defendant is not subject to suit in bankruptcy or district court in a state with which the defendant does not have minimum contacts. The court thus splits with the Second, Fifth and Seventh circuits in applying the general federal civil practice rule, rather than the rule intended by the drafters of Bankruptcy Rule 7004. *Warfield v. K.R. Entertainment, Inc. (In re Federal Fountain, Inc.)*, 143 F. 3d 1138 (8th Cir. 1998).

3.1.ppp. Rule 9006 "weekend" rule does not apply backwards. Where the relevant period (here, the two-year reachback relating to non-dischargeability of certain taxes) expired on a weekend, the relevant date is the actual weekend day, not the following business day, as it would be where an action is required to be taken within a period that runs forward and expires on a weekend. *Smith v. United States (In re Smith)*, 96 F.3d 800 (6th Cir. 1996).

3.1.qqq. Changed circumstances excuse a trustee from supporting a settlement agreement. Changed circumstances rendered a settlement agreement less valuable to the estate than the trustee had assumed when she reached agreement. She brought the matter before the bankruptcy court but did not recommend approval of the settlement. The Third Circuit holds that the bankruptcy court should choose between the trustee's fiduciary duty to the creditor body as a whole and her duty to go forward with a settlement agreement, and that the trustee is required to advise the bankruptcy court in full of the changed circumstances and is not required to recommend approval in such a circumstance. *Myers v. Martin (In re Martin)*, 91 F.3d 389 (3d Cir. 1996).

3.1.rrr. Debtor denied intervention in adversary proceeding. A debtor does not have the right to intervene in a chapter 7 adversary proceeding, where the trustee is the party entitled to prosecute the proceeding. Any intervention must meet the requirements of F.R.C.P. 24(a)(2). *Richmond v. First Woman's Bank (In re Richmond)*, 104 F.3d 654 (4th Cir. 1997).

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).

4.1.b. County hospital authority is a governmental unit that is not eligible for chapter 11. Georgia authorizes its counties to create a hospital authority as a "body corporate and politic" to "exercise public and essential governmental functions" and to invest it with the powers of eminent domain, to issue revenue anticipation certificates for essential public and governmental purposes and to sell its assets with public notice after a public hearing. A hospital authority is exempt from taxes to the same extent as Georgia counties and cities. The county appoints the authority's board, and its consent must be obtained before the authority may dissolve. A county created such an authority. The authority filed a chapter 9 petition. Georgia prohibits its municipalities from filing chapter 9 cases. The debtor moved to convert the case to chapter 11. An entity is eligible to be a debtor under a chapter only if it is a person. A governmental unit is not a person and is not eligible to be a chapter 11 debtor. An instrumentality of a state or a municipality is a governmental unit. Three factors affect whether an entity is a governmental unit: the extent to which it exercises traditional governmental powers, the extent of the county's control and the state's classification. The authority is a creature of a specific state statute, can exercise eminent domain, is tax exempt and may issue borrowing certificates for public and governmental purposes. The county exercises control, even though it does not exercise day-to-day control. And its designation as a body corporate and politic is a state designation that it is a governmental unit. Therefore, the authority is a governmental unit, not eligible for chapter 11, and the case must be dismissed. *U.S. Trustee v. Hosp. Auth. Of Charlton County (In re Hosp. Auth. Of Charlton County)*, 2012 Bankr. LEXIS 3042 (Bankr. S.D. Ga. Jul. 3, 2012).

4.1.c. LLC Agreement provision that prohibits bankruptcy filing is enforceable. The debtor's LLC operating agreement provided that the debtor "will not institute proceedings to be adjudicated bankrupt or insolvent … or file a petition seeking … reorganization or relief under any applicable federal or state law relating to bankruptcy". The agreement also granted the manager "all specific rights and powers required or appropriate to the management of the Company business", but required the manager to "conduct and operate its business as presently conducted" and denied the manager authority to "do any act that would make it impossible to carry on the ordinary business of the Company". The record did not contain any evidence that the company's lender had coerced the company into adopting the non-filing provision. Applicable nonbankruptcy law determines who has authority to commence a bankruptcy case on behalf of a juridical entity. An LLC's operating agreement governs the rights and duties of an LLC's members and managers. Therefore, the non-filing provision denies the debtor the authority to file a petition. Such an agreement does not violate public policy where it is solely among the LLC's members and not induced by a creditor. Moreover, even in the absence of the provision, the LLC agreement provisions requiring the manager to operate the business "as presently conducted" and prohibiting anything that "would make it impossible to carry on the ordinary business of the Company" preclude a voluntary bankruptcy petition. Operating in chapter 11, with all of the duties placed on a debtor in possession, makes it impossible to operate in the manner in which the business was conducted before filing, and placing a company into bankruptcy is not within the ordinary course of business. *DB Capital Holdings, LLC v. Aspen HH Ventures, LLC (In re DB Capital Holdings, LLC)*, 2010 Bankr. LEXIS 4176 (10th Cir. B.A.P. Dec. 6, 2010).

4.1.d. LLC statute does not permit automatic transfer of LLC voting rights to secured lender upon default. The debtor LLC's two members granted a security interest in their membership interests to a secured creditor. The security agreement provided that upon any payment obligation default, the pledge agreement automatically terminated the members' voting and distribution rights and vested them in the

creditor. The members defaulted in payment and authorized a voluntary chapter 11 petition for the LLC. A person filing a voluntary petition must be duly authorized to do so under applicable nonbankruptcy law. The applicable LLC statute provides that an LLC is managed by its members, unless its articles provide otherwise, and that the granting of a security interest in a membership interest "shall not cause the member to cease to be a member or to grant to anyone else the power to exercise any rights or powers of a member". Thus, the voting rights do not transfer automatically to the creditor upon the payment default but do so only upon enforcement of the security agreement. The members therefore properly authorized the petition. *In re Lake County Grapevine Nursery Ops.*, 441 B.R. 653 (Bankr. N.D. Cal. 2010).

4.1.e. Eligibility is not jurisdictional. The debtor filed her voluntary petition without obtaining the credit briefing (counseling) that section 109(h) requires. Section 109(h) provides, with limited exceptions, that "an individual may not be a debtor" unless the individual has received the required credit briefing. *Arbaugh v. Y.& H Corp*, 546 U.S. 500 (2006), distinguishes between subject matter jurisdiction and an essential element of a claim for relief. Courts should construe statutory requirements as elements of a claim, unless the statute makes clear that the requirement is jurisdictional. The bankruptcy jurisdictional provisions are set forth in section 1334 of title 28; the Code's eligibility requirements do not speak in jurisdictional terms. Therefore, an eligibility issue under section 109, as well as under section 303, is a predicate for relief, not a jurisdictional requirement for the court to hear the case. Otherwise, a case, an order for relief and all orders in the case could be subject to collateral attack, which would undermine the certainty required in bankruptcy cases. The Supreme Court's 2006 decision permits the Second Circuit to abrogate *In re BDC 56 LLC*, 330 F.3d 111 (2d Cir. 2003), which held that eligibility was jurisdictional. The appellate court leaves to the bankruptcy court's determination on remand whether to dismiss the case or strike the petition. *Adams v. Zarnel (In re Zarnel)*, 619 F.3d 156 (2d Cir. 2010).

4.1.f. An ineligible debtor's petition commences a case and triggers the automatic stay. The debtor filed her voluntary petition without obtaining the credit briefing (counseling) that section 109(h) requires. Section 109(h) provides, with limited exceptions, that "an individual may not be a debtor" unless the individual has received the required credit briefing. Section 301 provides, "A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter." Section 362 provides that the filing of a petition operates as an automatic stay, but the stay is limited or does not arise if the debtor has filed one or more cases that were pending during the prior year and were dismissed. The limitation in section 301 to an entity that "may" be a debtor is directed to the chapter under which the petition may be filed, not to whether the case is or may be commenced. Moreover, if a petition for an ineligible debtor does not commence a case, then the automatic stay, which is triggered by a petition, might still go into effect, even though there is neither an eligible debtor nor a case. Moreover, its termination would be uncertain, because section 362(c)(2) provides for termination based on the end of a "case". If the automatic stay did not go into effect because an ineligible debtor's petition did not commence a case, then the bright line certainty of the automatic stay's trigger would be lost. Thus, the petition commences a case and triggers the automatic stay. The appellate court leaves to the bankruptcy court's determination on remand whether to dismiss the case or strike the petition. *Adams v. Zarnel (In re Zarnel)*, 619 F.3d 156 (2d Cir. 2010).

4.1.g. 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).

4.1.h. District court receivership order may enjoin involuntary bankruptcy petition. The SEC initiated a receivership proceeding in the District Court against 244 related entities involved in an international Ponzi scheme. The receivership order appointed a receiver, authorized the receiver to commence bankruptcy cases for any of the entities, stayed litigation against the receivership and any action to interfere with the receivership, including the filing of a bankruptcy case. The district court has in

rem jurisdiction over all the receivership assets sufficient to support an injunction that prevents interference with the assets. The Bankruptcy Code does not grant creditors the absolute right to file an involuntary petition. Although the district court's power should be exercised sparingly, it includes the power to enjoin a bankruptcy filing. Here, the injunction was appropriate to enable the court to retain control over numerous, scattered entities and prevent creditors of a few entities from removing assets from the receiver's control to the possible detriment of all creditors. *S.E.C. v. Byers*, 2010 U.S. App. LEXIS 12160 (2d Cir. June 15, 2010).

4.1.i. Municipal debtor's specific authorization need not be legislative; debtor otherwise meets eligibility requirements. The Legislature determined before bankruptcy that a New York public benefit corporation was "insolvent and facing closure" and that "continued operation … is of paramount importance to the public interest". The Governor, relying on his constitutional authority and the Legislature's finding of a need to preserve the corporation, issued an Executive Order authorizing its filing of a chapter 9 case. The corporation developed a solution to its financial problems that required legislation, which several of its major creditors actively opposed. It engaged in negotiations with the Legislature, its major creditors and its unions to resolve its financial troubles. It worked with lenders to line up exit financing. Its plan was to obtain necessary statutory changes and exit financing that would allow it to pay creditors in cash in full upon plan consummation, but it never presented a formal plan. It was unable to reach agreement by the time it was about to run out of cash, so it filed a chapter 9 petition to protect itself and permit deferral of prepetition obligations. Section 109(c)(2) requires that a municipal debtor be "specifically authorized … to be a debtor … by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor". The Governor's Executive Order provided specific authorization. The Governor's broad executive power under state constitutional and statutory law, coupled with the Legislature's finding of need to preserve the debtor in the public interest, adequately empowered the Governor to authorize the filing. Specific legislative authorization is not required. Section 109(c)(5) imposes a pre-negotiation requirement on a municipal debtor. The debtor must have negotiated an agreement with a majority of creditors it intends to impair under a plan or have negotiated in good faith and failed to reach agreement, or negotiation must be impracticable. Negotiations need not involve a formal plan; an outline or term sheet suffices. The debtor here negotiated in good faith but failed to reach agreement. Negotiations are impracticable when statutory changes are required to support a plan or where negotiations with large, controlling creditors break down. Thus, even though the debtor reached agreement with some creditors, negotiations were on the whole impracticable. Section 921(b) requires the court to dismiss a chapter 9 petition that was not filed in good faith. Mere desire to delay payments to creditors does not indicate lack of good faith. Lack of good faith occurs where the debtor uses bankruptcy to deter and harass creditors or uses bankruptcy as a litigation tactic, without intent to reorganize. Here, the debtor's negotiations with creditors and the Legislature and its attempts to obtain exit financing, all of which started prepetition and continued postpetition, show the debtor's good faith. Moreover, a debtor need not have a feasible plan in place before filing a chapter 9 petition to be in good faith. *In re New York City Off-Track Betting Corp.*, 427 B.R. 256 (Bankr. S.D.N.Y. 2010).

4.1.j. Nonprofit, public benefit monorail company is not a municipality. The chapter 11 debtor owns and operates a monorail system. Its revenues come solely from passenger fares. It has no taxing power. It was formed under the state nonprofit corporation law as a nonprofit public benefit corporation. Upon dissolution, its assets revert to the state. Its by-laws allow the Governor to inspect and audit its books and records, disapprove by-law amendments, its rates and its annual budget and reject proposed board members or remove board members for cause. It financed construction by borrowing from a state agency, who issued nonrecourse tax exempt industrial revenue bonds and loaned the proceeds to the debtor under a financing agreement. It represented in its financing documents that it was an instrumentality of the state to qualify the bonds for federal tax exemption. A municipality is not eligible to file a chapter 11 case. A municipality is a "political subdivision or public agency or instrumentality of a State". "Instrumentality" has different meanings for tax law and bankruptcy law purposes. Under bankruptcy law, whether an entity is an instrumentality of a state depends on whether the entity has powers typical of public agencies such as eminent domain, the taxing power or sovereign immunity, whether the entity has a public purpose and is subject to sufficient state control and whether the state designates the entity as an instrumentality. Here, the debtor does not have powers of a public entity and does not directly perform a public function. The Governor's control is primarily strategic and periodic, rather than operational and constant, and is more

akin to regulation than direct operational control. Finally, state law classifies it as a nonprofit public benefit corporation and does not treat it as a municipality in that it does not apply municipal finance laws or laws relating to public improvements to the debtor. Therefore, the debtor is not a municipality and is eligible to file its chapter 11 case. *In re Las Vegas Monorail Co.*, 429 B.R. 770 (Bankr. D. Nev. 2010).

4.1.k. Court refuses to sanction defendant for failure, as a result of defendant's bankruptcy filing, to abide by court order. Defendant's counsel had warned plaintiff that defendant likely would file bankruptcy during the litigation. The court set a trial date and ordered the parties to prepare a joint pre-trial stipulation. Plaintiff produced a draft stipulation but received no response from defendant. Instead, defendant filed bankruptcy the day before the stipulation was due. Plaintiff sought sanctions, arguing that defendant and his counsel had acted in bad faith by allowing plaintiff's counsel to expend time and effort unnecessarily in preparing the draft stipulation without communicating defendant's intent to file bankruptcy on the due date's eve. A court has inherent power to award sanctions for vexatious or bad faith behavior; 28 U.S.C. § 1927 also authorizes sanctions, including for failure to abide by the court's order, such as the order to file the pre-trial stipulation. However, defendant had a right to file bankruptcy. Therefore, the court denies sanctions. *Stone v. Stripe-a-Lot of Am., Inc.*, 2009 U.S. Dist. LEXIS 108114 (N.D. Ill. Nov. 19, 2009).

4.1.l. A liquidating trust under an assignment for the benefit of creditors is not an eligible debtor. An individual operated a Ponzi scheme, in part through over 200 corporations. He made an assignment for the benefit of creditors, authorizing, among other things, the assignee to operate the corporations' businesses. Under applicable Michigan law, an assignment for the benefit of creditors creates a trust. The assignee filed a voluntary chapter 11 petition for the trust. Sixth Circuit precedent applies federal, not state, law to determine whether a trust is a business trust that is eligible to be a debtor and requires that the trust have been "created with the primary purpose of transacting business or carrying on commercial activity for the benefit of investors." The Sixth Circuit has also ruled that for purposes of 28 U.S.C. § 959(a), a chapter 7 trustee is not carrying on a business by liquidating a chapter 7 estate. By analogy, therefore, the assignee is not carrying on a business, and the trust created upon the assignment is not created to transact business or carry on commercial activity and is not eligible to be a debtor. *In re Estate of the Assignment for the Benefit of Creditors of May*, 405 B.R. 442 (Bankr. E.D. Mich. 2009).

4.1.m. An Illinois trust is an eligible debtor. The debtor is described in its organizational documents as an "Illinois trust" (not an "Illinois land trust"). It owns a single real estate project. It lacks employees and an independent governing body, and its beneficial interests are non-transferable. However, it is authorized to conduct business and is actively engaged in business, entering into leases for its real property, borrowing under a credit agreement and entering into service agreements. It operated to generate a profit for its investors. A "business trust" is authorized to be a debtor. A business trust is created to carry on a business for a profit, not solely to hold and preserve an asset. This debtor's business activities qualify it as an eligible debtor. *In re Gen. Growth Props., Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

4.1.n. Municipal debtor with labor contract issues is eligible to file chapter 9 case. The municipal debtor faced an substantial operating deficit, largely due to labor expenses. It attempted negotiations with its principal unions but was not able to reach a collective bargaining agreement that would have eliminated the deficit. Section 109(c) permits a municipality to file a chapter 9 case only if the municipality is insolvent, desires to effect a plan to adjust its debts and "has negotiated in good faith with its creditors and failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that [it] intends to impair under a plan" or such negotiation is impracticable. For a municipality, insolvency is determined under section 101(32)(C) on a present or projected cash flow basis. Because of its projected operating deficit, the city is insolvent. Whether a city desires to effect a plan is a subjective determination, which the city may satisfy by showing an attempt to resolve claims, by submitting a draft plan or by other evidence that the petition is not merely to buy time or evade creditors but is to implement a plan. This requirement does not contain a good faith element, which is contained separately in section 921(c). The city manager's declaration of intent to adjust debts, coupled with the city's running out of time to meet its obligations, satisfied this requirement. The negotiation requirement means that the city must have sought agreement to a plan or at least a plan term sheet, not merely

negotiation over new labor agreements that would enable the city to confirm a plan. Negotiation may be impracticable, however, if there are material impediments to negotiation other than just the number of creditors. Here, the city was unable to negotiate a plan because its absence of a labor agreement that would have determined its financial future prevented it from formulating a repayment plan. Therefore, the city met the eligibility requirements to file its chapter 9 petition. *Local 1186 v. City of Vallejo (In re City of Vallejo)*, 408 B.R. 280 (9th Cir. B.A.P. 2009).

4.1.o. Bankruptcy Clause does not require insolvency as a condition to filing bankruptcy. The debtor had few general unsecured claims, most of which were disputed, and a judgment for $12 million that was on appeal. The debtor was unable to post a bond to obtain a stay pending appeal. Immediately before the judgment creditor would have been able to enforce the judgment, the debtor filed a chapter 11 petition. The debtor fully disclosed all his assets in his schedules but either did not value or aggressively valued substantial assets. On a fair valuation, the debtor might have been solvent, but the debtor was illiquid. The judgment creditor did not file a proof of claim. As a result, the debtor was able to confirm a plan that paid all general unsecured creditors and left a substantial surplus. Neither the Bankruptcy Clause nor the Bankruptcy Code requires insolvency as a condition for application of the bankruptcy law. The full scope of "the subject of Bankruptcies" in the Bankruptcy Clause has never been defined, but it is broad and relates generally to the relations between creditors and debtors either unable or unwilling to pay their creditors. Any firm or individual in financial distress is eligible to be a debtor. A court may dismiss a petition, however, for bad faith, if the debtor filed without a proper rehabilitation purpose or to unreasonably deter and harass creditors. Filing on the eve of enforcement of a judgment or to avoid posting an appeal bond and aggressive assets valuations on the schedules do not constitute bad faith, and the debtor's proposal and confirmation of a plan can erase any suspicion that the debtor is using chapter 11 for an improper purpose. *Marshall v. Marshall (In re Marshall)*, 403 B.R. 668 (C.D. Cal. 2009).

4.1.p. Assignee for the benefit of creditors does not have authority to file a bankruptcy petition. The debtor's board of directors authorized an assignment for the benefit of creditors. The debtor made the assignment. After litigation began between the assignee and the directors, and with the consent of several large creditors, the assignee filed a chapter 7 case for the debtor. Management of a corporation is vested in its board of directors. Thus, the board of directors must authorize a bankruptcy filing. The assignment did not authorize the assignee to make that decision on the corporation's behalf. Therefore, the court dismisses the bankruptcy case. *In re N2N Commerce, Inc.*, 405 B.R. 34 (Bankr. D. Mass. 2009).

4.1.q. Incomplete board action may authorize closely-held corporation's petition. Creditors filed an involuntary petition against one of 19 related debtors, which consented to relief under chapter 11. Two related debtors and the 16 subsidiaries of the three principal debtors filed chapter 11 cases six months later. The debtors shared all shareholders, directors and officers. The subsidiaries' boards did not properly authorize the filing of their chapter 11 petitions. Separately, the court determined that the debtors should be substantively consolidated under the plan. A creditor objected only at plan confirmation to the debtors' filing authorization, six months after the cases were filed. Authority to file a bankruptcy petition rests with a corporation's managing body. However, whether to honor corporate formalities is an equitable determination. A closely held corporation is not held to the full rigors of corporate formalities. Because of the identity of the subsidiaries with the parents, the relaxed formalities applicable to a closely held corporation, the creditors' delay in objecting and the non-voting directors' ratification of the filing by their own inaction in objecting, the limited board actions authorizing the filings were adequate. *Windels Marx Lane & Mittendorf, LLP v. Source Enterps., Inc. (In re Source Enterps., Inc.)*, 392 B.R. 541 (S.D.N.Y. 2008).

4.1.r. Chapter 9's "impracticability" requirement does not apply only to a debtor with too many creditors. The debtor, a municipal health system that operated several hospitals, faced a severe liquidity crisis. It sought to restructure by issuing new bonds to refinance its debts and provide working capital, but the voters rejected the bond issue. It next attempted an asset sale, which the voters also rejected. Its liquidity problems then prevented it from having adequate time to implement a comprehensive business restructuring plan, which would have been the foundation for a negotiation with its creditors over its debts. Section 109(c)(5)(C) requires that to file a chapter 9 case, a municipality must, among other things, negotiate with its creditors, unless prepetition negotiation with creditors is impracticable. Impracticability does not contemplate only a situation in which the debtor's creditors are too numerous for meaningful

negotiation. Although the debtor here had over 2700 creditors, it did not argue that it had too many creditors for real negotiations, only that it was impracticable to negotiate at all before its liquidity problems forced a filing. Because chapter 9's eligibility requirements are to be construed broadly to provide relief to distressed municipalities, any form of impracticability meets the statutory requirement. *In re Valley Health Sys.*, 2008 Bankr. LEXIS 761 (Bankr. C.D. Cal. Feb. 20, 2008).

4.1.s. Auto repair service contract provider is not an ineligible insurance company. The debtor sold automobile repair service contracts, usually through automobile dealers. The Illinois Service Contract Act (ISCA), based largely on the Service Contract Model Act, exempts service contract providers from regulation under the Illinois Insurance Code if they register and comply with certain financial responsibility rules. A provider who fails to comply is subject to enforcement proceedings under ISCA by the Illinois Insurance Director, but may lose its insurance regulation exemption only in certain undefined circumstances. The debtor may have violated the financial responsibility rules shortly before bankruptcy. Still, the debtor is not an insurance company that is ineligible for bankruptcy, because ISCA exempts providers from insurance regulation. The debtor is also not the substantial equivalent of an insurance company. By exempting registered service contract providers, ISCA classifies them other than as insurance companies, and even though they may have the essential attributes of an insurance company, they are not the substantial equivalent, in large part because they are not subject to the Insurance Code's rehabilitation and liquidation provisions. *In re Automotive Profs. Inc.*, 370 B.R. 161 (Bankr. N.D. Ill. 2007).

4.1.t. A dissolved LLC may not file a bankruptcy petition. The LLC filed articles of dissolution with the Oklahoma Secretary of State, effective immediately, petitioned for and obtained the state court appointment of a receiver on the same day, and filed a bankruptcy petition seven months later. The bankruptcy petition was not authorized. Under Oklahoma law, an LLC comes into legal existence upon the filing of its articles of organization, which are cancelled upon the effective date of articles of dissolution. Since the LLC no longer existed, it was not eligible as a legal entity to be a debtor, and the filing of its petition was a nullity. *Holliman v. Midpoint Dev., L.L.C. (In re Midpoint Dev., L.L.C.)*, 466 F.3d 1201 (10th Cir. 2006).

4.1.u. The debtor has burden of proof on its officers' authority to file a petition. The debtor LLC filed a petition signed by its "authorized agent." Another party, who claimed to be the LLC's 100% owner and sole member, objected to the filing and made a prima facie case in support of her ownership. The debtor put on inconclusive evidence to the contrary. The court dismisses the petition, because the debtor has not met its burden of proof to show that it was properly authorized to file. *In re Real Homes, LLC*, 352 B.R. 221 (Bankr. D. Idaho 2005).

4.1.v. Bankrupt member of single member LLC may not authorize bankruptcy petition. The single member of the LLC debtor had previously filed a chapter 7 case. The U.S. trustee objected to the LLC's bankruptcy filing on the ground that the single member did not have authority to authorize and file the petition. In a multi-member LLC, the bankruptcy of a single member may or may not transfer management authority to the trustee, but in a single member LLC, the trustee succeeds to all of the member's economic and non-economic (management) rights. The court therefore dismisses the case. *In re A-V Electronics, LLC*, 350 B.R. 887 (Bankr. D. Idaho 2006).

4.1.w. Creditor successfully challenges inadequately authorized LLC petition. The single asset real estate LLC's operating agreement required the unanimous vote of its members to authorize a bankruptcy petition. When the LLC fell behind on loan payments, the controlling 90% member removed the 10% member as manager and unilaterally authorized and filed a bankruptcy petition for the LLC. The mezzanine lender objected. (The court notes that the lender was secured by the LLC's membership interest but does not directly address whether it was a creditor of the LLC or only of the members.) A creditor has standing under section 1109(a) as a party in interest to object to and move to dismiss a petition that is not properly authorized, because its interests may be pecuniarily affected by the filing. The operating agreement unanimity requirement is enforceable, and the court must therefore dismiss the petition. (The court does not address whether the same result would apply in a chapter 7 case, where section 1109(a) does not apply.) *In re Orchard At Hansen Park, LLC*, 347 B.R. 822 (Bankr. N.D. Tex. 2006).

4.1.x. State court receivership may not bar the bankruptcy courthouse door. Creditors obtained the appointment in state court of a receiver for all of the debtor's assets. The receivership court enjoined interference with the receiver's control of the assets, authorized the receiver to remove the directors or officers, and enjoined the filing of a bankruptcy petition. The order was not effective to require dismissal of the bankruptcy petition based on lack of authority to file. Generally, determination of authority to file a bankruptcy petition for a corporation is not governed by bankruptcy law. However, protection of access to the bankruptcy courts is an important federal policy, which is governed by federal common law. Access cannot be defeated by creditors' race to the courthouse. Therefore, the state court's order, even authorizing the receiver to remove directors and officers, cannot hamper access to the bankruptcy court. *In re Corp. and Leisure Event Prods., Inc.*, 351 B.R. 724 (Bankr. D. Ariz. 2006).

4.1.y. State court enjoins directors from entering into sale agreement that requires bankruptcy filing. A financially healthy Delaware corporation desired to sell substantially all of its assets, which Delaware law permits only with a shareholder vote. The corporation had not filed SEC reports for several years, apparently because of disputes with its auditors over its financial statements. SEC rules prohibit solicitation of proxies from shareholders without a proxy statement, which cannot be sent unless the company is current in its SEC filings. To break the stalemate, the corporation was prepared to agree with the buyer that it would file a chapter 11 petition and consummate the sale under section 363 without a common shareholder vote. The preferred shareholders, who would not have been able to vote on the sale outside of bankruptcy, would have a vote in the chapter 11 case and, in exchange for their vote, extracted concessions from the corporation that would have been detrimental to the common shareholders. The transaction, while technically within the spirit of the law, was profoundly inequitable. Although the court recognizes that it may not enjoin the filing of a bankruptcy petition, it enjoins the board from entering into the sale agreement without complying with the shareholder vote requirement of Delaware corporate law. It orders the corporation to seek an exemption from the SEC before proceeding further with the sale. *Esopus Creek Value LP v. Hauf*, 2006 Del. Ch. LEXIS 200 (Del. Ch. Nov. 29, 2006) (not yet released for publication).

4.1.z. Dissolved corporation is not eligible for bankruptcy. The debtor forfeited its corporate charter in 1995, which resulted in dissolution of the corporation. Nevertheless, the debtor continued to file tax returns. In 2005, in an SEC receivership action, the federal district court appointed a receiver for the corporation. The receiver filed a chapter 11 petition for the corporation. Under Texas law, a dissolved corporation continues in existence for three years to wind up its affairs. This corporation was no longer in existence. Therefore, it is not eligible for bankruptcy. *In re American Heartland Sagebrush Secs. Invs., Inc.*, 334 B.R. 848 (Bankr. N.D. Tex. 2005).

4.1.aa. De facto LLC is eligible to be a debtor. The debtor prepared limited liability company organizational documents, obtained a unique employer identification number from the Internal Revenue Service, was carried on the town's tax rolls as the property owner, did business under the LLC name, and managed the real property. However, the LLC documents were never filed with the Secretary of State, so the LLC's legal existence was never created. Still, state law would recognize the entity as a de facto limited liability company, so the LLC is eligible as a "person" to be a debtor under the Bankruptcy Code. *In re 4 Whip, LLC*, 332 B.R. 679 (Bankr. D. Conn. 2005).

4.1.bb. Foreign representative may not seek to stay action in U.S. without first obtaining recognition under chapter 15. The defendant in a civil action in the United States became a debtor in a Canadian insolvency proceeding. The Canadian receiver sought a stay of the U.S. proceeding. The court denies the stay because the receiver is a foreign representative and did not first seek recognition under chapter 15. In the absence of recognition, the court does not have authority to consider the stay request. If the receiver obtains recognition, a stay may be unnecessary, because the automatic stay of section 362 would likely apply. *United States v. J.A. Jones Constr. Group, LLC*, 333 B.R. 637 (E.D.N.Y. 2005).

4.1.cc. A limited liability company is a separate legal entity that qualifies as a "corporation" under the Bankruptcy Code definition. *Gilliam v. Speier (In re KRSM Props., LLC)*, 318 B.R. 712 (B.A.P. 9th Cir. 2004).

4.1.dd. Section 304 does not encompass an ordinary (non-distress) foreign corporate reorganization. A group of English insurance companies undertook a reorganization under proceedings in the UK courts. The British director of the reorganization sought a section 304 order enjoining U.S. creditors from taking any action inconsistent with the reorganization. Section 304 does not authorize the relief, because the UK proceeding is not a "foreign proceeding," as defined in the Bankruptcy Code. "Foreign proceeding" is a "proceeding, whether judicial or administrative . . . for the purpose of liquidating an estate, adjusting debts by composition, extension or discharge, or effecting a reorganization." The term "reorganization" must be read in context to refer to distress reorganizations, whether or not for an insolvent debtor, not just an ordinary restructuring of a corporation and its affiliates. Thus, the court lacks jurisdiction to grant relief under section 304. *In re Rose*, 318 B.R. 771 (Bankr. S.D.N.Y. 2004).

4.1.ee. Court grants section 304 relief to protect Argentine APE proceeding. The debtor had commenced an out-of-court workout under the Argentine *acuerdo preventivo extrajudicial* (APE) law, which operates similarly to a U.S. prepackaged process, concluding with an Argentine court consideration and approval of a restructuring plan. Holders of a substantial majority of its unsecured U.S. dollar-denominated public notes and all of its unsecured bank debt voted for the restructuring proposal. One noteholder fought the proposal and sued the debtor in New York state court to collect on the notes. The debtor filed an ancillary proceeding under section 304 seeking to enjoin the state court action; the creditor opposed section 304 relief and filed an involuntary chapter 11 case against the debtor in response. The APE, even though it starts as a non-judicial proceeding, is a "foreign proceeding" as defined in the Bankruptcy Code. Because the APE law leaves the debtor in control even after the commencement of the judicial portion of the process, the debtor's board of directors may qualify as a "foreign representative" who is entitled to commence the section 304 proceeding. The differences between the APE and a U.S. chapter 11 include differences in the way votes are solicited, so that an acceptance may be easier to cast than a rejection, and on the way votes are counted, a different classification scheme, and less judicial oversight on operations, approval standards, and application of the best interest (liquidation value) and absolute priority rules. These differences are not so great as to prevent section 304 relief. More importantly, the APE does not deny creditors due process or treat U.S. creditors unfairly, which is the applicable standard. Finally, because the standards for abstention under section 305(a)(2) are the same as for granting relief under section 304, the court dismisses the involuntary chapter 11 case. *In re Board of Directors of Multicanal S.A.*, 314 B.R. 486 (Bankr. S.D.N.Y. 2004).

4.1.ff. Section 304 authorizes broad injunction. A Cayman Islands company with U.S. operations had issued Vehicle Service Contracts to hundreds of thousands of U.S. vehicle owners. One of the owners commenced a purported class action against the debtor when the company failed to honor the contracts. The company filed a foreign proceeding in the Cayman Islands, and its liquidators sought broad relief under section 304, enjoining all acts to collect on the owners' claims except through the Cayman proceeding. The bankruptcy court did not abuse its discretion in granting the relief, even though the owners may not pursue a class action in the Cayman Islands and must pursue individual claims, which might not be allowable because Cayman law does not recognize contingent claims. "Just treatment of all claims" in section 304(c)(1) may be met in this case, because Cayman law permits the owners to liquidate their claims in Cayman court, and Cayman law does not give a preference to Cayman creditors over non-Cayman creditors. The bankruptcy court's further injunction against further U.S. discovery is also within the bankruptcy court's "near blank check" authority under section 304. *Hoffman v. Bullmore (In re National Warranty Ins. Risk Retention Group)*, 384 F.3d 959 (8th Cir. 2004).

4.1.gg. Dissolved limited liability company is eligible for title 11. The debtor Oklahoma limited liability company had filed articles of dissolution with the Secretary of State before filing its chapter 11 petition. The court nevertheless determines that the debtor is still a "corporation" as defined in the Bankruptcy Code, because under Oklahoma law, it still may take action to wind up its affairs and therefore must continue to exist in a legal sense. *In re Midpoint Dev., L.L.C.*, 313 B.R. 486 (Bankr. W.D. Okla. 2004).

4.1.hh. Foreign bank is eligible for section 304 ancillary case. A foreign bank is not eligible under section 109 to be a debtor in a case under chapter 7 or 11. However, an ancillary case under section 304 is not a case under one of those chapters. May the foreign representative of a foreign bank therefore file an ancillary case? Apparently so. Section 109 defines eligibility only for debtors and only for the various

chapters of the Bankruptcy Code and says nothing about the eligibility of a foreign representative to file a petition commencing an ancillary case. Section 304 contains no such limitation. As a result, the foreign representative could seek relief under section 304 to oust the Superintendent of Banks of the State of New York, who had seized the New York branch of a failed Yugoslav bank. *Agency for Deposit Ins. v. Superintendent of Banks*, 310 B.R. 793 (S.D.N.Y. 2004).

4.1.ii. General partner may file voluntary petition on behalf of partnership. Section 303 of the Bankruptcy Code authorizes fewer than all of the general partners in a partnership to commence an involuntary bankruptcy case against the partnership. Neither section 303 nor section 301 (voluntary cases) addresses whether fewer than all of the general partners in a partnership may commence a voluntary case for a partnership if adequately authorized under the partnership agreement. Former Bankruptcy Rule 1004 prohibited such a filing, but because of doubts about the statutory authority for the Rule, it was amended in 2002. In this case, the court determines that neither Bankruptcy Rule 1004, as in effect before the amendment at the time this case was filed, nor section 303 of the Bankruptcy Code prohibits the filing of a voluntary case for a partnership by fewer than all of its general partners. *In re Century/ML Cable Venture*, 294 B.R. 9 (Bankr. S.D.N.Y. 2003).

4.1.jj. To qualify as a business trust, the trust must transact business or commercial activity for the benefit of investors. A trust account maintained by a title agency did not qualify as a business trust that is eligible for bankruptcy relief. Relying on *In re Kenneth Allen Knight Trust*, 303 F.3d 671 (6th Cir. 2002), the court concludes that the principle purpose of the trust account was to preserve a trust res, not to make profit or to provide a return to investors. Therefore, the so-called business trust was nothing more than bank accounts designed to preserve the funds collected from the title agency's customers for disbursement to third parties. *Dayton Title Agency, Inc. v. The White Family Companies (In re Dayton Title Agency, Inc.)*, 292 B.R. 857 (Bankr. S.D. Ohio 2003).

4.1.kk. Eighth Circuit defines "business trust." The settlor/trustee/ primary beneficiary established a trust for his personal and business assets. The Eighth Circuit rules that federal law determines whether a trust is a "business trust" that is eligible to be a debtor under title 11. If the trust is created with the primary purpose of transacting business or carrying on commercial activity for the benefit of the investors, the trust is a business trust. The determination is fact specific based on the intention of the parties and on how the trust operated. The Eighth Circuit rejects a requirement (present under the former Bankruptcy Act) that the trust have transferable certificates of beneficial interest. *Brady-Morris v. Schilling (In re Kenneth Allen Knight Trust)*, 303 F.3d 671 (8th Cir. 2002).

4.1.ll. An LLC is eligible for bankruptcy. Finding that a limited liability company has attributes of both a partnership and a corporation, the court holds that an LLC is a "person" within the definition of section 101 and is therefore a separate legal entity and an eligible debtor. However, that status requires that it be represented by an attorney and may not appear by or through its manager. *In re ICLNDS Notes Acquisition, LLC*, 259 B.R. 289 (Bankr. N.D. Ohio 2001).

4.1.mm. Comity is not the principal consideration under section 304. The bank, which had a claim secured by assets located in the United States, opposed the petition of the Bahamian liquidator for ancillary relief and turnover under section 304, arguing that Bahamian law subordinated the security interest to administrative expenses, which would have consumed all of the bank's collateral. The liquidator opposed, on the grounds that section 304(c)(5), requiring the court to consider comity, took precedence over considerations of the treatment of particular claims. The Second Circuit disagreed, holding that the special status that United States law gives to secured claims provided adequate grounds for denying the petition under section 304(c)(4), which focuses on a comparison of the treatment of claims in the U.S. and non-U.S. proceeding. *Bank of New York v. Treco (In re Treco)*, 240 F.3d 148 (2d Cir. 2001).

4.1.nn. Ancillary case does not require U.S. assets. In a case of first impression, the District of Columbia Circuit holds that a case ancillary to a foreign proceeding under section 304 may be filed even if the debtor has no assets in United States. *Haarhuis v. Kumnan Enterprises, Ltd.*, 177 F.3d 1007 (D.C. Cir. 1999).

4.1.oo. Section 304 grants jurisdiction to enjoin even where there is no U.S. property. A California plaintiff obtained an arrest in the Belgian courts of assets belonging to a U.K. debtor. The California plaintiff commenced a California state court action to obtain a judgment that would form the basis of establishing liability in the Belgian courts. The U.K. administrators commenced an ancillary case under section 304, and the bankruptcy court enjoined the California action. The bankruptcy court had jurisdiction to do so under section 304(b)(1), even though the debtor did not have any property in the United States, because the section authorizes an injunction against "any action against a debtor with respect to property involved in such foreign proceeding." *A.P. Esteve Sales, Inc. v. Manning (in re Manning)*, 236 B.R. 14 (9th Cir. B.A.P. 1999).

4.1.pp. A debtor must use his own address. The court prohibits the debtor from using his counsel's address in his petition as a means of avoiding adverse publicity about his bankruptcy filing. *In re Laws*, 223 B.R. 714 (Bankr. D. Neb. 1998).

4.1.qq. Partnership in dissolution is not eligible for bankruptcy. One of the two partners of a partnership withdrew before the partnership filed its chapter 11 petition, resulting in the dissolution of the partnership. The Second Circuit holds "that a partnership in dissolution is not a `person' eligible to avail itself of reorganization in chapter 11," even if the sole purpose of the chapter 11 case is liquidation. *C-TC Ninth Avenue Partnership v. Norton Company (In re C-TC Ninth Avenue Partnership)*, 113 F.3d 1304 (2d Cir. 1997).

4.1.rr. Unauthorized corporate filing may be ratified. A corporation owned by two fifty percent disputing shareholders filed a bankruptcy petition authorized by a resolution approved by only one of the shareholders. Upon a jurisdictional challenge brought by the other shareholder, the Fourth Circuit held that the objecting shareholders delayed in bringing the objection, effectively ratifying the corporate authorization to file the bankruptcy petition, which thereby authorized the filing. *Hager v. Gibson*, 108 F.3d 35 (4th Cir. 1997).

4.2 Involuntary Petitions

4.2.a. Unstayed appealed judgment is not the subject of a bona fide dispute. The petitioning creditors obtained judgments against the debtor for intentional torts. The debtor appealed but did not obtain a stay pending appeal. While the appeal was pending, the creditors filed an involuntary petition against the debtor. Section 303(b)(1) permits an involuntary petition only by three or more holders of claims that are not "the subject of a bona fide dispute as to liability or amount". Generally, whether a claim is the subject of a bona fide dispute requires the bankruptcy court to determine whether there is an objective basis for a factual or legal dispute. "Claim" means "right to payment, whether or not such a right is reduced to judgment". Thus, the petitioners' "claim" here is the judgment, not the underlying tort claim, and the judgment is not subject to a bona fide dispute. Permitting the bankruptcy court to look behind an unstayed judgment would improperly permit a non-Article III federal court to examine whether a state trial court erred and would run counter to federalism principles and 28 U.S.C. § 1738, which requires federal courts to give full faith and credit to state court judgments. A dissent argues that a judgment is not a "claim" and that the court should examine the judgment to determine whether there is a bona fide basis for appeal. *Marciano v. Chapnick (In re Marciano)*, 708 F.3d 1123 (9th Cir. 2013).

4.2.b. Section 303(i) permits a fee award for collection of a section 303(i) award. The creditor brought a bad faith involuntary petition against the debtor. The court dismissed and awarded attorneys' fees, damages and punitive damages under section 303(i). The creditor then filed his own voluntary bankruptcy petition, which was later dismissed. After the dismissal, the creditor paid the section 303(i) award from the first case. The debtor sought additional attorneys' fees for the effort to challenge the creditor's bankruptcy and collect the award because of the creditor's bad faith conduct. Generally, a fee-shifting statute permits recovery of all fees incurred, including fees incurred to collect a judgment. Section 303(i), which authorizes an award of attorneys' fees and damages against a petitioning creditor, is a fee-shifting statute. As such, the general rule applies. Moreover, a debtor who must incur fees to collect a section 303(i) award incurs additional damages flowing from the involuntary petition. Accordingly, the court may award post-dismissal fees to collect the award, whether incurred in the bankruptcy court or

elsewhere. *Adell v. John Richards Homes Bldg Co., LLC (In re John Richards Homes Bldg Co., LLC)*, 475 B.R. 585 (E.D. Mich. 2012).

4.2.c. Appealed, unstayed state court judgment establishes that claims are not subject to bona fide dispute. As sanctions for repeated discovery abuses, the state court struck the debtor's answer to the complaint and entered judgment for an amount determined by a jury. The debtor appealed. The appellate court denied a stay pending appeal. Several plaintiffs obtained liens on the debtor's property in enforcement actions. Others filed an involuntary petition against the debtor within 90 days after the first plaintiffs obtained the liens. An involuntary case is commenced by the filing of a petition by creditors who hold claims that are not contingent as to liability or the subject of a bona fide dispute as to liability or amount. An unstayed state court judgment (other than a default judgment) establishes a debtor's liability and that it is not in bona fide dispute for purposes of section 303. Moreover, the petitioners' good faith in filing the petition is not relevant to whether the court should grant an order for relief. It is relevant only if the court dismisses the case and must determine attorneys' fees and damages under section 303(i). *Marciano v. Fahs (In re Marciano)*, 459 B.R. 27 (9th Cir. B.A.P. 2011).

4.2.d. Creditors holding joint judgment do not count as separate creditors. A husband and wife and their jointly owned business sued the alleged debtor on three separate claims. The debtor settled with all three by a consent judgment in a single amount that was not allocated to any of the plaintiffs. The three plaintiffs then filed an involuntary petition against the alleged debtor. Section 303(b)(1) permits an involuntary petition "by three or more entities, each of which is … a holder of a claims against" the debtor. Courts apply the "three or more" requirement flexibly where more than one creditor holds a note or judgment against the debtor, but where the creditors cannot act separately in enforcing the obligation, courts treat the group as one creditor for purposes of section 303(b)(1). Here, the settlement combined the three creditors' claims into a single judgment that could not be allocated among the creditors. Therefore, the group was a single creditor for purposes of section 303(b)(1). *Huszti v. Huszti*, 451 B.R. 717 (E.D. Mich. 2011).

4.2.e. A valuation dispute over a CDO's assets is not a ground to dismiss a chapter 11 petition. The debtor's sole business is a CDO-squared vehicle that owns a pool of securities that serves as collateral for its notes. Under the indenture for the notes, a default terminates the collateral manager's right to manage the pool actively and permits it only to collect payments on the underlying securities and distribute the cash to holders of notes according to their priorities. The debtor defaulted. Holders of senior notes filed an involuntary petition to avoid the indenture restriction on active management of the securities after a default. The debtor did not oppose the petition. The court ordered relief. The petitioning creditors filed a plan that provided for the transfer of the pool to the senior noteholders. Holders of junior notes moved to dismiss. Filing a petition and a plan to avoid transfer restrictions is consistent with chapter 11's purpose. Whether the court confirms the plan depends on whether the securities are worth more than the amount of the senior notes. But a valuation dispute is not a ground to dismiss the petition. *In re Zais Inv. Grade Ltd. VII*, 455 B.R. 839, (Bankr. D.N.J. 2011).

4.2.f. Only the trustee may appeal an involuntary order for relief. Creditors filed an involuntary chapter 11 petition against a corporate debtor. The debtor opposed, but the bankruptcy court ordered relief and then converted the case to chapter 7. A trustee was appointed. The corporation's managers appealed from the order for relief in the name of the corporation. The trustee moved to dismiss the appeal for lack of appellate standing. Only a person aggrieved may appeal a bankruptcy court order. Here, the corporation may have been aggrieved. However, under *CFTC v. Weintraub*, 471 U.S. 343 (1985), upon his appointment, the trustee succeeds to the corporation's management and assets, and corporate officers are completely ousted. Therefore, only the trustee has the right to appeal from the order for relief on behalf of the corporation. *C.W. Mining Co. v. Aquila, Inc. (In re C.W. Mining Co.)*, 636 F.3d 1257 (10th Cir. 2011).

4.2.g. 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)

4.2.h. Voluntary case filing while involuntary petition is pending amounts to consent to an order for relief in the involuntary case. Three creditors filed an involuntary chapter 7 petition against the debtor, which filed a voluntary chapter 11 petition in the same district 26 days later. The debtor sought dismissal of the involuntary petition on mootness grounds. The court rejects case law under the former Bankruptcy Act, which was based on different, lengthier procedures for involuntary petitions under the Act and which determined whether to proceed with the voluntary case based on whether prejudice would result from the later filing date. Instead, the court treats the voluntary petition as the functional equivalent of the debtor's admission that an order for relief should be entered in the involuntary case and the two cases consolidated under Rule 1015. Sections 301, 706 and 1112 allow the debtor to select the chapter under which a voluntary case should proceed. The same procedure should apply here, rather than requiring the debtor to seek conversion, so the court orders relief under chapter 11, effective as of the date of the voluntary petition. *In re Premier Gen. Holdings, Ltd.*, 427 B.R. 592 (Bankr. W.D. Tex. 2010).

4.2.i. Section 303(i) does not require joint and several liability against all petitioning creditors. The debtor obtained a dismissal of the involuntary petition and sought fees against only one petitioning creditor. The bankruptcy court required the debtor to serve all petitioning creditors with the motion and awarded fees against all jointly and severally, under a tort theory. Section 303(i) provides that the bankruptcy court "may" award fees upon dismissal of an involuntary petition. The provision is permissive and discretionary, not mandatory. Therefore, the bankruptcy must exercise its discretion, based on the totality of the circumstances, including relative culpability among the petitioners, motives and objectives and reasonableness of conduct, in determining an award of fees against each petitioner. Tort theories have no role in section 303(i)'s application. *Sofris v. Maple-Whitworth, Inc. (In re Maple-Whitworth, Inc.)*, 556 F.3d 742 (9th Cir. 2009).

4.2.j. Involuntary bankruptcy petitioner eligibility requirements are no longer subject-matter jurisdictional in the Eleventh Circuit. Several years after the court entered an order for relief, the debtor sought dismissal on jurisdictional grounds of a single-creditor involuntary petition in a case in which the debtor had more than 12 creditors. Reversing its panel decision in this case, 525 F.3d 1095 (11th Cir.), and overruling its prior panel decision, *In re All Media Props., Inc.*, 646 F.2d 193 (5th Cir. Unit A 1981), the Eleventh Circuit *en banc* concludes that the requirements for an involuntary petition are not jurisdictional. A statute's requirements are jurisdictional if the statue clearly expresses the substantive requirements for relief in jurisdictional terms. Section 303(b)'s petitioning creditor qualification requirements do not speak in jurisdictional terms, nor is there any indication that Congress intended bankruptcy courts to consider petitioning creditors' qualification *sua sponte*, as they must do if their subject matter jurisdiction is at stake, because section 303(h) requires the court to grant relief if the petition's allegations are not timely controverted. Therefore, the requirements are not jurisdictional and may be waived, as they were in this case. *Trusted Net Media Holdings, LLC v. The Morrison Agency, Inc. (In re Trusted Net Media Holdings, LLC)*, 550 F.3d 1035 (11th Cir. 2008).

4.2.k. Involuntary bankruptcy creditor eligibility requirements remain subject-matter jurisdictional in the Eleventh Circuit. Several years after the court entered an order for relief, the debtor sought dismissal on jurisdictional grounds of a single-creditor involuntary petition in a case in which the debtor had more than 12 creditors. Although the Eleventh Circuit panel concludes that the requirements for an involuntary petition are not jurisdictional, it determines that it is bound by an earlier Eleventh Circuit decision to the contrary and dismisses the case. *Trusted Net Media Holdings, LLC v. The Morrison Agency,*

Inc. (In re Trusted Net Media Holdings, LLC), 525 F.3d 1095 (11th Cir.), *vacated and ordered reh'g en banc*, 530 F.3d 1363 (11th Cir. 2008).

4.2.l. LLC member's right to consent to a voluntary petition is enforceable. The lender advanced funds and took a note and a "Class B" equity interest in the Georgia LLC debtor. The LLC agreement prohibited certain major decisions, including filing a voluntary bankruptcy case, without the Class B holder's consent. Some of the "major decision" provisions expired upon payment of the loan, but the right to consent to a voluntary petition did not. On the eve of the lender's foreclosure and after the Class B holder refused consent to a voluntary petition, the debtor orchestrated an involuntary petition. The lender/Class B holder moved to dismiss the petition. Georgia law permits LLC members to make all decisions in managing an LLC. The LLC agreement's provision giving the Class B holder the right to veto a voluntary petition is therefore enforceable. Only the debtor may contest an involuntary petition. But the court may consider the grounds the lender asserted (that the petitioning creditors did not have standing) in determining whether the involuntary petition was filed in bad faith, and the traditional bad faith filing analysis applies equally to an involuntary petition. The circumstances of this case, which include a "pure subterfuge for a voluntary petition", evidence bad faith, so the court dismisses the case. *In re Global Ship Sys., LLC*, 391 B.R. 193 (Bankr. S.D. Ga. 2007).

4.2.m. Court may award attorney's fees and costs against fewer than all petitioners. Section 303(i)(1) permits a court to award attorney's fees and costs against "the petitioners" if the court dismisses an involuntary petition. Section 303(i)(2) permits the court to award "damages proximately caused by" the petition and "punitive damages" against "any petitioner that filed the petition in bad faith". Section 303(i)(2) imports tort concepts, which include the concepts of joint and several liability against joint tortfeasors and contribution or indemnity among them. Under the former concept, the tort victim need not pursue a claim against all tortfeasors, as their liability is joint and several. Section 303(i) should be read to incorporate the same concept, so the alleged debtor need not seek recovery from all petitioners, even under section 303(i)(1). Any petitioner who is held liable may seek contribution or contractual indemnity from the others in the bankruptcy court, through a motion to join the other petitioners, a third-party action, or an independent equitable action against them. A dissent argues that "the petitioners" in section 303(i)(1) means something different from "any petitioner" in section 303(i)(2) and that the court should recognize the difference by requiring any claim for attorney's fees and costs to be brought against all petitioners. Neither the majority nor the dissent mentions section 102((7), which provides, "the singular includes the plural", but not the opposite. *Sofris v. Maple-Whitworth, Inc. (In re Maple-Whitworth, Inc.)*, 375 B.R. 558 (9th Cir. B.A.P. 2007).

4.2.n. Court dismisses involuntary chapter 11 case where it cannot effectively reorganize Argentine debtor that is already proceeding under an Argentine *Concurso Preventivo*. The debtor had been the subject of an Argentine *Concurso Preventivo* (the rough equivalent of a U.S. chapter 11 case) for over five years. Dissatisfied with the *Concurso*'s progress, several holders of U.S. dollar-denominated unsecured notes filed an involuntary chapter 11 case in New York. The debtor's only U.S. assets were U.S. registered trademarks; nearly all of its assets, business, customers, suppliers, and trade creditors were in Argentina. On a section 305(a)(1) motion to abstain, the court must consider, among other things, the availability of fair, economical, efficient, and equitable alternative relief. Although a *Concurso* differs from a chapter 11 case in several respects, including no automatic stay of secured creditor enforcement actions, no equitable subordination or broad discovery, a *Concurso* is fundamentally similar to chapter 11 and provides fair, economical, efficient, and equitable relief to creditors and the debtor. A chapter 11 case would serve little purpose here, because the U.S. court would not be able to enforce many of its own orders, let alone a plan confirmation order, in Argentina, and coordination of the two cases and potential plans would be rendered challenging at best by the differences in the two laws' classification and treatment regimes. Chapter 11's only benefit in this case would be the automatic stay of secured creditor enforcement action, which would be enforceable because the principal secured creditors are Delaware companies. However, the automatic stay is not an end in itself but a means to achieving reorganization or liquidation. Where neither is a realistic possibility in the U.S. court, the case should not be retained solely to perpetuate the stay. Therefore, the court dismisses the case. *In re Compañia de Alimentos Fargo, S.A.*, 376 B.R. 427 (Bankr. S.D.N.Y. 2007).

4.2.o. Court may limit the time for joinder in an involuntary petition. Section 303(c) provides that a creditor may join an involuntary petition "after the filing of [the petition] but before the case is dismissed or

relief is ordered". At a status conference shortly after the involuntary petition was filed, the debtor challenged the qualifications of two of the four petitioning creditors. The court set a deadline of the day before the involuntary petition trial, 10 days hence, for other creditors to join in the petition and ordered notice of the deadline be given to other creditors. One creditor joined, but after the deadline. Rule 1003(b) requires the court to "afford a reasonable opportunity for other creditors to join in the petition". Rule 1013(a) requires that an involuntary petition be determined expeditiously. These rules permit the court to make orders governing the conduct of the case and to exercise its case management role. Section 303(c) does not limit application of those provisions. It provides only a maximum time limit on joinder, not a minimum. *Riverview Trenton RR Co. v. DSC, Ltd. (In re DSC, Ltd.)*, 486 F.3d 940 (6th Cir. 2007).

4.2.p. Court may award attorney's fees for an involuntary petition dismissed under section 305. The debtor lost patent litigation. Realizing it could not pay the judgment, it made an assignment for the benefit of creditors. The assignee sold all the debtor's assets about four months later, though for just a fraction of what was owing. The patent creditor, who did not participate in the assignment, filed an involuntary bankruptcy petition against the debtor four days after the sale. The court determines that the interests of creditors and the debtor would be better served by dismissal and dismisses the petition under section 305(a). The court then awards the debtor attorney's fees against the petitioner. Section 303(i) permits an attorney's fee award "if the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and the debtor does not waive judgment under this subsection". This section authorizes a fee award even for a dismissal under section 305(a) because "under this section" modifies "petition" rather than "dismisses". Therefore, the Code permits a fee award for any dismissal of an involuntary petition. However, because the authority is so broad, the court should exercise caution in awarding fees upon a dismissal under section 305(a), as a petition might be entirely proper yet should be dismissed on the basis of the interests of creditors and the debtor. In this case, the debtor had made an assignment, which was nearly concluded, so the petition appeared to be for litigation advantage rather than for a proper use of bankruptcy, and fees were therefore appropriate. *Wechsler v. Macke Int'l Trade, Inc. (In re Macke Int'l Trade, Inc.)*, 370 B.R. 236 (9th Cir. B.A.P. 2007).

4.2.q. Creditor may not offset claim against section 303(i) fee award. After the court dismissed an involuntary petition, it awarded fees against the creditor under section 303(i). The creditor may not offset its claim against the award. Otherwise, there would be little penalty to a creditor that files an improper petition. In many cases, even where a petition is improper, there is a risk that the creditor will not receive full recovery on its claim. Allowing the setoff would permit full recovery, would thereby reduce the downside to a creditor's resort to an involuntary petition, and would not fully compensate the debtor for the loss it suffered in successfully defending against the petition. It would undercut a debtor's ability, which section 303(i) was designed to bolster, to resist a creditor's use of an involuntary petition for litigation advantage. *Wechsler v. Macke Int'l Trade, Inc. (In re Macke Int'l Trade, Inc.)*, 370 B.R. 236 (9th Cir. B.A.P. 2007).

4.2.r. Court may not award attorney's fees to nonpetitioning creditors. A petitioning creditor filed an involuntary case in bad faith to stop a foreclosure. The court annulled the automatic stay to validate the foreclosure sale and dismissed the petition. The nonpetitioning creditors, which included the foreclosing mortgagee and the foreclosure sale purchaser, sought attorney's fees against the bad faith petitioner. Section 303(i) permits the court, "if the debtor does not waive the right to judgment," to grant judgment "(1) against the petitioners and in favor of the debtor" for attorney's fees and "(2) against any petitioner that filed the petition in bad faith" for proximate and punitive damages. The difference in clauses (1) and (2) creates an ambiguity that suggests that proximate and punitive damages may be awarded in favor of an entity other than the debtor, such as the nonpetitioning creditors who opposed the petition and were harmed by the stay and delay the petition caused. However, the introductory clause makes clear that the court may grant judgment only in favor of the debtor under both clauses. Section 105(a) does not empower the court to grant damages, because section 303(i) provides the exclusive remedy for damages for a bad faith involuntary petition, and section 105(a) therefore may not override section 303(i)'s prohibition on granting fees to a nondebtor. *In re VII Holdings Co.*, 362 B.R. 663 (Bankr. D. Del. 2007).

4.2.s. Creditor may not contest involuntary petition to which debtor consents. The debtor's affiliate filed an involuntary petition against it, alleging a debt to the affiliate that was undisputed and liquidated. After the court granted relief, a creditor moved to dismiss the petition. The creditor argued that because

the debt was disputed and unliquidated, the bankruptcy court did not have jurisdiction over the case, citing *In re BDC 56 LLC*, 330 F.3d 111 (2d Cir. 2003), which holds that the requirement of a liquidated undisputed claim is "subject matter jurisdictional" under section 303(b). However, section 303(d) permits only the debtor to contest an involuntary petition, and section 303(h) mandates that the court order relief on an uncontested petition. Granting a creditor's late motion to dismiss on section 303(b) grounds would effectively nullify these other provisions of section 303, which have equal dignity with the jurisdictional limits of section 303(b). Therefore, the court denies the motion to dismiss. *In re MarketXT Holdings Corp.*, 347 B.R. 156 (Bankr. S.D.N.Y.).

4.2.t. Bankruptcy court may resolve legal dispute on involuntary petition. Petitioning creditors must have claims that are not subject to bona fide dispute. However, the court may conduct a limited legal analysis of disputed issues of law on largely stipulated facts. Here, although the debtor argued that it was not liable to the petitioning creditors under agency law, the law was clear on the issue, and the debtor did not show any clear alternative line of authority that would lead to a different conclusion. The bankruptcy court may determine whether there is a good faith legal dispute. Where there is not, the court may issue the order for relief. *Mktg. and Creative Solutions, Inc. v. Scripps Howard Broad. Co. (In re Mktg. and Creative Solutions, Inc.)*, 338 B.R. 300 (6th Cir. B.A.P. 2006).

4.2.u. Not guilty plea does not create bona fide dispute over petitioning creditor's claim. The debtor admitted to shooting his wife and mother-in-law. The wife's estate representative asserted a claim for wrongful death and filed an involuntary petition with two other creditors. The debtor had pled not guilty in the criminal case. That plea did not raise a bona fide dispute for purposes of determining the creditor's eligibility to file a petition under section 303(b)(1). In a civil case such as the bankruptcy proceeding, the plea amounts to a mere denial. The bankruptcy court must apply an objective standard to determine whether there is a bona fide dispute. The debtor must show that there are substantial factual or legal questions that bear upon liability. Given the debtor's crime scene admission, there was no bona fide dispute about his liability for wrongful death. *Metz v. Dilley (In re Dilley)*, 339 B.R. 1 (1st Cir. B.A.P. 2006).

4.2.v. Non-profit company that engages in commercial activity is not subject to involuntary bankruptcy. Under section 303(a), a corporation that is not a "moneyed, business, or commercial corporation" is not subject to an involuntary bankruptcy petition. Courts have construed the phrase to encompass entities organized as not-for-profit entities. The alleged debtor was a "Community Housing Development Organization," organized as a non-profit corporation under Texas law to own and operate low-income housing. It owned and operated a 220-unit apartment complex. Despite the operation of a commercial facility—the apartment complex—the debtor is not a "moneyed, business, or commercial corporation" for purposes of section 303(a). Although a court may look past non-profit incorporation to determine whether an alleged debtor is a moneyed, business, or commercial corporation, mere ownership and operation of a commercial facility do not qualify the debtor as eligible for involuntary bankruptcy. *In re MAEDC Mesa Ridge, LLC*, 334 B.R. 197 (Bankr. N.D. Tex. 2005).

4.2.w. Farmer may waive exemption from involuntary bankruptcy. Years after the court issued an order for relief on an involuntary petition, the debtor moved to dismiss the case for lack of subject matter jurisdiction because he was a farmer. The farmer exemption from involuntary bankruptcy is a defense that must be raised or it is waived. It does not go to the court's subject matter jurisdiction. Subject matter jurisdiction is granted by 28 U.S.C. § 1334. Section 303(b) exempts a farmer from involuntary bankruptcy, but section 303(h) requires the court to grant an order for relief on an involuntary petition if it is not timely controverted. Therefore, a farmer must timely assert his status to defeat the petition. *Marlar v. Williams (In re Marlar)*, 432 F.3d 813 (8th Cir. 2005). *Accord U.S. Bank N.A. v. Young (In re Young)*, 336 B.R. 775 (B.A.P. 8th Cir. 2006) (farmer exemption from involuntary petition is not jurisdictional).

4.2.x. Section 303(i) provides the exclusive remedy for filing an involuntary petition that is dismissed. After the bankruptcy court dismissed involuntary petitions against a husband and wife, the couple's children brought actions against the petitioners in state court for state law torts arising from the distress caused the children by the parent's bankruptcies. The creditors removed the actions to the bankruptcy court, which dismisses them. Section 303(i) provides the exclusive remedy against a creditor who files an involuntary petition that is later dismissed and preempts any state law remedies. Section

303(i) is a comprehensive remedial scheme. It is important to the effectuation of Congressional policy that neither state law nor state courts determine the consequences of filing a bankruptcy petition, which could subvert the bankruptcy court's exclusive jurisdiction and undermine uniformity. *Miles v. Okun (In re Miles)*, 430 F.3d 1083 (9th Cir. 2005).

4.2.y. Creditor's lack of knowledge that debtor had more than 12 creditors does not require dismissal of one-creditor petition for bad faith. The creditor had obtained a judgment against the debtor and had taken post-judgment discovery in which the debtor could not identify more than 8 creditors. Nearly a year later, shortly before the creditor filed a one-creditor involuntary petition, the debtor's counsel wrote to the creditor's counsel stating that the debtor had at least 17 creditors, but did not identify them. An involuntary petition filed by a creditor who knows that the debtor has more than 12 creditors must be dismissed as a bad faith filing. The debtor moved to dismiss the petition on the ground that the creditor filed in bad faith. Because the bankruptcy court found that the creditor did not know that the debtor had more than 12 creditors, the petition was not filed in bad faith. *Bock Transp., Inc. v. Paul (In re Bock Transp., Inc.)*, 327 B.R. 378 (Bankr. 8th Cir. 2005).

4.2.z. Court may limit time for joinder in an involuntary petition. Section 303(c) provides that a creditor may join an involuntary petition "after the filing of [the petition] but before the case is dismissed or relief is ordered." At a status conference shortly after the involuntary petition was filed, the court determined that only two of the petitioning creditors qualified as petitioners. It ordered the petitioners to give notice of a deadline for other creditors to join the petition. Two did so, but after the deadline. The court disallowed their joinder, reasoning that Rule 1013 (which requires that an involuntary petition be determined expeditiously), Fed. R. Civ. P. 16 (which applies to the trial of a contested involuntary), and section 105(d) all permit the court to make orders governing the conduct of the case and to exercise its case management role. Section 303(c) does not limit application of those provisions. It provides only a maximum time limit on joinder, not a minimum. *In re DSC, Ltd.*, 325 B.R. 741 (Bankr. E.D. Mich. 2005).

4.2.aa. Co-op that contracts out farming operations is ineligible for involuntary bankruptcy. The debtor contracted out all of its pig farming operations. It purchased the pigs, arranged with independent contractors to transport the pigs to hog producers to raise them, sold the raised pigs to packers, and hired trucking companies to ship the pigs to the packers. The debtor was not a passive investor. It actively oversaw and supervised the operations. The fact that the operations were conducted by independent contractors rather than employees does not make the debtor any less a farmer and therefore ineligible for involuntary bankruptcy. *Cooperative Supply, Inc. v. Corn-Pro Nonstock Coop., Inc. (In re Corn-Pro Nonstock Coop., Inc.)*, 318 B.R. 153 (B.A.P. 8th Cir. 2004).

4.2.bb. Foreign debtor is not immune from an involuntary petition. A Brazilian company was undergoing an out-of-court workout in Brazil. It had minimal assets in the United States but had raised substantial capital here. A U.S. creditor who did not agree with the conduct of the out-of-court work-out process filed an involuntary petition against the company in New York. The record indicated that a Brazilian court would not enforce a U.S. bankruptcy court's orders dealing with the debtor's property or with Brazilian creditors. The court nevertheless could not dismiss the case on the ground that it would be too difficult to obtain the debtor's cooperation in the case or to obtain jurisdiction over the debtor's property outside the United States. The court has subject matter jurisdiction under 28 U.S.C. § 1334, and the debtor, by reason of having property in the United States, is an eligible debtor under section 109(a). Assuming the court has personal jurisdiction over the debtor based on "minimum contacts," the court's *in rem* jurisdiction over the debtor's property, "wherever located," would allow it to issue orders necessary to deal with the property and manage the case, and its *in personam* jurisdiction over the debtor would permit it to issue and enforce orders regarding the conduct of the case and of the debtor, as debtor in possession. Where the court has such jurisdiction, it must exercise it, unless Congress authorizes abstention, such as under section 305(a). *GMAM Inv. Funds Trust I v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, 317 B.R. 235 (S.D.N.Y. 2004).

4.2.cc. Dispute over claim amount does not create disqualifying bona fide dispute. Although the alleged debtor disputed the amount it owed the petitioning creditors, it did not seriously dispute the existence of a debt in an amount greater than the amount required to file an involuntary petition. Such a

dispute is not a bona fide dispute that disqualifies the petitioning creditors. *Focus Media, Inc. v. National Broad. Co. (In re Focus Media, Inc.)*, 378 F.3d 916 (9th Cir. 2004).

4.2.dd. Fees for dismissal awarded under "totality of circumstances" test. After dismissing an involuntary chapter 7 case that appeared to have been filed to destroy a competitor, the bankruptcy court awarded fees to the alleged debtor. Although the award of fees is not mandatory, the presumption is in favor of fees, and the petitioners have the burden to rebut the presumption. The Ninth Circuit adopts the totality of the circumstances test for determining whether they have done so. Recognizing that the test may be amorphous, the court suggests that the bankruptcy court consider, among other things, the merits of the petition, the role of any improper conduct by the alleged debtor, the petitioners' reasonableness, and the motivation and objectives behind the petition. The bankruptcy court should rely on the evidence developed in the trial on the petition rather than conducting a new trial on fees. The court may not award fees, however, for any appeal from the dismissal order, which are governed solely by Fed. R. App. P. 38. *Higgins v. Vortex Fishing Systems, Inc.,* 379 F.3d 701 (9th Cir. 2004).

4.2.ee. Judgment might not eliminate "bona fide dispute" for purposes of eligibility to file an involuntary petition. Although the creditor had obtained a judgment against the debtor in state court, the debtor had appealed and presented substantial legal issues on the appeal. As a result, the creditor's claim remained subject to a bona fide dispute, and the creditor was not an eligible petitioning creditor on an involuntary petition. *Schlossberg v. Byrd (In re Byrd)*, 357 F.3d 433 (4th Cir. 2004).

4.2.ff. Presence of a bona fide dispute in an involuntary petitioner's claim is determined under an objective test and is jurisdictional. A creditor that files an involuntary petition must hold a claim that is not the subject of a bona fide dispute. This requirement is jurisdictional; that is, the bankruptcy court does not have subject matter jurisdiction over an involuntary petition brought by a creditor whose claim is subject to bona fide dispute. Whether a debt is subject to bona fide dispute must be determined on whether there is an objective basis for either a factual or legal dispute as to the validity of the debt, because Congress did not intend to subject a debtor to involuntary bankruptcy when the debtor had a legitimate grounds for disputing the debt. The petitioning creditor must establish a prima facie case that no bona fide dispute exists. The burden then shifts to the debtor to demonstrate the opposite. *Key Mechanical Inc. v. BDC 56 LLC (In re BDC 56 LLC)*, 330 F.3d 111 (2d Cir. 2003).

4.2.gg. Only debtor may claim damages for a bad faith involuntary petition. Several related debtors were the subject of state court litigation by two creditors. The debtors' insider, who was also a creditor, filed an involuntary petition against the related corporations. The bankruptcy court dismissed the case as a bad faith filing. The non-petitioning creditors sued the petitioning insider creditor under section 303(i) for damages for a bad faith filing. However, section 303(i) grants damages only to the debtor, not to any non-debtor parties. *Franklin v. Four Media Company (In re Mike Hammer Productions, Inc.)*, 294 B.R. 752 (9th Cir. B.A.P. 2003).

4.2.hh. Section 303(i) preempts state damage remedies. A neighbor filed an involuntary petition against the alleged debtor. The court dismissed the petition as a bad faith filing. The alleged debtor's wife and daughter sued the petitioning creditor in state court on theories of defamation, abuse of process, emotional distress, negligent misrepresentation, and negligence. The petitioning creditors removed the action to the bankruptcy court. Even though the action did not assert any bankruptcy claims, the bankruptcy court had jurisdiction to hear it. But section 303(i), which provides for damages for a bad faith filing, preempts all state causes of action related to the filing of an involuntary petition, so the complaint was dismissed. *Miles v. Okun (In re Miles)*, 294 B.R. 756 (9th Cir. B.A.P. 2003).

4.2.ii. Involuntary petition against farmer is allowed. Section 303(a) does not permit an involuntary petition against a farmer. The Fifth Circuit rules that this prohibition is not jurisdictional. It is an affirmative defense that the alleged debtor may waive by failure to raise it in defending against the involuntary petition. *McCloy v. Silverthorne (In re McCloy)*, 296 F.3d 370 (5th Cir. 2002).

4.2.jj. Award of attorney's fees on dismissal of involuntary petition is not mandatory. The alleged debtor defeated an involuntary petition on the grounds that the creditors' claims were disputed. When the

alleged debtor sought attorney's fees under section 303(i), the court ruled that the award of attorney's fees is discretionary. The court declines to award fees because the petitioning creditors did not file the involuntary petition in bad faith or seek to do the alleged debtor any harm. The principle reason for filing the petition was to preserve the debtor's cash. *In re Allied Riser Communications Corp.*, 283 B.R. 420 (Bankr. N.D. Tex. 2002).

4.2.kk. Automatic stay strictly enforced during involuntary gap. During the involuntary gap period, the debtor paid proceeds of collateral to its lender. The lender applied the proceeds to the loan. The lender's application of the proceeds violated the automatic stay, which applies during the involuntary gap. Although the debtor is authorized under section 303(f) to use or dispose of property as though a petition had not been filed, it does not authorize the lender to apply proceeds received from the debtor during the gap to the loan. *Bankvest Capital Corp. v. Fleet Boston (In re Bankvest Capital Corp.)*, 276 B.R. 12 (Bankr. D. Mass. 2002).

4.2.ll. A debtor's counterclaim against a creditor does not defeat an involuntary petition. Section 303(b) permits a creditor to bring an involuntary petition only if its claim is not subject to a bona fide dispute. If the claim is subject to a counterclaim on an unrelated transaction, then the claim is not subject to a bona fide dispute, although it would be if the claim was subject to recoupment (arising out of the same transaction). Here, the creditor received its claim against the debtor by way of assignment, and the debtor's claim against the creditor did not render the creditors claim subject to a bona fide dispute. *Chicago Title Ins. Co. v. Secko Investment, Inc. (In re Secko Investment, Inc.)*, 156 F.3d 1005 (9th Cir. 1998).

4.2.mm. An indenture trustee is a separate qualified petitioner. Three debenture holders filed an involuntary petition against the debtor. One of the holders was disqualified as a petitioning creditor. The indenture trustee joined the petition. The court of appeals rules that the indenture trustee qualifies as a third petitioning creditor, even though the claim of the other two petitioning creditors are subsumed within the indentured trustee's claims. *Grey v. Federated Group, Inc. (In re Federated Group, Inc.)*, 107 F.3d 730 (9th Cir. 1997).

4.3 Dismissal

4.3.a. Debtor who can satisfy all claims in the ordinary course may obtain dismissal of its chapter 11 case. The debtor was a charitable foundation whose sole member was a not-for-profit hospital. The foundation was a separate legal entity, with a separate board. It conducted its operations independently from the hospital. The hospital filed a chapter 11 petition because of numerous debts, but the foundation filed only because of its co-liability on a bond with the hospital. During the chapter 11 cases, the hospital sold property and satisfied the bond, relieving the foundation of liability. The foundation thereby became able to satisfy all of its other obligations in the ordinary course and sought dismissal of its chapter 11 case. Section 1112(b) permits dismissal for cause on motion of a party in interest. A debtor is a party in interest and may seek dismissal. "Cause" includes that a chapter 11 case would no longer serve a bankruptcy purpose. Although courts typically apply that cause on a creditor's motion to dismiss, when there is no reorganization purpose to be served, it applies equally on a debtor's motion, where the debtor has the resources to pay all of its creditors outside of bankruptcy and has no need for bankruptcy protections or mechanisms. Because the foundation debtor is solvent and able to pay its debts, continuation of the chapter 11 case would serve no bankruptcy purpose, and dismissal is in the best interest of creditors. *In re Forum Health*, 444 B.R. 848 (Bankr. N.D. Ohio 2011).

4.3.b. Court dismisses chapter 11 case as not filed in good faith where case does not serve to maximize asset value. The debtor had stopped operations over six years before bankruptcy and had dissolved. It was the defendant in environmental litigation, which implicated its parent companies under an alter ego theory. A few months before trial, it filed a chapter 11 case. It had a few other, minor actions pending against it. Its principal assets were a small amount of cash, loaned from its parent, and possible insurance policy claims. A court may dismiss a chapter 11 case that is not filed in good faith. A court determines good faith based on whether the petition serves a valid bankruptcy purpose and on whether it is filed merely to gain tactical litigation advantage. A valid bankruptcy purpose includes preserving a going

concern or maximizing the estate's value. However, the analysis requires a comparison of what could be achieved without a bankruptcy or, put differently, whether value would be lost outside of bankruptcy that would not be lost in a bankruptcy case. Here, the debtor made no showing or any valid bankruptcy purpose. The debtor had stopped operations long before bankruptcy, so there was no going concern to preserve. The filing also did not provide any particular advantage in bankruptcy over what might have occurred outside bankruptcy concerning focusing of claims in a single forum (because there were few claims other than the environmental litigation of any significance), litigation of the environmental claims or insurance policy recovery. In addition, because of its proximity to the environmental litigation trial date, the filing appeared to be to gain tactical litigation advantage. Therefore, the petition was not filed in good faith and should be dismissed. *Santa Fe Minerals, Inc. v. Bepco, L.P. (In re 15375 Memorial Corp.)*, 589 F.3d 605 (3d Cir. 2009).

4.3.c. Court denies motion to dismiss chapter 11 cases filed by bankruptcy remote single purpose real estate debtors. The debtors were bankruptcy remote single purpose real estate companies that were part of a large conglomerate of real estate companies. Debt of some of the debtors was in default, though not accelerated, and was due one to three years after the petition date. However, the commercial lending markets' condition suggested that refinancing within those time periods was uncertain. The debtors' parent was in default on various credit lines, and many of their affiliates' loans were in default, in hyperamortization or due. The debtors' equity holders replaced the debtors' independent directors with new independent directors who had greater familiarity and experience with distressed real estate. The parent and nearly all of its single purpose subsidiaries filed chapter 11 petitions. The debtors' secured lenders filed motions to dismiss the debtors' cases as having been filed in bad faith, arguing that the debtors' filings had been premature. A chapter 11 case may be dismissed for bad faith if there is no reasonable probability that the debtor will be able to reorganize, and a case may be dismissed if the debtors' financial distress is speculative. Here, the debtors were in present financial distress because some of their loans were already in default, and there was a high likelihood that none could be refinanced when they became due. When viewed from a single debtor perspective, a debtor need not delay a filing until foreclosure is imminent, just as a debtor need not be insolvent to file. When viewed from the group's perspective, the financial condition of the group may be taken into account in determining whether subsidiaries may file, so that cases may address the financial affairs of the group as a whole. Reorganizing the parent entities' significant debt without dealing with all the subsidiaries' maturing debt would not have been feasible. Therefore, the group's financial predicament supported filing by the group's members, even those that were not immediately distressed. Because the creditors did not show a reasonable likelihood that the debtors did not intend to reorganize, the court denies the motion to dismiss. *In re Gen. Growth Props., Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

4.3.d. "Cause" for dismissal does not include conduct covered by another Bankruptcy Code provision. The district court had ordered the debtor to disgorge payments received from a corporation that was under an SEC receivership. Just before entry of judgment, the debtor filed bankruptcy. The SEC moved to dismiss under section 707(b) for cause, arguing that the debtor improperly used bankruptcy as a refuge from the district court, that the bankruptcy was part of a scheme to disfavor the SEC as against other creditors, and that the debtor exaggerated his financial problems by overstating liabilities and expenses. The Bankruptcy Code specifically addresses each of these kinds of conduct by narrower remedies than dismissal. This suggests that Congress intended to permit bankruptcy relief despite the specific conduct. In this case, section 362 addresses using bankruptcy as a refuge from other courts and contains several exceptions. Section 362(d)'s "cause" ground for stay relief, rather than dismissal under section 707(a), provides a more direct and tailored remedy for any illegitimate filing, such as one based on misrepresentation. Section 547 permits recovery of a preference but only to the precise extent provided by Congress, implying that other preferences are permissible and should not be disturbed. The bankruptcy court should not use dismissal as a means to expand the remedy against preferences. Section 727(a) provides a remedy against false statements on the debtor's schedule. Where these matters are covered by a specific Bankruptcy Code provision, they do not constitute "cause" for dismissal under section 707(b). *Sherman v. SEC (In re Sherman)*, 441 F.3d 794 (9th Cir. 2006).

4.3.e. "Cause" for dismissal does not include something covered by another Bankruptcy Code provision. The district court had ordered the debtor to disgorge payments received from a corporation that

was under an SEC receivership. Just before entry of judgment, the debtor filed bankruptcy. The SEC moved to dismiss under section 707(b) for cause, arguing that the debtor improperly used bankruptcy as a refuge from the district court, that the bankruptcy was part of a scheme to prefer creditors other than the SEC, and that the debtor exaggerated his financial problems by overstating liabilities and expenses. The Bankruptcy Code has remedies for each of these issues: Section 362(b)(4) excepts the SEC's enforcement powers from the automatic stay, and the bankruptcy court may grant relief under section 362(d) for unexcepted actions, so bankruptcy does not provide a total refuge from the district court action. Section 547 permits recovery of preference but only to the precise extent provided by Congress, implying that other preferences were permissible and should not be disturbed. The bankruptcy court should not use dismissal as a means to expand the remedy against preferences. Section 727(a) provides a remedy against false statements on the debtor's schedule. Where these matters are covered by a specific Bankruptcy Code provision, they do not constitute "cause" for dismissal under section 707(b). *Sherman v. SEC (In re Sherman)*, 441 F.3d 794 (9th Cir. 2006).

4.3.f. Russian oil company's chapter 11 case is dismissed under "totality of circumstances" test. Yukos Oil Co., Russia's largest oil company with very limited U.S. contacts or assets, filed a chapter 11 case in Texas to stay the Russian government's seizure of assets to pay claimed tax debts. The bankruptcy court rejects dismissal on jurisdictional grounds, holding that Yukos's U.S. property is sufficient to confer jurisdiction. It rejects dismissal on *forum non conveniens* grounds, holding that doctrine inapplicable to an entire bankruptcy case (as opposed to a proceeding within the case). It similarly concludes that comity is not a ground to dismiss an entire case and that despite the involvement of the Russian government, the act of state doctrine does not apply. However, based on the totality of the circumstances, the court dismisses under section 1112(b). The assets that created jurisdiction were transferred to the U.S. only days before the filing. The proposed reorganization is not a financial reorganization, and since most of its assets were oil and gas assets located in Russia, a reorganization without Russian government cooperation would have been futile. Yukos sought to substitute U.S. law for Russian and international arbitration laws in its dispute with the Russian government. Under the circumstances, the court dismisses the case. *In re Yukos Oil Co.*, 321 B.R. 396 (Bankr. S.D. Tex. 2005).

4.3.g. Court permits automatic chapter 13 dismissal for failure to file documents. The court has a local rule under which the clerk gives notice immediately after the date of the filing of a petition that is not accompanied by all required documents that the case will be dismissed if the documents are not filed within the 15 days permitted by Rule 1007(c), unless the debtor requests and the court grants additional time. Dismissal under this local rule is proper, because the debtor receives notice and opportunity for a hearing, and the court is authorized to act sua sponte under section 105(a). Section 1307(c) authorizes dismissal "on request of a party in interest or the United States trustee," and paragraph (9) of that section permits dismissal for failure to file documents "only on request of the United States trustee." This provision is intended to preclude parties in interest from requesting dismissal under this paragraph, not to preclude the court from acting sua sponte. *Tennant v. Rojas (In re Tennant)*, 318 B.R. 860 (B.A.P. 9th Cir. 2004).

4.3.h. Section 105 "abuse of process" dismissal is not appropriate for properly pleaded involuntary petition. A Brazilian company was undergoing an out-of-court workout in Brazil. It had minimal assets in the United States but had raised substantial capital here. A U.S. creditor who did not agree with the conduct of the out-of-court work-out process filed an involuntary petition against the company in New York. Dismissal of the case under the section 105(a) "abuse of process" provision is improper, because that provision is intended to apply to parties that willfully mislead the court, file frivolous proceedings, or fail to comply with court orders. It is not intended to apply to a petition that facially appears to state a good faith claim for relief. The court may, however, consider dismissal under section 305(a)(1) or on the ground of *forum non conveniens*, which applies to an involuntary petition against a foreign debtor. *GMAM Inv. Funds Trust I v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, 317 B.R. 235 (S.D.N.Y. 2004).

4.3.i. Partnership case filed by general partner without authority to do so must be dismissed. The general partner had been dissolved under state law for nonpayment of taxes. A new entity was formed, which purported to succeed to the first entity's rights as a general partner, but the limited partners had not

elected it as the new general partner, as required by the partnership agreement. Therefore, neither entity was authorized to act for the partnership, and the voluntary bankruptcy petition that the second entity had filed for the partnership had to be dismissed. *In re Telluride Income Growth Ltd. P'ship*, 311 B.R. 585 (Bankr. D. Colo. 2004).

4.3.j. Petition filed without valid bankruptcy purpose is dismissed for bad faith. The debtor's business had failed, leaving it only with intellectual property worth about $2 million, miscellaneous assets worth about $500,000, and cash of $105 million. The only claims were a securities class action claim that had been capped at $25 million and the landlord's uncapped lease rejection damage claim of $26 million. Although the Code permits a solvent debtor to file chapter 11, there must be a valid bankruptcy or reorganization purpose for doing so, such as to preserve going concern value or to maximize the value of the estate. Merely seeking a tactical litigation advantage or the benefit of a specific Bankruptcy Code provision, such as the lease damage cap of section 502(b)(6) or the automatic stay, does not justify a chapter 11 petition; conversely, seeking the specific benefit of such a provision does not constitute bad faith if there is a valid purpose in seeking bankruptcy relief. In this case, the business had terminated and the debtor was in dissolution proceedings under state law before it filed its chapter 11 case. Accordingly, the chapter 11 case was filed in bad faith and was dismissed. *NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (In re Integrated Telecom Express, Inc.)*, 384 F.3d 108 (3d Cir. 2004).

4.3.k. Absence of present need for bankruptcy relief requires dismissal for bad faith. The debtor was an unsuccessful technology start-up that had raised and still had substantial cash on hand. Its principal unpaid obligations were for breach of a long term lease for space it no longer needed, a substantial patent infringement claim, and securities fraud claims resulting from accounting irregularities, which were insured and about to be settled. Even if it lost on all claims and did not get the benefit of the reduction of the landlord's claim under section 502(b)(6), it would have enough cash to pay all claims and still continue operating. Although an intent to take advantage of specific Bankruptcy Code provisions, such as section 502(b)(6) or the ability to sell assets under section 363, does not imply bad faith, the debtor must have a need independent of these provisions for bankruptcy relief. Under the circumstances, the court concludes that because the debtor is neither insolvent nor illiquid, it does not have a present need for bankruptcy relief. *In re Liberate Technologies*, 314 B.R. 206 (Bankr. N.D. Cal. 2004).

4.3.l. Court refuses to dismiss foreign debtor's case. The substantial portion of the foreign debtor's assets was located in a foreign country. However, the majority of its creditors were U.S. based. One creditor moved to dismiss the case under section 305, arguing that the chapter 11 case should not proceed unless the debtor also filed a case in its own country. The majority of the foreign creditors had participated and cooperated with a chapter 11 case, and the debtor had reached agreements with many of its major U.S. creditors. Accordingly, the court denies the motion to dismiss. The court can not find that the interest of the debtor and the creditors would be better served by dismissal, as required by section 305(a)(1), because there was no showing that the debtor could have obtained jurisdiction over the non-home country creditors in a home country proceeding, and the foreign creditors cooperated in the U.S. proceeding. Dismissal was also not warranted under section 305(a)(2) (cross-referencing factors for dismissal of an ancillary proceeding under section 304), because there was no effort to use chapter 11 improperly to gain an undue advantage over foreign creditors or to take advantage of provisions of chapter 11 that differ substantially from foreign law. The court clearly had jurisdiction under section 109, because of the presence of property in the U.S. *In re Aerovias Nacionales v. Columbia S.A. Avianca*, 303 B.R. 1 (Bankr. S.D.N.Y 2003).

4.3.m. Attorney sanctioned for bad faith chapter 11 filing. Sanctions may be warranted under Rule 9011(b) in the case of a filing that is both frivolous and for an improper purpose. The more compelling the showing as to one element, the less compelling the showing as to the other needs to be. In this case, the debtor, represented by counsel, filed a chapter 11 petition two days before the state court was to set a trial date on a specific performance action against the debtor for sale of real property. The value of the property plus the debtor's other assets was more than enough to pay all claims, including the specific performance claim, and the nature of the debtor's financial condition made it impossible for the debtor to confirm a plan without the consent of the specific performance plaintiff. Therefore, the petition was filed both for an improper purpose and was frivolous, in that it would not have accomplished

any restructuring objective. Sanctions on both the debtor and his attorney were appropriate. *Dressler v. The Seeley Co. (In re Silverkraus)*, 336 F. 3d 864 (9th Cir. 2003).

4.3.n. A bankruptcy filing to take advantage of the section 502(b)(6) cap is not a bad faith filing. The bankruptcy court found that one of the principle reasons for the debtor to file its chapter 11 case was to take advantage of the cap under section 502(b)(6) on landlord damage claims. The landlord argued that such a motive constituted bad faith. The bankruptcy court concluded that, to the contrary, the debtor was using the Bankruptcy Code for exactly the purpose it was intended and that the filing was therefore not an abuse of the bankruptcy law. The court of appeals affirmed, ruling that the good faith determination is fact intensive and a case by case inquiry, that the standard for review is abuse of discretion, and that under the totality of circumstances, the bankruptcy court did not abuse its discretion. *Solow v. PPI Enterprizes (U.S.), Inc. (In re PPI Enterprizes (U.S.), Inc.)*, 324 F.3d 197 (3d Cir. 2003).

4.3.o. Chapter 11 case may be dismissed for bad faith, even if there is a confirmable plan. The debtor had generally regained financial health and worked out a restructuring agreement with its lender when minority shareholders brought a derivative action against the corporation and its directors and officers. The debtor filed chapter 11 and proposed a reorganization plan. Following the lead of the Third Circuit in *In re SGL Carbon Corp.*, 200 F.3d 154 (3d Cir. 1999), the Eighth Circuit rules that chapter 11 contains an implicit good faith filing requirement, that the filing primarily to stay litigation constitutes a bad faith filing, and that the case may be dismissed for bad faith, even if the debtor has proposed a confirmable reorganization plan. *Cedar Shore Resort, Inc. v. Mueller (In re Cedar Shore Resort, Inc.)*, 235 F.3d 375 (8th Cir. 2000).

4.3.p. Failure to pursue divorce proceeding may constitute bad faith in a bankruptcy filing. The debtor's wife had instituted divorce proceedings seven years before bankruptcy, but the proceedings were never pursued. The debtor went jobless for several years and incurred substantial credit card debt. Once the debtor found work, he filed bankruptcy. Had he concluded his divorce proceedings, his substantial equity interest in the family home, which he held in tenancy by the entirety with his estranged wife, would have been available for creditors. The failure to do so rendered the bankruptcy petition a bad faith filing, which provided cause for dismissal under section 707(a). *Tamecki v. Frank (In re Tamecki)*, 229 F.3d 205 (3d Cir. 2000).

4.3.q. Chapter 11 case dismissed on good faith ground where company was financially healthy. The debtor filed chapter 11 because of pending antitrust litigation that threatened substantial liability but that would not likely have rendered the company insolvent. It filed early in the antitrust litigation, before a threat of liability was imminent. On these facts, the Third Circuit rules that a chapter 11 filing requires good faith, including a valid reorganization purpose, and dismisses the case on the grounds that the debtor was financially healthy and was primarily seeking to gain a negotiating advantage in the non-bankruptcy litigation. *In re SGL Carbon Corp.*, 200 F. 3d 154 (3d Cir. 1999).

4.3.r. Dismissal with prejudice may bar subsequent filings. The debtors' third chapter 11 case, intended to stay foreclosure on their residence, was dismissed "with prejudice." When they subsequently filed a chapter 13 case on the eve of the next scheduled foreclosure sale, the creditor went forward with the sale anyway. The bankruptcy court dismissed the chapter 13 case *nunc pro tunc* to the filing date and validated the foreclosure sale. The Second Circuit affirms the bankruptcy court's authority to do so and to impose a dismissal with prejudice that prevents filing for longer than the 180-day period specified in section 109(g). *Casse v. Key Bank N.A. (In re Casse)*, 198 F.3d 327 (2d Cir. 1999).

4.3.s. Chapter 11 filing in response to litigation is not in bad faith. The debtor was the defendant in major antitrust litigation. Although the case had not yet begun trial, the debtor risked substantial liability. It filed chapter 11 as a protective measure, at least in part because of the current financial troubles (short of insolvency) that the litigation was causing. The court held that the filing was not in bad faith and denied a motion to dismiss for cause. *In re S.G.L. Carbon Corp.*, 223 B.R. 285 (D. Del. 1999).

4.3.t. Section 707(b) is constitutional. Section 707(b), which permits a bankruptcy court to dismiss a case involving primarily consumer debts for substantial abuse is constitutional, despite a challenge under

the equal protection clause that a similar standard does not apply to business debtors. The court also adopts the "totality of the circumstances" test in applying the substantial abuse standard. *Stewart v. United States Trustee (In re Stewart)*, 175 F.3d 796 (10th Cir. 1999).

4.3.u. First Circuit adopts "totality of circumstances" test for substantial abuse analysis. Following the lead of the Fourth and Sixth Circuits, the first circuit adopts the "totality of circumstances" test, rejecting *per se* rules based on ability to repay and focusing on equitable discretion, the purpose of section 707(b) to guide, not constrain, and "the open-textured nature of section 707(b)." *First U.S.A. v Lamanna (In re Lamanna)*, 153 F.3d 1 (1st Cir. 1998).

4.3.v. Filing bankruptcy with too much debt may constitute "substantial abuse." With an annual gross income of $50,000, the debtors ran up $336,000 in credit card debt. Annual interest was accruing at $67,000 per year, and over $225,000 of the combined balances was accrued interest. The debtors had taken cash advances from some cards to pay minimum monthly payments on others in order to maintain a good credit rating. As a result, they owed money on 59 credit cards, six of which were issued by one bank and seven by another. The debtors had not lived extravagantly, had no medical bills, and did not have any gambling or substance abuse problems. Nevertheless, the filing of the case was a substantial abuse, and the case was dismissed. *In re Wolniewicz*, 224 B.R. 302 (Bankr. W.D.N.Y. 1998).

4.3.w. Run up in credit card debts does not give grounds for bad faith or substantial abuse dismissal. Where the debtors comply with all of the requirements of the Bankruptcy Code, a run up of credit card debts before a bankruptcy does not constitute bad faith. When the debtor does not have the ability to repay, dismissal for substantial abuse would amount to a denial of discharge or a dismissal with prejudice, which is not warranted in the absence of the grounds specified under section 727. However, a substantial abuse dismissal may be warranted when (1) the overwhelming percentage of the debtor's unsecured debt is due to credit cards; (2) the debtor has used so many cards that it would multiply the work load of the court to adjudicate non-dischargeability action separately; (3) there is no economic incentive to individual creditors to bring non-dischargeability actions; (4) the credit card debt was used for luxury, goods, high lifestyle or other improper purposes; and (5) the debtor has failed to make an honest effort to repay the obligations. *In re Motaharnia*, 215 B.R. 63 (Bankr. C.D. Cal. 1997).

4.3.x. Pre-petition bankruptcy waiver not enforced. The debtor and the secured creditor entered into a forbearance agreement before bankruptcy, which provided that breach of the forbearance agreement would constitute bad faith giving rise to grounds for dismissal of a chapter 11 case. The bankruptcy court holds that pre-petition waivers are not invalid per se, but will not be enforced if they adversely affect other creditors. *In re Southeast Financial Associates, Inc.*, 212 B.R. 1003 (Bankr. N.D. Fla. 1997).

4.3.y. Bankruptcy remote provisions questioned. In the face of bankruptcy remote provisions that required unanimous board consent for the authorization of a bankruptcy and placed on the board an "independent" director designated by the lender, the debtor's management "orchestrated" the filing of an involuntary petition. Faced with strong evidence of nonfeasance (and possibly worse) by the independent director, and recognizing the duty of the board to the debtor, not to the lender, the court denied a motion to dismiss on grounds of collusion. The court questioned but did not rule on the efficacy of the bankruptcy remote provisions. However, because the directors' conduct indicated that they had abdicated their fiduciary responsibilities, the court ordered the appointment of a chapter 11 trustee. *In re Kingston Square Associates*, 214 B.R. 713 (S.D.N.Y. 1997).

4.3.z. Standing order of dismissal of chapter 7 cases vacated. The Bankruptcy Court for the Middle District of Pennsylvania and the United States Trustee for that district developed a "standing motion" under which the United States Trustee moved for dismissal of any case in which the required schedules and statements were not timely filed. The Bankruptcy Court responded with a "standing order" that dismissed such cases if the defect was not cured shortly after notice by the clerk. On a motion brought by individual debtors to vacate the standing order, the court held that the "standing" procedure violated section 707(a) and Bankruptcy Rule 2002(a)(5) and nullified the standing order. *In re General Order Governing Dismissal of Cases*, 210 B.R. 941 (Bankr. N.D. Pa. 1997).

4.3.aa. Ex parte chapter 7 dismissal procedure disapproved. In a chapter 7 case, the initial notice stated "failure by the debtor to appear at the 341 meeting shall result in the dismissal of the case upon ex parte order." On an appeal from such a dismissal, the Second Circuit B.A.P. rules that the notice is inadequate under section 707(a), which permits dismiss only "after notice and a hearing." The B.A.P. also castigates the trustee for presenting the ex parte dismissal motion to the bankruptcy court without a full explanation of the unique circumstances of the case, which the B.A.P. felt underscored the need for a hearing in any dismissal proceeding. *Dinova v. Harris (In re Dinova)*, 212 B.R. 437 (2d Cir. B.A.P. 1997).

4.3.bb. Dismissal for bad faith not a substitute for dischargeability complaint. The Debtor incurred gambling losses financed by credit cards and filed a chapter 7 petition. The debtor acted honestly with full disclosure in the chapter 7. Nevertheless, the bankruptcy court dismissed for lack of good faith. The B.A.P. reversed, holding that the dismissal was not a substitute for a dischargeability complaint under Section 523. *Padilla v. U.S. Trustee (In re Padilla)*, 214 B.R. 496 (9th Cir. B.A.P. 1997).

5. CHAPTER 11 PLANS

5.1 Officers and Administration

5.1.a. The trustee succeeds to the debtor in possession's status in an adversary proceeding. The debtor in possession sued the bank to avoid a judicial lien under section 547. The court dismissed the adversary proceeding under Rule 12(b)(6) with leave to amend, and then finally dismissed it after the debtor in possession failed to file an amended complaint. The case converted to chapter 7, and the trustee brought the same action against the bank. Res judicata applies when the court in the prior action had jurisdiction, there was a final judgment on the merits and both cases involve the same claim and the same parties or their privies. The bankruptcy court here had jurisdiction over the claim, the dismissal was a final judgment, and the trustee brought the same claim that the debtor in possession had brought. A party is in privity with another party if the party succeeds to the other party's interest in property or is controlled by the other party or if the party's interest was adequately represented by the other party. The debtor in possession acts as representative of the estate. Upon appointment, the trustee succeeds to the debtor in possession as representative of the estate and therefore is the successor in interest to the debtor in possession. As such, the trustee is bound by all of the debtor in possession's authorized acts. Accordingly, res judicata bars the trustee's action here. *Drake v. Sea Island Bank (In re Collins)*, 489 B.R. 917 (Bankr. S.D. Ga. 2012).

5.1.b. 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.*, 484 B.R. 427 (Bankr. N.D. Ala. 2012).

5.1.c. Employees who are not appointed to their positions by the board are not officer-insiders. The debtor in possession airline proposed to implement a key employee retention plan for its director of flight safety, vice president-flight operations, chief pilot, senior director of maintenance and director-quality assurance and projects. None of the individuals sat on the board of directors or even attended board meetings. None were elected to their positions by the board. Each reported to a senior officer, such as the chief operating officer or a vice president. Section 503(c) imposes strict limits on implementing such a plan for an "insider". Under section 101(31)(B), insider includes director, officer or person in control. Neither the director nor vice president title determines whether a person is a director or officer. A

"director" is one who sits on the board of directors. An "officer" is one elected or appointed by the board to manage the corporation's affairs. None of these employees meets these requirements. Therefore, they are not insiders, and section 503(c) does not limit a retention plan. *In re Global Aviation Holdings Inc.*, 478 B.R. 142 (Bankr. E.D.N.Y. 2012).

5.1.d. Cash collateral order expires upon case dismissal. With the court's approval in periodic orders, the secured creditor and the real estate debtor in possession agreed that rents and other proceeds were cash collateral and could be used for certain property maintenance and related expenses. Before the last order expired, the court dismissed the case. Promptly after dismissal, the debtor transferred cash to third parties who had guaranteed the loan from the secured creditor. The creditor sought a temporary restraining order in district court against dissipation of the funds, on the grounds that they remained cash collateral even after dismissal of the chapter 11 case. Section 363(a) defines "cash collateral" as "cash … in which the estate and an entity other than the estate have an interest." Section 363(c)(2) prohibits a trustee's or debtor in possession's use of cash collateral without the other entity's consent or a court order. The statutory language negates any reading that the restrictions survive dismissal, because there is no longer an estate that could have an interest in the cash, nor a trustee or debtor in possession. In addition, a cash collateral order does not determine any rights; it operates only as an interim regulatory measure during the case, similar to a preliminary injunction. Therefore, section 363's restrictions do not survive dismissal. *Jefferson-Pilot Invs., Inc. v. Cap. First Realty, Inc.*, 2012 U.S. Dist. LEXIS 73942 (N.D. Ill. May 29, 2012).

5.1.e. One case in an administratively consolidated group of cases may be a single asset real estate case. The debtor was one of 53 single asset real estate debtors owned by a single parent debtor. They shared administrative services and cash management and operated as a consolidated enterprise. In the absence of substantive consolidation, the Code treats each corporate entity separately, even though the entities may be part of a consolidated enterprise. The definition of "single asset real estate debtor" does not contain any exceptions for such a debtor that is part of a consolidated enterprise. Therefore, the single asset real estate rules apply to each debtor in the corporate group. *Meruelo Maddux Props.-760 S. Hill St. v. Bank of Am. N.A. (In re Meruelo Maddux Props., Inc.)*, 667 F.3d 1072 (9th Cir. 2012).

5.1.f. Dissolved liquidating debtor does not have right to unclaimed funds deposited into court registry. The debtor confirmed a plan that provided for all of its assets to be vested in a liquidating trust, which would collect and liquidate the assets and make distributions to creditors. The plan provided that the debtor and its shareholder would not receive or retain any property under the plan. The debtor was administratively dissolved under state law. After the trust completed the liquidation and distribution, it remitted unclaimed distributions to the court registry. The debtor's last officer assigned any rights the debtor had in any estate funds to a "fund locator", who would pursue the funds and share a portion with the officer. Section 347(b) provides that any unclaimed funds under a plan distribution "becomes the property of the debtor or of the entity acquiring the assets of the debtor under the plan, as the case may be." Under state law, a dissolved corporation is not authorized to make assignments as attempted in this case. The debtor did not continue to exist for purposes of section 347(b), and the plan provided for disposition of the funds in a manner that excluded the debtor and its shareholders. Therefore, the funds will be treated the same as unclaimed funds in a chapter 7 case and will remain in the court registry until claimed by creditors entitled to receive them. *In re A.G.A. Flowers, Inc.*, 457 B.R. 884 (Bankr. S.D. Fla. 2011).

5.1.g. Segregated cash deposit offered by the debtor in possession provides adequate assurance for utility service. The debtor in possession filed a first day motion to determine adequate assurance for its utilities. It proposed a segregated, interest-bearing bank deposit of two weeks' service charges. Section 366(c)(2) permits a utility to alter or discontinue service if, during the 30-day period after the petition date, the utility does not receive from the debtor in possession "adequate assurance of payment for utility service that is satisfactory to the utility." Section 366(c)(3)(A) permits the court, on request of a party in interest, to modify the assurance amount. Section 366(c)(2) does not contemplate that only the utility may set the form and manner of assurance. The debtor in possession may propose the assurance. If the utility is not satisfied, either party (the utility or the debtor in possession) may request modification. Otherwise, the debtor in possession could lose service by the utility's inaction, and the court's ability to set the assurance form and amount would be limited. Section 366(c)(3)(B) requires that

the assurance be in the form of a cash deposit, a letter of credit, a certificate of deposit or prepayment. The escrow deposit here meets that requirement. It is similar to a letter of credit, without the fees. *Long Isl. Lighting Co. v. The Great Atl. & Pac. Tea Co., Inc. (In re The Great Atl. & Pac. Tea Co., Inc.)*, 2011 U.S. Dist. LEXIS 131621 (S.D.N.Y. Nov. 14, 2011).

5.1.h. A beneficial owner of certificates in an investment trust that holds claims against the debtor is not a party in interest. A REMIC trust held a note secured by a mortgage on the debtor's real estate. The REMIC issued certificates of beneficial interest to investors. The trust agreement provides for a servicer of the trust's assets to administer the assets and exercise remedies for the trust. The agreement prohibits a certificate holder from instituting any suit, action or proceeding to enforce any of the assets of the trust without compliance with specified procedures. Section 1109(b) permits a party in interest, including a creditor, to appear and be heard on any issue in a chapter 11 case. As the holder of the note and mortgage, the trust is the creditor, and the servicer is the sole person authorized to enforce remedies on the trust's behalf. A certificate holder is only an investor in a creditor and thus is not a party in interest in the chapter 11 case, even though its interest is a beneficial interest in the trust's assets. Therefore, the certificate holder does not have standing in its capacity as such to appear and be heard in the case. *In re Innkeepers USA Trust*, 448 B.R. 131 (Bankr. S.D.N.Y. 2011).

5.1.i. Bankruptcy court may modify a utility's demand for adequate assurance before the debtor in possession complies with the demand; a segregated cash account is adequate. The debtor in possession, with the bankruptcy court's approval, established a segregated cash account to provide adequate assurance to utilities. The court's order established a procedure for utilities to request more assurance. They could submit a written request to the DIP, and if the DIP did not agree, the DIP would have to seek a court determination of adequate assurance. One utility requested an additional direct deposit from the DIP, which the DIP refused, but it increased the segregated cash account to the full amount the utility had requested. Section 366(c) permits a utility to discontinue service if it does not receive from the debtor in possession, within 30 days after the order for relief, "adequate assurance of payment … satisfactory to the utility" and permits the court to modify the amount of the assurance. Adequate assurance must take the form of a cash deposit, letter of credit, certificate of deposit, surety bond, prepayment or other form agreed by the utility. The establishment of a segregated account under the DIP's control complies with these provisions. They require that the utility "receive" adequate assurance, not the cash itself. The court may modify and thereby establish the amount of assurance before the DIP provides it to prevent a stubborn utility from making demands that are impossible to satisfy. *In re Crystal Cathedral Ministries*, 454 B.R. 124 (C.D. Cal. 2011).

5.1.j. Receipts from a miniature golf course are not cash collateral. The debtor operated a miniature golf course. Patrons paid for admission in cash at the entrance. Payment entitled them only to a license to use the course. The debtor's lender had a perfected security interest in all the debtor's assets, including the course, the putters and golf balls, accounts and general intangibles. The lender had possession of none of the collateral at the petition date. Section 363(a) defines "cash collateral" as cash or cash equivalents in which the estate and another entity have an interest. Under the U.C.C., "general intangibles" includes money, but a lender perfects a security interest in money only by possession. An "account" is a "right to payment of a monetary obligation, whether or not earned by performance". Cash on hand or cash received upon provision of a good or service is not an "account", as it is not a "right to payment"; it is payment already received. "Proceeds" is whatever is acquired upon sale, lease, license or exchange or other disposition of collateral" and "whatever is collected on, or distributed on account of, collateral". Section 552(a) prevents a prepetition security interest from attaching to assets that are acquired postpetition unless the postpetition assets are proceeds of prepetition collateral. Because the lender did not have a perfected interest in the petition date cash on hand, and the postpetition customer fees were not proceeds of prepetition collateral, the lender did not have an interest in the cash, and the debtor's cash was not "cash collateral". *In re Wright Group, Inc.*, 443 B.R. 795 (Bankr. N.D. Ind. 2011).

5.1.k. "Insider" does not include "director" level employees. The debtor in possession proposed a key employee retention plan for "director" level employees. Section 503(c) limits such plans for insiders. Section 101 defines insider as a "director", "officer" or "person in control of the debtor". "Director" means member of the board of directors. "Officer" is one who has been elected by the board of directors and exercises executive authority. Title is not determinative, but authority and responsibility are. The court must

examine the totality of the circumstances to determine whether the individual has a controlling interest in the debtor or the authority to dictate corporate policy or asset disposition. "Director" level employees here were employees without such authority. They report to corporate officers, not to the board, they are responsible only for running day-to-day operations, and they do not have decision-making authority akin to an executive. Therefore, they are not insiders. *In re Borders Group, Inc.*, 453 B.R. 459 (Bankr. S.D.N.Y. 2011).

5.1.l. Court may not grant a priming lien to provide adequate protection for the use of cash collateral. When the debtor, a resort developer, filed bankruptcy, it held cash that was subject to its lenders' lien and an uncompleted project that was subject to the lenders' and mechanics liens. The lenders and the mechanics lienors disputed the priority of their liens on the project. The court authorized the debtor in possession to use the cash collateral to stabilize and maintain the project and to pay the chapter 11 expenses of administration, including the cost of an examiner. The authorizing order deemed that the debtor in possession repaid the cash to the lenders and reborrowed it from them under section 364(d), granted the lenders a priming lien on the project, ahead of the mechanics liens, and required that any third party debtor in possession financing proceeds be used first to repay the lenders the amount of cash collateral that the debtor in possession used. Although the court found that the cash collateral use was necessary to the chapter 11 case, it did not find that the use would protect the value of the mechanics lienors' interest in the project if it were later determined that their lien was senior to the lenders' lien. Later, the debtor in possession obtained such third party financing from a good faith lender and used the proceeds to pay the lenders as the original cash collateral order required and for other purposes. Section 363(c) authorizes a debtor in possession to use cash collateral if the interest of the lienor is adequately protected. Section 364(d) authorizes a debtor in possession to borrow and to grant the lender a priming lien, as long as the interest of the existing lender is adequately protected. Section 363(c) does not authorize the grant of a priming lien to provide adequate protection of the cash lienor. The order deeming the cash collateral repaid and reborrowed was a legal fiction that the Code does not authorize. Therefore, the priming lien to provide adequate protection of the lenders' interest was not authorized. *Desert Fire Protection v. Fontainebleau Las Vegas Holdings, LLC (In re Fontainebleau Las Vegas Holdings, LLC)*, 434 B.R. 716 (S.D. Fla. 2010).

5.1.m. 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.n. 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).

5.1.o. Committee may not recover DIP loan commitment fee after debtor in possession determines to proceed with loan. The debtor in possession agreed with its prepetition secured lender on use of cash collateral for two weeks. During the two weeks, it sought debtor in possession financing but was able to reach an agreement only with its prepetition lender. The agreement provided for a significant commitment fee, to which the creditors committee objected. The lender made clear in court that it would not proceed with the financing without approval of the commitment fee, because the lender was required to set aside capital once the financing was approved. The court approved the financing, including the commitment fee, on an interim basis and set the matter for final hearing. One day before the final hearing, the debtor in possession determined that it could survive on use of cash collateral and did not need the new financing. It withdrew the motion for approval of the financing. Later, the committee obtained authority to pursue estate causes of action and sought recovery of the commitment fee. Section 364(c)(1) authorizes incurring of debt "with priority over any or all administrative expenses". Such a debt differs from an administrative expense. Priority under this provision therefore does not require compliance with the requirements for allowance of administrative expenses under section 503(b)(1), such as benefit to the estate. Section 364(e) provides that reversal or modification on appeal of an order approving a financing does not affect the validity of "any debt so incurred, or the priority of any lien so granted". Although section 364(e) applies only on an appeal, its policy applies equally to a motion to modify the financing order. Section 364(e) would offer illusory protection if the estate could evade its protections by seeking modification of an order at the trial court, rather than on appeal. Rule 60(b)(6) permits modification of an order on any equitable ground. It should be used only sparingly, to prevent manifest injustice. Therefore, Rule 60(b)(6) does not provide grounds for modification of the order or recovery of the commitment fee. *In re Fleetwood Enterps., Inc.*, 427 B.R. 852 (Bankr. C.D. Cal. 2010).

5.1.p. 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 pre-dated 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).

5.1.q. Court may determine utility adequate assurance terms before payment. Before bankruptcy, the debtor had not paid its utility charges. The utility sought a deposit from the debtor-in-possession of two months' charges as adequate assurance. Before making the deposit, the debtor-in-possession asked the court to modify the required deposit. "Subject to paragraphs (3) and (4)", section 366(c)(2) permits a utility to discontinue service, if, within 30 days after the petition date, it does not receive from the chapter 11 trustee or debtor-in-possession a cash deposit as "adequate assurance of future payment for utility service that is satisfactory to the utility." Paragraph (3) permits the court to "order modification of the amount of an assurance payment under paragraph (2)." Because the utility's right to discontinue service is "subject to paragraph[] (3)", it is therefore subject to the court's power to modify. In addition, the "assurance payment" to which paragraph (3) refers is a payment "that is satisfactory to the utility", not an amount "that is paid". Thus, the court may modify the adequate assurance amount before payment. The court refuses to follow *In re Lucre*, 333 B.R. 151 (Bankr. W.D. Mich. 2005), and notes the other cases that have also rejected *Lucre*. *In re Bedford Town Condominium*, 427 B.R. 380 (Bankr. D. Md. 2010).

5.1.r. Court enforces intercreditor agreement that silences second lien holders. The debtor had issued both first lien and second lien debt, secured by all of its assets, although the lenders were unable by reason of federal communications law to perfect a security interest in the debtor guarantor subsidiaries' FCC broadcasting licenses. The lenders had a perfected lien in the stock of those subsidiaries. Under an intercreditor agreement, the second lien debt holders acknowledged the first lien debt's priority and that it would not be impaired by "any nonperfection of any lien purportedly securing" any of the first lien debt. The agreement also prohibited any second lien debt holder from objecting to any postpetition financing or any plan the terms of which are consistent with the first lien holders' rights unless the first lien lenders were paid in full. The first lien debt totaled $850 million; the debtor's value did not exceed $450 million. The debtor proposed a chapter 11 plan that provided for distribution of substantially all its value to the holders of the first lien debt. A second lien holder objected on the ground that the FCC licenses were unencumbered and their value should be available for distribution to holders of unsecured claims. Section 510(a) requires a bankruptcy court to enforce a subordination agreement. Although bankruptcy policy liberally permits parties to appear and be heard in a chapter 11 case, a party may waive its right to do so under such an agreement. Some courts have refused to enforce such a waiver where it involves the right to vote on a plan. The intercreditor agreement here applies to collateral whether or not the first lien holders have perfected their lien on it. It does not infringe on the second lien holders' right to vote. Therefore, it is enforceable under section 510(a), and the second lien holders do not have standing to object to the plan. *Ion Media Networks, Inc. v. Cyrus Select Opportunities Master Fund, Ltd. (In re Ion Media Networks, Inc.)*, 419 B.R. 585 (Bankr. S.D.N.Y. 2009).

5.1.s. Debtor in possession is not bound to seek court approval of an agreement that commits it to do so. The debtor in possession entered into an asset purchase agreement (APA) with a buyer that required the DIP to obtain approval of bidding procedures, including a structured auction process, and buyer protections, including a break-up fee, but the APA was not binding on the buyer pending its completion and approval of due diligence. The due diligence deadline expired after the court approved the bidding procedures and break-up fee. The DIP and the buyer later agreed to extend the deadline. Before the extended deadline expired, another buyer offered a higher price for the assets, but the original buyer completed and approved the due diligence before the extended deadline expired. A DIP's agreement that is subject to court approval is not binding on the DIP until court approval, and the DIP may walk away from the agreement while it seeks court approval until the court approves it. The court should not approve the agreement if there is a better offer. The court here construes the original agreement as having expired when the buyer did not approve due diligence by the date in the original agreement that was before the court when it approved the bidding procedures and construes the agreement with the extended deadline agreement as a new agreement. The DIP was not bound by the new agreement and properly conducted the informal auction that resulted in the higher bid and a new assets purchase agreement. The court approves the buyer protections for the new buyer and permits the DIP to withdraw the motion to approve the buyer protections for the original buyer. *In re Metaldyne Corp.*, 409 B.R. 661 (Bankr. S.D.N.Y. 2009).

5.1.t. Receiver may become the debtor in possession. The debtor ran a Ponzi scheme. Its principals were indicted, convicted and jailed. The United States obtained forfeiture orders that resulted in seizure of all the debtor's assets other than litigation claims. Some unpaid creditors brought an action in federal district court against the debtor and sought the appointment of a receiver under section 10(b) of the Securities Exchange Act of 1934 and under state law. The district court appointed an individual to act as receiver and vested him "with the sole and exclusive power and authority to manage and direct the business and financial affairs of the [debtor], including without limitation, the authority to petition for protection under the Bankruptcy Code". The receiver filed a chapter 11 petition for the debtor. The U.S. trustee moved for the appointment of a trustee, arguing that the receiver was a "custodian" that must turn over property under section 543 and was therefore disqualified from acting as the debtor in possession's management (though not as a trustee if the U.S. trustee appointed him). The standard for appointment of a chapter 11 trustee is very high and requires a showing by clear and convincing evidence. The receiver here was given all corporate governance power and authority and therefore functioned as management of the corporate debtor in possession. His receiver role (a "custodian" under section 543) was not exclusive; the district court could combine the receivership and corporate governance roles in the same individual so that he could serve as debtor in possession after a chapter 11 filing. *Adams v. Marwil (In re Bayou Group L.L.C.)*, 564 F.3d 541 (2d Cir. 2009).

5.1.u. Prepetition receiver may serve as chapter 11 trustee. The individual shareholder owned and operated two investment companies, one apparently legitimate and one apparently fraudulent. On the U.S. Attorney's allegation of criminal securities fraud, the district court appointed a receiver for the debtor and all its assets and gave the receiver full management control of the companies, to the exclusion of the individual shareholder, and authorized the receiver to file bankruptcy petitions for the two companies. The receivership order also ordered the receiver to "coordinate with representatives of the United States Attorney's office and Court personnel as needed to ensure that any assets subject to the terms of this Order are available for criminal restitution, forfeiture, or other legal remedies in proceedings commenced by or on behalf of the United States". After the receiver filed chapter 11 cases for both companies, the shareholder was arrested and incarcerated, and the U.S. Trustee moved for the appointment of a trustee, on the grounds that the debtors were without any management. The court granted the motion, and the U.S. Trustee appointed the receiver as trustee for both companies, in part because of the receiver's already deep knowledge of the companies. A creditor of the apparently legitimate business asserted that the receiver had two conflicts: an "external" conflict because of his duties under the receivership order and an "internal" conflict because of the differing interests of the creditors and victims of the apparently illegitimate company and the creditors of the apparently legitimate company. Section 101(14)(C) requires that the trustee not "have" an interest materially adverse to the estate. In contrast, section 327(a) bars employment of an attorney who "holds or represents" an interest adverse to the estate. Section 101(14)(C), therefore, focuses on the trustee's personal interests, not his representations. Here, the only possible adversity was in the receiver's representative capacity, not his personal capacity. In addition, the receiver, as trustee, pledged to the court to resist criminal seizure of the debtors' assets, and the court determined that the "cooperation" provision of the receivership order did not require otherwise. Therefore, the trustee, as receiver, did not have a disqualifying interest. Rule 2009 permits a single trustee for multiple estates unless a creditor shows "that creditors … of the different estates will be prejudiced by conflicts of interest". This provision requires an actual, not merely a potential conflict. Here, though a conflict might develop once the trustee completes his investigation of the fraud and collects assets, at this early stage of the case, involving only investigation and collection, not allocation or distribution, the conflict is only potential and therefore there is no showing of prejudice to creditors. This preliminary ruling will not, however, be binding in the future if an actual conflict and actual prejudice arise. Therefore, the receiver may serve as chapter 11 trustee for both estates. *In re Petters Co., Inc.*, 401 B.R. 391 (Bankr. D. Minn. 2009), *aff'd sub nom. Ritchie Specl. Credit Invs., Ltd. v. U.S. Trustee*, 415 B.R. 391 (D. Minn. 2009).

5.1.v. Court may enjoin enforcement action against foreign guarantor parent. The debtors' foreign parent corporation had guaranteed both the debtors' subordinated unsecured bonds and some operational liabilities. The parent had numerous indirect non-U.S. subsidiaries that were not financially distressed and had not filed insolvency proceedings in the U.S. or abroad. However, the parent's only material assets were the subsidiaries' stock and intercompany claims arising from the parent's downstreaming of bond proceeds to the subsidiaries. Insolvency proceedings for the parent would likely result in liquidation and forcing the non-U.S. subsidiaries into their own insolvency proceedings, resulting in substantial loss of value to the debtors, because the affiliates operate as an integrated, global enterprise, and would also default the debtor in possession loan. The debtors in possession sought to enjoin guarantee enforcement about 30 days after the petition date. The court has jurisdiction over proceedings arising under title 11 or arising in or related to a case under title 11. The proceeding arises under title 11 because the debtors seek the injunction under section 105(a) and arises in the case because it addresses the debtors' ability to reorganize and their estates' value. The court may issue the injunction if there is a likelihood of reorganization, there is a threat of imminent harm to the estate, the balance of harms tips in favor of the moving party and the public interest weighs in favor of an injunction. Likelihood of success requires only a reasonable likelihood and does not require a showing of likely payment of unsecured claims in full. Irreparable harm includes burdening, delaying or impeding the reorganization case, and the court may enjoin where necessary to preserve or protect the estate or reorganization prospects. The movant need not show an actual threat where the harm would be grievous. The devastating damage to reorganization prospects from insolvency proceedings to the non-U.S. affiliates suffices. The balance of harms tips in favor of the estates because of the likely inability of the guaranteed creditors to collect anything on their guarantees even if the court did not issue the injunction. Finally, there is a public interest in generally protecting guarantee enforceability, but it is not without exception. Imposing the injunction for only a short period to allow the parent to obtain its own direct protection, either by insolvency proceedings or an out-of-court workout, does not contravene the public

interest in protecting guarantees in general. Therefore, the court enjoins enforcement for 60 days, subject to certain limitations and protections unique to particular creditors. *Lyondell Chemical Co. v. Centerpoint Energy Gas Servs. Inc. (In re Lyondell Chem. Co.)*, 402 B.R. 571 (Bankr. S.D.N.Y. 2009).

5.1.w. Court approves non-competition payments to former insiders. Shortly after the debtor filed its chapter 11 case, it accepted the resignations of its CEO and COO. It also agreed to enter into consulting agreements with them for four months and three months, respectively, at their prior salaries. The debtor in possession did not expect them to perform any consulting services. Rather, the agreements were designed to prevent the former officers from stealing the debtor's customers, which the former officers were legally and practicably able to do. The debtor in possession sought court approval of the agreements. Section 503(c)(1) restricts payments "for the purpose of inducing such person to remain with the debtor's business". These payments do not qualify, as they are intended only to prevent the former officers from competing. Section 503(c)(2) restricts severance payments. These payments are not severance payments, as the former officers had already received severance, although the court must be vigilant to ensure that severance payments are not disguised in non-compete payments. Section 503(c)(3) requires the court to determine that transfers or obligations outside the ordinary course of business are "justified by the facts and circumstances of the case". The provision is unclear on whether it applies only to transfers to insiders, but this case does not present that issue. It requires the court to do more than evaluate whether the debtor in possession articulates a good business reason, as under section 363(b). The court must determine on its own that the transaction is justified, especially where the transaction is with an insider or former insider. These agreements meet the test, because of the substantial risk that the former officers could lure away the debtors in possession's customers, which would damage the debtor's business substantially. *In re Pilgrim's Pride Corp.*, 401 B.R. 229 (Bankr. S.D. Tex. 2009).

5.1.x. Court avoids constitutional issue of involuntary servitude in an individual chapter 11 case in which a trustee is serving. An individual filed a chapter 11 case. The court appointed a trustee. The debtor filed a plan, which drew numerous objections. The debtor then moved to convert the case to chapter 7 under section 1112. Section 1112 gives a chapter 11 debtor the absolute right to convert a case to chapter 7 if the debtor remains in possession. If a trustee has been appointed, the court may convert only if conversion is in the best interest of creditors. Section 1115, added by the 2005 Amendments, makes an individual debtor's postpetition earnings property of the estate. Therefore, conversion is not in the interests of creditors, who would benefit from the debtor's postpetition earnings during the five-year life of the plan if the case is not converted. The Thirteenth Amendment prohibits involuntary servitude, which includes requiring an individual to work for his creditors. Chapter 13, which has an analogous provision to section 1115, provides escape valves for a debtor that does not wish to continue devoting future income to his creditors. Once a chapter 11 trustee has been appointed, chapter 11 has no similar escape valve. To avoid the constitutional question of whether chapter 11 might thus impose involuntary servitude, the court terminates the trustee's appointment under section 1105, permitting the debtor to exercise the right to convert the case to chapter 7. *In re Clemente*, 2009 Bankr. LEXIS 1460 (Bankr. D.N.J. June 9, 2009).

5.1.y. A corporation with publicly traded securities need not disclose bankruptcy planning. The debtor had substantial debt. It had made clear disclosure to the market of its precarious financial condition, and several analysts predicted that it might file bankruptcy. It began bankruptcy planning in connection with a sale of major assets but also considered other alternatives to resolve its financial problems. While in sale negotiations and while planning and preparing a bankruptcy filing, the debtor issued press releases on separate topics reporting various material events in the operation of its business, which were true in and of themselves and were generally positive. After it reached agreement with the asset buyer, its board authorized the debtor to file bankruptcy, which it did the next day. Its stock price dropped significantly. Stockholders brought a class action against the CEO for securities fraud, alleging that the public statements were misleading in the absence of disclosure that the debtor was also preparing a bankruptcy filing. Liability for nondisclosure attaches only if public statements were misleading without the additional disclosure. Because of the public information and analysis about the debtor's distressed financial condition, the nondisclosure of actual bankruptcy planning was not misleading. What's more, a requirement that a company undergoing bankruptcy planning disclosure that fact would put an unacceptable burden on a company and its officers, likely result in a self-fulfilling prophesy and pose challenges in determining when in the planning process disclosure would be required. Therefore, the public statements were not misleading by reason of the

absence of bankruptcy planning disclosure. *Belenson v. Schwartz*, case no. 03-CV-6051 (S.D.N.Y. Feb. 24, 2009).

5.1.z. Court may order transfer to court registry of chapter 11 plan unclaimed funds. Section 347(a) permits unclaimed funds in a chapter 7, 12 or 13 case to paid into the court's registry, but section 347(b) requires that unclaimed funds under a chapter 11 plan be paid to the debtor or to the entity acquiring the debtor's assets under the plan. The chapter 11 plan for a Ponzi scheme debtor provided for a liquidating trust to acquire the debtor's assets and for the debtor to dissolve. At the end of the trust's administration, shortly before the trust was to be terminated, some assets remained unclaimed, despite the trustee's best efforts to find the claimants. The court permits deposit into the court registry in the absence of any alternative. *In re Premiere Holdings of Texas LP*, 393 B.R. 156 (Bankr. S.D. Tex. 2008).

5.1.aa. Timber company is not a single asset real estate debtor. The single purpose debtor owns timberland, on which it plans timber planting, grows and maintains timber, builds and maintains roads, supervises the harvest of timber (although it does not conduct the harvest itself), sells the timber and then prepares and replants the timber sites. It ensures compliance with extensive environmental regulations by preparing and submitting permit applications and performing watershed analysis and maintenance, vegetation management and streambed remediation. It employs 60 people. Under the Code, "single asset real estate" is real estate on which "no substantial business is being conducted … other than the business of operating the real property and activities incidental thereto". The definition refers to investment property, such as undeveloped land, an apartment complex or a commercial building, where the business activity is passive collection of income such as rents, with little or no effort or involvement other than by the principals, rather than to a business that requires multiple, varied entrepreneurial efforts of the principals and employees, such as a marina, golf course or hotel. The timberland here is not single asset real estate. *Ad Hoc Group of Timber Noteholders v. The Pac. Lumber Co. (In re Scotia Pac. Co., LLC)*, 508 F.3d 214 (5th Cir. 2007).

5.1.bb. Court declines to appoint patient ombudsman for hospital. The chapter 9 debtor operates three hospitals and a skilled nursing facility, with a combined total of 632 beds. The court finds that the appointment of an ombudsman is not necessary for the protection of patients, based on an analysis of the nine applicable factors. The cause of bankruptcy was problems under the debtor's bonds, not patient care. The debtor is subject to extensive oversight and regulation by a national accrediting organization and two state public health departments. The debtor's past history of patient care is excellent, and the debtor has adopted redundant internal procedures to insure quality care. The patients are able to protect their rights through internal hospital procedures, the state health department, the accreditation agency, and other private agencies. An ombudsman might result in substantial administrative expense, because the statutory duties are extensive for a debtor of this size. Cutting the other way, the patients are highly dependent on the debtor, and the potential injury to them upon curtailment or material reduction in quality of service would be substantial. These factors, however, do not overcome the others. The court also rejects the US Trustee's argument that bankruptcy puts patients at greater quality of care risks and that a hospital in bankruptcy has an inherent conflict with its patients and therefore requires independent bankruptcy-centered supervision. *In re Valley Health Sys.*, 381 B.R. 756 (Bankr. C.D. Cal. 2008).

5.1.cc. Court denies trustee appointment even though new management was selected by prior tainted management. The debtors' principal caused the debtors to loan substantial sums to his other companies, which did not have the cash to repay the loans when the debtors needed it. Various government agencies were conducting criminal investigations of the principal. The debtors filed bankruptcy because of the resulting illiquidity. The principal irrevocably transferred management to a chief restructuring officer and gave him authority to designate a new managing member of the debtors. The principal confirmed the new managing member when designated after bankruptcy. An active creditors committee negotiated a plan with the debtors. However, because of the principal's possibly criminal conduct, the U.S. Trustee moved for the appointment of a trustee, citing section 1104(e)'s requirement that she do so if there are reasonable grounds to suspect current management of fraud of criminal conduct. Section 1104(e) does not modify section 1104(a)'s appointment standards, but the U.S. Trustee acts prudently when moving for a trustee in such circumstances where the tainted management selected the current untainted management, and a court should apply heightened scrutiny where the U.S. Trustee has established a prima facie case of such a selection. The burden then shifts to the debtor in possession to show that the new management is

unconflicted by any association with prior tainted management. Here, the management authority transfer was regular and court approved, and the tainted principal irrevocably waived further control. Therefore, the court does not find "cause" for appointment under section 1104(a)(1). The court also does not find "best interest" for appointment under section 1104(a)(2). Though several unsecured creditors distrusted the debtors, even with new management, an active creditors committee has made substantial progress with the debtors in resolving the case. It would not be in the best interest of the estate to displace the process with a trustee. *In re 1031 Tax Group, Inc.*, 374 B.R. 78 (Bankr. S.D.N.Y. 2007).

5.1.dd. Secured creditor's blanket lien extends to assets generated postpetition. The debtor operated a service business that used substantial equipment but little inventory. The creditor had a blanket security interest in all the debtor's assets, including inventory and accounts receivable. The Ninth Circuit construes "proceeds" broadly. If the creditor can trace postpetition assets, including accounts receivable, to proceeds of its petition date collateral, then its security interest attaches to the postpetition assets. Here, only the secured creditor's collateral was spent to generate new accounts receivable and cash. Therefore, all postpetition assets are proceeds of the secured creditor's petition date collateral and remain subject to the creditor's security interest. Similarly, the secured creditor's security interest reaches the collateral's increase in value. The increase derives from the entire collateral package, much as rents derive from underlying real property collateral, and section 552(b) provides for parallel treatment of proceeds and rents. *Burlingame Cap. P'ners II., L.P. v. Qmect, Inc. (In re Qmect, Inc.)*, 373 B.R. 682 (N.D. Cal. 2007).

5.1.ee. Adequate protection payments protect only against collateral's value diminution. The creditor had a blanket security interest in all the debtor's assets, including inventory and accounts receivable. After bankruptcy, the debtor in possession made adequate protection payments to an escrow account for the secured creditor's benefit. Permitting the secured creditor to recover the adequate protection payments without showing diminution of the value of the creditor's collateral would impermissibly compensate the creditor for delay rather than loss of value. *Burlingame Cap. P'ners II., L.P. v. Qmect, Inc. (In re Qmect, Inc.)*, 373 B.R. 682 (N.D. Cal. 2007).

5.1.ff. Court may enjoin service termination by utility that does not respond to DIP's section 366 proposal. The debtor in possession filed with the petition and gave its utilities notice of a motion for an order establishing adequate assurance for utilities and enjoining service termination. Several utilities did not respond within the 30-day period of section 366(c) during which the statutory injunction against termination remains in effect. Expressly disagreeing with *In re Lucre, Inc.*, 333 B.R. 151 (Bankr. W.D. Mich. 2005), the court determines that the failure to respond constitutes acquiescence that the DIP's proposal provides adequate assurance. Because Congress enacted section 366(c) to protect against service termination, a construction of the statute to allow utility silence to authorize termination would be unreasonable and would prohibit a court from enjoining termination after the utility has had an opportunity to demand adequate assurance. Under the motion's terms, the utility may still request modification of the adequate assurance after the 30-day period. *In re Syroco, Inc.*, 374. B.R. 60 (Bankr. D.P.R. 2007).

5.1.gg. Investor may condition plan funding on pension plan termination. The debtor searched extensively for an investor to fund a reorganization plan. It found only one, who was willing to fund only if the debtor terminated its three PBGC-insured defined benefit pension plans. Without the investment, the debtor would have had to liquidate, which would have resulted in plan termination. ERISA authorizes plan termination in bankruptcy of a defined benefit plan if the employer is unable to pay its debts unless the plan is terminated. The court does not reach the issue of whether the bankruptcy court must review the three plans on a plan-by-plan or aggregate basis (that is, whether termination of fewer than all plans will enable the employer to pay its debts), because without the investment, the debtor would liquidate and not be able to pay any debts. Because the debtor required the investment to reorganize and the investor required plan termination as a condition to the investment, the debtor met the ERISA termination standard for all plans. This does not allow the investor to usurp the bankruptcy court's role in determining ability to pay, because the investor is not obligated to fund unless its conditions are met. The judge must still determine whether the financial test is met without the investment. *Pension Benefit Guaranty Corp. v. Falcon Prods., Inc. (In re Falcon Prods., Inc.)*, 497 F.3d 838 (8th Cir. 2007).

5.1.hh. Court declines to appoint patient ombudsman for juvenile psychiatric care facility. The state licensed debtor provides child placement and residential caring and psychiatric services to disturbed children. The vast majority of its patients are referred from other child care agencies, but its website

provides a "placement availability" link, and a very small number of its patients are brought in directly by parents. Its financial troubles resulted from an uninsured fire loss at its most profitable location. The debtor is a "healthcare business", because its services are generally available to the public, are for the diagnosis and treatment of "injury, deformity, or disease", and include drug treatment and psychiatric care. However, the court declines to appoint a patient ombudsman, because the bankruptcy's cause is not related to patient care, the state licensing and supervisory authorities adequately regulate and supervise the debtor's activities, the debtor has an excellent patient care history (3 complaints in 20 years' operation), there are adequate internal safeguards, such as medical and professional supervision, to protect patients, and the debtor could not bear an ombudsman's cost. The factors suggesting appointment—the patients' general inability to protect their own rights, their high dependency on the facility, and the potential patient injuries if the debtor drastically reduced care levels—do not outweigh the other factors, because many child patients have guardians ad litem to protect their interests, and the debtor and the patients share an interest in rescuing the facility. *In re Alternate Family Care*, 377 B.R. 754 (Bankr. S.D. Fla. 2007).

5.1.ii. Receiver may become the debtor in possession. The debtor ran a Ponzi scheme. Its principals were indicted, convicted and jailed. The United States obtained forfeiture orders that resulted in seizure of all the debtor's assets other than litigation claims. Some unpaid creditors brought an action in federal district court against the debtor and sought the appointment of a receiver under section 10(b) of the Securities Exchange Act of 1934 and under state law. The district court appointed an individual to act as receiver and vested him "with the sole and exclusive power and authority to manage and direct the business and financial affairs of the [debtor], including without limitation, the authority to petition for protection under the Bankruptcy Code". The receiver filed a chapter 11 petition for the debtor. The U.S. trustee moved for the appointment of a trustee, arguing that the receiver was a "custodian" that must turn over property under section 543 and was therefore disqualified from acting as the debtor in possession's management. The court rejects the argument, because the receiver was given all corporate governance power and authority and therefore functioned as management of the corporate debtor in possession. His receiver role was not exclusive; the district court could combine the receivership and corporate governance roles in the same individual so that he could serve as debtor in possession after a chapter 11 filing. The court recognizes this result—the ability of creditors to select a receiver/corporate manager in a receivership action, vest him with governance powers, including the authority to file a chapter 11 petition, and leave him in position as debtor in possession—as a loophole in the Bankruptcy Code's scheme that only the U.S. trustee select a trustee, but concludes that the circumstances in which it might occur would be rare and that the solution lies with Congress. *Adams v. Marwil (In re Bayou Group L.L.C.)*, 363 B.R. 674 (S.D.N.Y. 2007).

5.1.jj. Court may approve a postpetition financing retroactively in special circumstances. During his chapter 11 case, the debtor quitclaimed his interest in his residence to his wife, who refinanced the mortgage and reconveyed the property to herself and to the debtor as joint tenants, as title had previously been held. The property's title report, which the lender saw, noted the debtor's bankruptcy, but the lender overlooked it. The debtor used the proceeds to pay off a higher-priced, above-market mortgage, to pay refinancing expenses, and to fund his chapter 11 plan. Afterwards, the debtor in possession sought retroactive approval of the postpetition borrowing. The court may approve the borrowing retroactively, as it may approve employment of a professional retroactively, if the financing benefits the estate, the creditor adequately explains its failure to obtain prior approval, the borrowing fully complies with section 364, and the circumstances "present one of those rare situations in which retroactive authorization is appropriate". Here, the borrowing benefited the estate by lowering the debtor's monthly expenses and providing plan funding, the loan complied with section 364, the lender's failure to note the pending bankruptcy was an oversight made in good faith, and for all those reasons, presents "one of those rare situations in which retroactive approval is appropriate". *Sherman v. Harbin (In re Harbin)*, 486 F.3d 510 (9th Cir. 2007).

5.1.kk. First Circuit B.A.P. questions validity of a carve-out. At the beginning of the chapter 11 case, all three secured creditors expressly consented to a carve-out for certain professionals' fees. After all of the estate's assets were sold, the case was converted to chapter 7. There were insufficient unencumbered assets to pay all administrative expenses and insufficient assets to pay the claim of one of the secured creditors. The professionals therefore sought allowance and payment of fees from the carve-out. The

unpaid secured creditor was judicially estopped from objecting to the allowance and payment of the fees from the carve-out, because his objection was inconsistent with his earlier position in court consenting to the carve-out, that earlier position prevailed, and allowing him to assert the inconsistent position now would impose an unfair detriment on those who relied on his earlier consent. In reaching this conclusion, however, the First Circuit B.A.P. expresses grave reservations about the propriety of a carve-out, especially in a case such as this, where the carve-out did not reduce the secured creditors' recoveries, the carve-out beneficiaries were only some of the professionals and other administrative claimants, and there were unpaid administrative claims. Costa v. Robotic Vision Sys., Inc. (In re Robotic Vision Sys., Inc.), 367 B.R. 232 (1st Cir. B.A.P. 2007).

5.1.ll. Section 503(c) limits only administrative claims. The debtor in possession had proposed an executive compensation plan that violated section 503(c)(1), because it did not provide sufficient performance incentives and provided compensation based primarily on retention rather than performance. The DIP proposed a revised plan, which provided executives salary, annual incentive pay, long term incentive pay, and assumption of unfunded pension obligations. The DIP assumed the pension obligations, however, only if the DIP did not terminate the union pension plans, and the pension benefits were payable only after plan consummation. If an executive were terminated without cause before plan consummation, the executive would have a general unsecured prepetition claim for a portion of the unpaid pension amount. Section 503(c) governs only administrative claims, so it does not limit the allowance as a general unsecured claim of the pension obligations. The plan's other provisions may have a retentive effect, but they primarily incentivize performance, so section 503(c)(1) does not apply. Turning instead to section 363(b)'s standards, the court itself, rather than deferring to the DIP's business judgment, reviews the balance of the plan holistically. It determines that, subject only to imposition of a total annual compensation limit so that the combination of annual salary, annual incentive payments, and long-term incentive payments does not become unreasonable, the plan provides reasonable compensation for the executives and is appropriately designed to further the reorganization's goals. *In re Dana Corp.*, 358 B.R. 567 (Bankr. S.D.N.Y. 2006).

5.1.mm. Section 503(c) does not restrict an annual incentive bonus program that is in the ordinary course of business. The debtor in possession adopted an annual incentive plan for six levels of employees, from senior executives through junior non-officer managers, which provided bonuses based on the DIP's financial performance for the year. It did not obtain prior court approval but committed to the court that if it made any changes to the plan, it would seek approval. The DIP failed to meet the financial targets in the incentive plan. The DIP then modified the plan to provide reduced bonuses to the employees and sought court approval of the modification. In prior years, the debtor had regularly adopted annual incentive plans, which provided bonuses based on financial performance, and regularly modified them after year-end to provide reduced bonuses in those years when the debtor's business did not meet financial targets. Section 503(c)(3) restricts "transfer or obligations that are outside the ordinary course of business … [to, or] for the benefit of, officers, managers, or consultants." This plan was in the ordinary course of business, because it meets both the horizontal and vertical tests. A compensation expert testified that other companies of comparable size in the same industry routinely adopted programs similar to this plan. The debtor had also done so in prior years, so plan adoption and modification was consistent with creditor expectations. Therefore, section 503(c)(3) does not restrict its adoption. By contrast, section 503(c)(1) prohibits allowance and payment of claims to an insider (director or officer) "for the purpose of inducing such person to remain with the debtor's business," whether within or outside the ordinary course of the debtor's business. All payments to employees, even ordinary course, have some retentive purpose and effect. Therefore, section 503(c)(1) must be read to apply only to plans whose primary purpose is retention rather than incentivizing performance. Because this plan's primary purpose was motivating employees during the chapter 11 case, this plan does not violate section 503(c)(1). *In re Nellson Nutraceutical, Inc.*, 369 B.R. 787 (Bankr. D. Del. 2007).

5.1.nn. Home development project is "single asset real estate." The home construction debtor had multiple subsidiaries, each of which owned a single parcel of real estate which was held for development of homes for sale to the public. The development work includes acquiring the land, planning the site, obtaining site plan approvals from local government, constructing infrastructure such as roads, sewers, and utilities, constructing the homes, and running the sales operation. Section 101(51B) defines "single asset real estate" as "real property constituting a single property or project … which generates substan-

tially all of the gross income of a debtor …and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto." The development activities in which the debtor engages are incidental to the property operation, unlike the activities of a hotel's or golf club's providing catering, meeting, or other services to guests. The development activities all relate to the sale of the lots and houses, which is the debtor's sole business. Therefore, the real estate is "single asset real estate." The court does not address the issue of whether development constitutes operation rather than a separate business activity. *Kara Homes Inc. v. Nat'l City Bank (In re Kara Homes)*, 363 B.R. 399 (Bankr. D.N.J. 2007).

5.1.oo. Undersecured creditor may make KERP payments. The debtor and its principal secured creditor agreed before bankruptcy on a sale of the business assets. Prompted by a senior executive exodus at the time, the creditor signed agreements with the remaining senior executives to pay them each a bonus if there were a sale that resulted in cash proceeds to the creditor and the executive remained employed in good standing at the time of the sale. After the sale closed, the creditor paid the bonuses from its proceeds. Because the creditor was undersecured and paid the bonuses from its own funds, section 503(c) does not apply. The bonuses were not allowed as claims against the estate and were not paid from property of the estate. The executives did not breach their fiduciary duties to the estate by contracting with and accepting payment from the secured creditor, because the agreements themselves required the executives to carry out their fiduciary duties to the estate. Therefore, the court denies the committee's motion for a turnover of the bonuses. *Official Comm. of Unsecured Creditors v. Airway Indus., Inc. (In re Airway Indus., Inc.)*, 354 B.R. 82 (Bankr. W.D. Pa. 2006).

5.1.pp. Distress pension termination should be based on aggregate effect on the reorganization of all plans. The debtor was subject to several collective bargaining agreements, each of which provided for a defined benefit pension plan. The debtor sought rejection of the agreements and termination of the plan under the reorganization distress termination provisions of ERISA, section 1341(c)(2)(B)(ii)(IV), which requires that the bankruptcy court determine that termination is necessary to permit reorganization. In making this determination, the bankruptcy court may consider the collective effect on the reorganization of all plans and need not evaluate them on a plan-by-plan basis. ERISA gives no indication that the evaluation should be made plan-by-plan, as it gives no guidance on the order in which multiple plans should be evaluated. In addition, section 1113 permits rejection of collective bargaining agreements only if "all of the affected parties are treated fairly and equitably." A court could not conduct such a balancing if each plan had to be evaluated separately. The court follows the Third Circuit's decision on the same issue. *In re Kaiser Alum. Corp.*, 456 F.3d 328 (3d Cir. 2006). *Pension Ben. Guar. Corp. v. Falcon Prods., Inc. (In re Falcon Prods., Inc.)*, 354 B.R. 889 (E.D. Mo. 2006).

5.1.qq. Court unseals tort settlements. After confirmation, the plan authorized the reorganized debtor to settle tort claims of over $250,000 arising from the operation of its long-term care hospital only with court approval. The court granted the reorganized debtor's motion to seal the records of the settlements; the local newspaper moved to unseal the records. The newspaper did not meet the First Amendment's two-part requirement for unsealing court records, because even though bankruptcy proceedings have historically been open to the press and the general public, the settlement amounts would not inform the public about issues relating to the debtor's care or neglect of residents or governmental regulation and therefore would not "play a significant positive role in the functioning of the particular process in question." However, section 107, which supersedes any common law right of access, requires the court to unseal the records. Section 107(b)(1) permits sealing of confidential commercial information, which includes only information that relates to the debtor's (or reorganized debtor's) commercial operations or that would unfairly advantage competitors. Settlement amount information does not, at least in this case, qualify. *In re Alterra Healthcare Corp*., 353 B.R. 66 (Bankr. D. Del. 2006).

5.1.rr. Cable television is not a utility. The individual debtor's cable television provider terminated service when the debtor filed bankruptcy and did not pay prepetition amounts owing. Section 366 does not prohibit it from doing so, as a cable television provider is not a "utility." Section 366 covers only those entities that have a special relationship to the debtor, which includes providing a service that is a necessity for minimum standards of living. The inability to obtain comparable service elsewhere easily does not

loosen the requirement that the service must be a necessity. *Darby v. Time Warner Cable, Inc. (In re Darby)*, 470 F.3d 573 (5th Cir. 2006).

5.1.ss. Undisclosed insider purchase of estate property constitutes breach of fiduciary duty. The single asset real estate chapter 11 debtor's principals consented to stay relief to permit the lender to foreclose and formed a new entity, which bid at the foreclosure sale. When a creditor moved for reconsideration of the stay relief order, alleging that there was equity in the property and that the bidder was comprised of insiders, the debtor denied any affiliation between the new entity and the debtor's principals, and the court denied reconsideration. After the case was converted to chapter 7, the trustee sued the principals and the new entity for damages for breach of fiduciary duty. The action was therefore not a collateral attack on the stay relief order. By acting in their own self-interest in stipulating to stay relief and secretly buying the real estate and by misrepresenting the facts to the court, the principals breached their fiduciary duty to the estate. The court does not adopt a *per se* rule against a fiduciary buying from the estate but requires full disclosure, arm's-length, good faith negotiations, and inherent fairness. The remedy for the breach is imposition of a constructive trust in favor of the estate on the property and all its net cash flow while the insiders owned it. *Lange v. Schropp (In re Brook Valley IV, J.V.)*, 347 B.R. 662 (8th Cir. B.A.P. 2006).

5.1.tt. Fostering plan confirmation merits substantial contribution award. A major bondholder persuaded its affiliate to offer debtor in possession financing as an alternative to the financing previously proposed and persuaded the indenture trustee for the bonds to withdraw a confirmation objection, which would have slowed or prevented confirmation. The availability of alternative financing gave the debtor in possession negotiating leverage, and the withdrawal of the objection facilitated confirmation. A court may award fees for a substantial contribution if the efforts conferred a demonstrable benefit on the estate, fostered and enhanced the reorganization, and would have been undertaken even without expectation of reimbursement. The efforts here met those requirements. *In re FF Holdings Corp.*, 343 B.R. 84 (D. Del. 2006).

5.1.uu. Court disallows executive compensation plan. The debtor in possession proposed a bonus plan for its senior executives, who were officers and therefore clearly insiders. The plan promised a portion of the compensation based on financial performance. The balance, termed a "Completion Bonus," was payable if the executive was still employed at the conclusion of the case and was based on the debtor's total enterprise value at the effective date. A substantial portion was payable even if the total enterprise value declined during the case. The plan also included a severance package, which was linked to a non-compete agreement. Section 503(c) applies to this package. A substantial portion of the compensation is a "Pay to Stay" plan rather than a "Produce Value for Pay" plan. As such, it does not meet the standards of section 503(c). Similarly, the proposed severance arrangement by its nature primarily compensates the executive for severance, not for the non-compete agreement. The court therefore does not approve the plan. *In re Dana Corp.*, 351 B.R 96 (Bankr. S.D.N.Y. 2006).

5.1.vv. Chapter 11 trustee appointment does not require "clear and convincing" evidence. The debtor failed to file a list of creditors with the petition; its principal did not appear at the 341 meeting, citing Fifth Amendment privilege. The US Trustee moved for the appointment of a trustee. Acknowledging a departure from the majority of other courts that have ruled on the question, the court determines that the US Trustee needs to satisfy the "fraud, dishonesty, or gross mismanagement" or the "best interest" grounds under section 1104(a) for appointment of a trustee only by a preponderance of the evidence. Other appellate courts that have imposed a "clear and convincing" standard have nevertheless reviewed the bankruptcy court's decision only for abuse of discretion, undercutting the imposition of a higher standard. In addition, the statute does not indicate a higher standard, even for a fraud allegation, and the Supreme Court's decision in *Grogan v. Garner*, 498 U.S. 279 (1991), which applied a preponderance standard to nondischargeability based on fraud, suggests that the Bankruptcy Code does not generally require a higher burden of proof for matters requiring a showing of fraud, even where the matter affects a core bankruptcy principle such as the fresh start. *Tradex Corp. v. Morse*, 339 B.R. 823 (D. Mass. 2006).

5.1.ww. Section 1112(b) dismissal does not require presence of all causes for dismissal. Section 1112(b), as amended by BAPCPA, requires the court to dismiss a chapter 11 case for cause. Section

1112(b)(4) provides, "'cause' includes (A) substantial and continuing loss … ; *and* (P) failure of the debtor …." (emphasis added). A literal reading of "and," so that cause exists only when all 14 elements are present, would lead to absurd results. It would render section 1112(b) a nullity, because it would be nearly impossible for all 14 elements to exist in the same case, and they could never exist in a non-individual's case, because one of the elements relates to payment of domestic support obligations. Therefore, "and" in this section should be read in the disjunctive, as "or," and the presence of any element may constitute cause for dismissal. *In re TCR of Denver, LLC*, 338 B.R. 494 (Bankr. D. Colo. 2006).

5.1.xx. Multiple debtor case does not require separate representation of each estate. Counsel for the debtors in possession represented all related estates in a multiple debtor chapter 11 case. Counsel had agreed to refrain from any litigation of the multiple, complex, and substantial intercompany claims but to continue to advise all of the debtors in possession about the claims and to attempt consensual resolution. Counsel had not acted adversely to any of the estates. In fact, the debtors in possession on several occasions had agreed to allow a committee to prosecute intercompany claims, when the debtors in possession were conflicted. Nevertheless, the committee for one of the debtors sought to disqualify counsel from any role in any of the intercompany claims. Section 327(a), which requires disinterestedness, does not require any such per se ban on multiple representations, but permits the court to review the particular facts and circumstances to decide whether the potential conflict requires disqualification under that section. A per se rule "would burden estates with unjustified and insurmountable costs." Therefore, counsel would not be disqualified here. Still, the court requires counsel to maintain neutrality with respect to any intercompany disputes. Similarly, these facts do not require the appointment of an independent chapter 11 trustee for each estate. *In re Adelphia Commc'ns Corp.*, 342 B.R. 122 (S.D.N.Y. 2006), *aff'g* 336 B.R. 610 (Bankr. S.D.N.Y. 2006).

5.1.yy. SEC has standing as a creditor based on its role as an enforcer of the securities laws. In an SEC receivership action against the debtor's client, the court ordered the debtor to repay excess amounts it had received before the receivership. The order did not specify to whom the debtor should pay the amounts, but the funds would likely have gone to the receiver. Before he paid the amounts, the debtor filed bankruptcy. Although the SEC did not have a direct claim against the debtor for the funds, the SEC had standing as a creditor to pursue dismissal of the case. Relying on *Nathanson v. NLRB*, 344 U.S. 25 (1952), a case in which the Supreme Court recognized the NLRB's standing as a creditor on behalf of employees entitled to back pay, the court concludes that the SEC's role as enforcer of the securities laws grants it standing as a creditor even if it is not entitled to receive payment of the debtor's debt on which the SEC bases its claim. *Sherman v. SEC (In re Sherman)*, 441 F.3d 794 (9th Cir. 2006).

5.1.zz. Nunc pro tunc substantive consolidation is improper to reverse prior bankruptcy court orders. The creditor sued a corporation and its shareholder, who had guaranteed each others' loans. Shortly after, the corporation filed bankruptcy. The creditor sought limited relief from the stay to pursue the litigation, which the trustee did not oppose and the court granted. The creditor and the shareholder soon settled the litigation, by the shareholder consenting to judgment and granting the creditor a lien. The shareholder later filed bankruptcy. The trustee sought substantive consolidation of the shareholder and the corporation nunc pro tunc to the date of the corporation's petition, which would have effectively unwound the settlement, the judgment, and the lien. Such an order is improper to undo the bankruptcy court's prior authorization to the creditor to prosecute the collection litigation against the shareholder. The court notes that nunc pro tunc consolidation would effectively consolidate the debtor corporation with the shareholder, who, as of the effective date of consolidation, was a non-debtor, questions (but does not decide) whether consolidation between a debtor and a non-debtor is proper, and cautions that it should be ordered only in special circumstances. The court does not adopt a test for consolidation, other than to note that it should be used sparingly, but it quotes extensively from *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005). Finally, it does not address the creditor's argument that *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), eliminated a bankruptcy court's authority to consolidate. *Wells Fargo Bank of Tex. N.A. v. Sommers (In re AMCO Ins.)*, 444 F.3d 690 (5th Cir. 2006).

5.1.aaa. Court limits committee's duty to share information with constituents. Section 1102(c) requires that a chapter 11 committee "provide access to information" to its constituents. The unsecured creditors' committee here sought an order limiting the information to which it must provide access.

Section 1102(c) is similar to section 704(7), which requires a trustee to "furnish such information concerning the estate and the estate's administration as is requested by a party in interest." Case law interpreting section 704(7) construes the trustee's duty broadly; the committee's duty under section 1102(c) is similarly broad. The duty is not, however, unlimited. A trustee may obtain a protective order against disclosing information that is subject to the attorney-client privilege or is otherwise confidential. The limitations are informed by the trustee's fiduciary duties to protect creditors and the estate. The committee plays a pivotal role in a chapter 11 case, which it can fulfill only by protecting information that should remain confidential. Preserving confidentiality protects the estate from harms that could result from release of the information, increases the debtor in possession's willingness to share information with the committee, and prevents violations of the securities laws. Therefore, the committee is not required to provide access to confidential information unless the requesting party agrees to appropriate confidentiality restrictions. If there is a dispute over what is confidential or the scope and terms of the restrictions, the court should resolve it on a case-by-case basis. *In re Refco, Inc.*, 336 B.R. 187 (Bankr. S.D.N.Y. 2006).

5.1.bbb. Court denies motion to appoint a trustee to address intercompany claims resolution. The debtor in possession made serious efforts through the chapter 11 case to resolve difficult and complex intercompany claims. Finally, the debtor in possession moved to establish a procedure for various creditor groups to be able to litigate the intercompany claims, with the debtor in possession remaining on the sidelines. Parties in interest representing the different creditor estates supported the motion, and the court granted it. Late in the case, when the creditors' committee for one of the debtors apparently demanded amendments to the pending reorganization plan to improve its treatment and was rebuffed, the committee brought a motion for the appointment of a trustee or, in the alternative, for the appointment of an independent fiduciary to investigate and prosecute this debtor's intercompany claims and to require the debtor in possession's board and counsel to recuse themselves from any involvement in that process. The court denies the motion. The existence of intercompany claims, which the debtor in possession labored hard but unsuccessfully to resolve by negotiation among all creditor groups, does not create grounds for the appointment of a trustee. These facts do not rise to the level of a showing of cause for the appointment of a trustee, and appointment would not be in the interests of creditors or the estate because of the delay and expense it would generate. Section 105 suggests that the court does not have authority to appoint an independent fiduciary, and section 1107(a), allowing the court to prescribe limits on the debtor in possession's activities, does not provide a grant of such authority or trump section 105's limitations. However, the court grants the motion only to the extent that it requests that the debtor in possession's and counsel's current voluntary recusal from the intercompany claim issues be made mandatory. In the course of the opinion, the court describes in detail the methods used in other mega-cases to resolve intercompany claims. *In re Adelphia Commc'ns Corp.*, 336 B.R. 610 (Bankr. S.D.N.Y. 2006).

5.1.ccc. Chapter 11 creditor derivative standing requires prior approval. The debtor in possession's CEO resigned, began negotiations with one of the DIP's largest customers, formed a new company, and encouraged the DIP's suppliers to follow him. Major creditors asked the CRO to seek an injunction against the former CEO. The CRO instead orally authorized the creditors and the committee to bring the action. In response to the former CEO's challenge to the creditors' standing to bring the action, the bankruptcy court found that the creditors had standing because of their concern over the reorganization and they had an interest in the outcome. However, the CEO's actions harmed the estate, which therefore owned the claim against the CEO. The creditors may not assert it through derivative standing unless the bankruptcy court expressly authorizes standing in advance. Derivative standing is the exception to debtor in possession's central role as the estate's representative. Creditors' interests are often adverse to the estate and diverse among themselves, so creditors are not generally the appropriate parties to represent the estate. Prior authorization is a necessary check on creditors improperly hijacking the case or major issues in the case. *Scott v. Nat. Century Fin. Enters., Inc.*, 432 F.3d 557 (4th Cir. 2005).

5.1.ddd. Creditors may not seek settlement approval under Rule 9019. The debtor in possession sued the purchaser of the estate's assets. The bankruptcy court encouraged settlement and stayed discovery. In the meantime, the creditors committee reached a settlement with the purchaser and moved for approval under Rule 9019. The debtor in possession opposed. The debtor in possession is the estate representative and controls any causes of action. Rule 9019 vests the right to settle solely in the trustee or debtor in possession. Derivative standing may be appropriate to permit creditors to pursue a claim that

belongs to the estate that the debtor in possession refuses to pursue, often when the claim is against the debtor's principals. However, derivative standing to pursue a settlement requires a much stronger showing, because the debtor in possession's interests are more likely to be aligned with the estate's. No showing of derivative Rule 9019 standing was made here, because the court did not make any determination about the possible validity of the claims. Section 1109(b), which authorizes parties in interest to intervene in adversary proceedings, does not authorize them to take ownership of the estate's claims, which must remain under the estate representative's control. Finally, section 105(a) does not permit the court, independent of these other provisions, to authorize creditors to settle an estate's claim, because section 105(a) cannot be used to override specific Code provisions. The court emphasizes the centrality of the debtor in possession's control of the estate and has harsh words for the purchaser's efforts to exclude the debtor in possession from settlement discussions with creditors and even harsher words for the bankruptcy court's refusal to permit the debtor in possession to conduct discovery and to insist that the litigation be settled. *Smart World Techs. LLC v. Juno Online Servs., Inc. (In re Smart World Techs. LLC)*, 423 F.3d 166 (2d Cir. 2005).

5.1.eee. Settlement with PBGC over pension plan termination does not violate section 1113. The debtor in possession sought a distress termination of its pension plan under ERISA section 1341(c). Because such a termination may not override a collective bargaining agreement, the debtor in possession also sought authority to reject the agreement under section 1113. Independently, the PBGC may terminate a plan under ERISA section 1342, to protect its own assets and liabilities, regardless of whether the termination violates a collective bargaining agreement. Here, the debtor in possession and the PBGC agreed on the amount of the PBGC's pension underfunding claim that would be allowed in the chapter 11 case and that the PBGC would evaluate whether to terminate the plan under section 1342. Upon court approval of the agreement, the debtor in possession withdrew its motion to terminate the plan under section 1341(c) and to reject the collective bargaining agreement. The PBGC later determined to terminate the plan. This process did not violate section 1113, because the debtor in possession did not unilaterally modify the collective bargaining agreement or violate any duty owed to the union. The debtor in possession did not cause the PBGC to terminate the plan; the PBGC made its own determination to do so. *In re UAL Corp.*, 428 F.3d 677 (7th Cir. 2005).

5.1.fff. Section 366(c) protects only utilities that provide end-user service to the estate, but gives them veto power over adequate assurance offer. The debtor in possession sought an order under section 366(c), as amended by BAPCPA, prohibiting utilities from altering or terminating service. The bankruptcy court addresses issues under amended section 366. First, because section 366(c)(2) permits a utility to alter or terminate service if the debtor in possession does not offer adequate assurance "that is satisfactory to the utility," the court may not enjoin the utility based on the utility's failure to respond to the debtor in possession's adequate assurance offer. Section 366(c)(3) only permits the court to modify an initial assurance payment that is satisfactory to the utility, for example, based on changed circumstances or the utility's failure to negotiate in good faith, not to determine and fix it initially. Second, the court may order continuation of service during the 10-day gap period between the 20-day automatic protection period of subsection (b) and the 30-day period of subsection (c) based on the debtor in possession's proposal of adequate assurance, but the utility may terminate after 30 days if the assurance is not satisfactory to the utility. Third, subsection (c) applies only to "utility service," while subsections (a) and (b) apply to any service that a utility provides. Thus, the broader utility protection that subsection (c) provides applies only to traditional utility service to the debtor as an end-user, not to ancillary services and not to service for resale to the debtor's customers. *In re Lucre, Inc.*, 333 B.R. 151 (Bankr. W.D. Mich. 2005).

5.1.ggg. Debtor may modify retiree benefits after confirmation but before effective date. One of the conditions to the debtor's plan confirmation was modification of retiree benefits under section 1114. During the confirmation process, the condition was modified to require retiree benefit modification before the effective date. Section 1129(a)(13) requires that the plan provide for continuation of retiree benefits after the effective date at the level established before confirmation under section 1114(e)(1)(B) (agreed-to-modifications) or 1114(g) (court-ordered modifications). This requirement does not render section 1114 inapplicable after confirmation and before the effective date. The court may still order modifications after confirmation under section 1114(g). *In re Ormet Corp.*, 324 B.R. 654 (Bankr. N.D. Ohio 2005).

5.1.hhh. Substitution of retiree benefit representative requires motion. The union negotiated stipulated with the debtor in possession for a modification of retiree benefits under section 1114. Its counsel sent a letter to retirees advising them that he could not represent them in opposing approval of the stipulation, because he negotiated the stipulation on behalf of the union and was adverse to the retirees. Another lawyer appeared for the retirees to oppose the stipulation. Section 1114(c)(1) provides that if a union serve as the representative, unless the union elects not to serve as the retirees' representtative and "the court, upon a motion . . ., determines that different representation of such persons is appropriate." Because there was no such motion here, the attorney could not represent the retirees. *Hourly Employees/Retirees v. Erie Forge & Steel Inc. (In re Erie Forge & Steel, Inc.)*, 418 F.3d 270 (3d Cir. 2005).

5.1.iii. An examiner's report should not be sealed. Section 107(b)(2) permits the court to seal a document that contains scandalous or defamatory matter. The authority should be used sparingly because of the importance of public access to court papers, and the burden on the requesting party is high. Bankruptcy Rule 9018 does not expand the court's authority. Material that is scandalous or defamatory is "material that would cause a reasonable person to alter their [sic] opinion of [a party] based on the statement therein." True information cannot qualify as scandalous or defamatory. The fact that the report might embarrass some individuals or harm their reputations is not adequate grounds to seal the report, as long as the information is true or appropriately described as preliminary investigatory results. The report met those requirements here and should not be sealed. *In re Gitto/Global Corp.*, 321 B.R. 367 (Bankr. D. Mass. 2005).

5.1.jjj. DIP financing agreement restriction on plan filing is permissible. Some but not all of the debtor's prepetition secured lenders provided debtor in possession financing, secured by a priming lien. The DIP financing agreement required the debtor to file a plan by a specified date that was acceptable to two-thirds in amount and a majority in number of the prepetition secured lenders. The court approves the requirement. It is not an improper lock-up agreement and is not an improper postpetition solicitation without a disclosure statement, because it does not commit the prepetition lenders to vote for a particular plan. It does not eliminate the ability of the debtor to cram down the prepetition lenders, because as written, it permits the DIP lenders only to stop funding the DIP loan if the debtor does not comply with the provision. It does not violate the "deemed acceptance" provision of section 1126(f) as applied to a class that is not impaired, for the same reason. Finally, it does not prevent the debtor in possession from carrying out its fiduciary duties. It does not require the debtor in possession to cede control over its operations, plan formulation, or general chapter 11 case management to the lenders. The court finds that the provision was intensely negotiated and critical to the DIP lenders' willingness to lend and should not be upset. *Official Comm. of Unsecured Creditors v. New World Pasta Co.*, 322 B.R. 560 (M.D. Pa. 2005).

5.1.kkk. Trustee does not have standing to bring creditor's claims against third party. The debtor's management falsified the debtor's books and records and defrauded its auditor, who opined on the debtor's financial statements. A creditor was defrauded and asserted a claim against the auditor for fraud and negligence. The creditor assigned the claim to the liquidating trustee under the plan. The trustee, whom the court treats as having the same rights as a bankruptcy trustee, does not have standing to bring a creditor's action against a third party, even though the creditor expressly assigns the claim to the trustee. The trustee has standing to bring only those claims that the debtor could have brought before bankruptcy. The court does not address whether section 544(b) might apply to this action. *Ernst & Young v. Bankruptcy Servs., Inc. (In re CBI Holding Co.)*, 318 B.R. 761 (S.D.N.Y. 2004).

5.1.lll. Trustee may pursue creditors' claims assigned under chapter 11 plan. The chapter 11 plan provided for the establishment of a creditors' trust and the assignment to the trustee of all claims of the grower creditors against former management for fraud. The trustee may pursue the claims, despite *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972). Unlike *Caplin*, the assignment of the claims to the trustee made the claims property of the estate under section 541(a)(7) (after-acquired property), all of the growers' fraud claim were assigned, so there is no risk of inconsistent results with individual creditor law suits, and the recovery is for the benefit of the trust, not directly for the assigning creditors (as in *Caplin*). The court does not discuss whether the plan confirmation terminated the estate and vested the assets in the trust rather than the estate, nor whether a plan may properly appropriate the property of

nonconsenting creditors (the growers' individual fraud claims) to the estate or trust. *Schnelling v. Thomas (In re Agribiotech, Inc.)*, 319 B.R. 207 (D. Nev. 2004).

5.1.mmm. Interim trustee's appointment does not toll avoiding power statute of limitation. Under section 546(a), a trustee may bring an avoiding power claim only within two years after the order for relief or, in a case converted to chapter 7, within one year after the election or appointment of the first trustee under section 702, if the election or appointment occurs in the initial two-year period. Here, after conversion, the interim trustee was appointed under section 701 within two years after the order for relief, but he did not become the permanent trustee under section 702 until after the two-year period expired. His appointment therefore did not extend the statute of limitation. *Singer v. Franklin Boxboard Co. (In re American Pad & Paper)*, 319 B.R. 791 (D. Del. 2005).

5.1.nnn. Motion for appointment of a trustee requires clear and convincing evidence. The Third Circuit reaffirms that a party moving for the appointment of a trustee must meet its burden of proof by clear and convincing evidence. The court had previously stated that rule in a case in which it said that there is a strong presumption in favor of leaving the debtor in possession. Here, the court rules that the presumption should be construed as a restatement of the heavy burden of persuasion, not as an evidentiary presumption under F.R.E. 301 that affects the burden of going forward or the level of proof. Even the absence of factors that normally give rise to the presumption, which the moving party argued here, does not reduce the moving party's burden or proof, because the presumption in favor of a debtor in possession derives from the statute, not from the facts of a particular case. *Official Comm. of Asbestos Claimants v. G-I Holdings, Inc.*, 385 F.3d 313 (3d. Cir. 2004).

5.1.ooo. Liquidating chapter 11 provides grounds for conversion to chapter 7. The debtor in possession had sold all its assets, paid the proceeds to the secured creditor, and had unencumbered funds remaining to pursue claims and to make a distribution to creditors. The United States trustee moved under section 1112(b)(2) to convert the case to chapter 7. The court granted the motion, concluding that there was continuing loss to or diminution of the estate and that there was no reasonable likelihood of rehabilitation, because the estate was incurring administrative expenses and, even though the debtor might confirm a plan, it would be a liquidating plan, not rehabilitation. In addition, the debtor and creditors were unable after several months of negotiations to agree on the terms of a plan, which would have involved pursuing the estate's claim and a contribution from the debtor's parent, which wanted to use the debtor's tax operating loss carryforwards. The bankruptcy court converted the case. The Eight Circuit affirmed, noting that the facts met the definition of "cause" in section 1112(b) and that the enumerated grounds in (b)(1) through (12) are not exclusive. To the argument that the ruling would require conversion in every liquidating chapter 11 case, the court replied that the clear weight of authority permits liquidating plans and that conversion under section 1112(b) was not mandatory. It remained in the bankruptcy court's discretion. *Loop Corp. v. United States Trustee*, 379 F.3d 511 (8th Cir. 2004).

5.1.ppp. Court denies examiner appointment in public company case. The debtor is a public company with more than $5 million in unsecured debt. Disgruntled shareholders alleged that the debtors and the creditors' committee were improperly colluding to depress their valuation and sought an examiner to "investigate" the debtors' value at the estate's expense after the court had denied their requests for an equity committee to conduct a valuation, also at the estate's expense. The court denied the motion under section 1104(c)(1). It reasoned that "the basic job of an examiner is to examine, not to act as a protagonist," but that an examiner here "would, at best for the shareholders, advance only their interest in oppostion to the Debtors' plan." The shareholders could pursue their own objection to plan confirmation, but are "not entitled to the appointment of an examiner ... to help it advance that objection." It also denied the motion under the mandatory provision of section 1104(c)(2). An examiner's purpose is "only to conduct an 'investigation'" as generally understood, and the requested assignment here was unrelated to an investigation. *In re Loral Space & Communications Ltd.*, 313 B.R. 577 (Bankr. S.D.N.Y. 2004).

5.1.qqq. Court may not prevent disclosure of sealed document by removing document from the court's files. In support of a motion to appoint a trustee, the Committee filed, under a blanket sealing order, a report on the debtor's prepetition conduct prepared by the debtor's counsel. The report contained substantial information that was irrelevant to the trustee motion and that might have harmed innocent

individuals, if disclosed. A news organization moved for an order unsealing the report. Because the report had not been admitted and contained extraneous material, the bankruptcy court ordered it returned to the Committee, to file in redacted form, if appropriate. The debtor in possession and the Committee then settled the trustee motion. The bankruptcy court denied the unsealing motion, because the report was no longer part of the court record. On appeal, the district court ordered the report restored to the record, under seal, and required the debtor in possession to justify why certain portions should be redacted or kept under seal, under the standards for sealing documents. The public's right to know the contents of judicial proceedings takes precedence over a blanket sealing order, and the court may not defeat that right by ordering a document removed from the court's files, even though the report was never admitted into evidence and might not have been properly filed in the first instance. *The Copley Press, Inc. v. Peregrine Sys., Inc. (In re Peregrine Sys., Inc.)*, 311 B.R. 679 (D. Del. 2004).

5.1.rrr. DIP financing carve out does not limit professional fees. Under the debtor in possession financing order, the court approved a carve out for professional fees, which was allocated in separate amounts to the debtor in possession's professionals and the committee's professionals. The committee's professionals incurred and requested compensation in excess of the carve out amount. The court has authority to allocate the total fees allowed under the carve out and approved the financing with that limitation. In addition, the court has authority to order disgorgement of fees paid to some professionals so as to equalize the distribution to all professionals in an insolvent administration. *In re Channel Master Holdings, Inc.*, 309 B.R. 855 (Bankr. D. Del. 2004).

5.1.sss. Court reverses critical vendor order. On a first day motion, the bankruptcy court promptly authorized the debtor in possession to pay any vendor it deemed critical, in the exercise of the debtor in possession's unilateral discretion, as long as the vendor agreed to provide goods on customary trade terms in the future. The record did not contain evidence, and the bankruptcy court did not make findings, that the vendors would refuse to ship without payment, or that the estate would be better off paying some but not all prepetition claims before a plan. Section 105 did not provide an adequate basis for the court's order. The Bankruptcy Code's priority scheme contemplates equal treatment of unsecured prepetition claims. Neither section 105 nor a "doctrine of necessity" authorizes the court to depart from that priority scheme. Section 363(b) might provide a basis for authorizing the use of the estate's property to pay prepetition unsecured claims. It would require, however, specific findings that the vendors would have ceased doing business with the debtor in possession if the prepetition claims had not been paid and that all other creditors would have been better off, through the prospect of reorganization, by payment of the favored few. (The court does not resolve whether such payments would be in the ordinary course or business or not.) *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004).

5.1.ttt. DIP financing order authorizes creditors committee to bring avoiding power actions. In the debtor in possession financing order, the debtor in possession stipulated to the validity of the lender's claims and liens. However, the order and subsequent stipulations authorized the creditors committee to pursue investigations and to file an action to challenge the lender's claims and liens within a fixed deadline. That provision was adequate to authorize the action without a separate formal request to the debtor in possession to bring the action, denial of that request, and separate court authorization for the committee. *Official Committee of Unsecured Creditors v. Clark (In re National Forge Co.)*, 304 B.R. 214 (Bankr. W.D. Pa. 2004).

5.1.uuu. Chapter 11 creditors committee dissolves upon conversion to chapter 7. The debtor in possession had obtained an order approving a break-up fee as part of its sale procedures motion in advance of the sale of all of its assets. The chapter 11 creditors committee appealed. After the sale was consummated, the court converted the case to chapter 7, and a trustee was appointed. Counsel for the creditors committee assigned the committees rights under the appeal to the trustee, and the trustee argued that he could substitute as a matter of right for the committee on the appeal. The district court rules that the committee ceased to exist upon the conversion, so the post-conversion assignment of the right to appeal was ineffectual. In addition, the trustee, as representative of the estate, is bound by the actions of the debtor in possession, as representative of the estate. Because the debtor in possession sought and obtained the order approving the break-up fee, the trustee could not appeal it. *Official*

Committee of Unsecured Creditors v. Belgravia Paper Co. (In re Great Northern Paper, Inc.), 299 B.R. 1 (D. Me. 2003).

5.1.vvv. "Vicinity of insolvency" is measured by the balance sheet and by adequacy of capital. In an action to hold directors and officers liable for breach of fiduciary duty to creditors while the corporation was in the vicinity of insolvency, the plaintiff and defendant agreed that the balance sheet test (fair value of assets against liabilities) is one of the two tests to determine solvency. But they disagreed on whether the second test was inability to pay debts as they become due (focusing on current maturities in the ordinary course of business) or cash flow and capital adequacy (measured over a longer period of time). The court adopts the latter test, analogizing it to the "unreasonably small capital" test of the fraudulent transfer law. It rules that "a company will be considered inadequately capitalized if it does not have sufficient cash flow to 'account for difficulties that are likely to arise, including interest rate fluctuations and general economic downturns, and otherwise incorporate some margin for error.'" *Pereira v. Cogan*, 294 B.R. 449 (S.D.N.Y. 2003).

5.1.www. Debtor's president is liable to trustee for breach of fiduciary duty. Before bankruptcy, the debtor's president negotiated a sale of the corporation's assets without undertaking any substantial marketing effort. The buyer proposed an employment contract for the president. In addition, the president caused the corporate to delay filing for bankruptcy until the sale agreement was ready. During the delay, the debtor nearly ran out of cash. He also made payments to or for the benefit of insiders. His inadequate marketing efforts violated his duty of care. The delay in seeking bankruptcy protection was an additional breach of the duty of care. Finally, the president breached the duty of loyalty because of his personal interest in the employment contract arising out of the transaction. The court awards damages in the amount lost as a result of the delay in filing bankruptcy and the inadequate marketing and punitive damages of $1 million. *Roth v. Mims*, 298 B.R. 272 (N.D. Tex. 2003).

5.1.xxx. Court limits critical vendor payments. In its decision in *In re CoServ*, 273 B.R. 487 (Bankr. N.D. Tex. 2002), Judge Lynn permitted payment of critical vendors only on a claim-by-claim showing that it was critical to the debtor to continue to deal with the creditor, failure to do so could risk harm to the estate disproportionate to the creditor's prepetition claim, and there was no alternative. Adapting the *CoServ* test to the demands of the *Mirant Corp.* chapter 11, the court permits payment of valid prepetition liens and payment of prepetition claims that the debtor, upon advice of counsel, believes meets the *CoServ* test. However, if an entity demands payment of a claim that does not meet the *CoServ* standards, then: (a) If the debtor pays the amount, the creditor must show cause why the claim should be paid under the *CoServ* standards. If it does not, but returns the payment and continues to deal with the debtor, it will not be in violation of the automatic stay. (b) If the creditor refuses postpetition goods or services to the debtor without meeting the *CoServ* standards, it may be held in violation of the automatic stay. *In re Mirant Corp.*, 296 B.R. 427 (Bankr. N.D. Tex. 2003).

5.1.yyy. Critical vendors order is reversed. The district court reverses the bankruptcy court's order authorizing payment of critical vendors, including foreign vendors and liquor suppliers. The court concludes that section 105 does not authorize the bankruptcy court to expand the provisions of the Code and that the critical vendors order is contrary to the priority scheme set forth in sections 503 and 507. The court follows the cases that have ruled that the "doctrine of necessity" was not included in the Bankruptcy Code and therefore did not survive its enactment. *Capital Factors, Inc. v. Kmart Corp.*, 291 B.R. 818 (N.D. Ill. 2003).

5.1.zzz. DIP financing agreement asset sale time lines are filed under seal. Section 107 provides that papers filed in a bankruptcy case are public records, open to examination, but that the court may protect an entity with respect to confidential commercial information. The debtor-in-possession financing agreement contained a time line by which the debtor agreed to market and sell certain major assets. Because the disclosure of that information would give competitors an unfair advantage and could give potential buyers more leverage in the sale process, the court orders that portion of the DIP financing agreement to be filed under seal. *In re Farmland Industries, Inc.*, 290 B.R. 364 (Bankr. W.D. Mo. 2003).

5.1.aaaa. Non-voting parent corporation is an "affiliate." Section 101(2)(A) defines affiliate as "entity that directly or indirectly owns, controls, or holds with power to vote, 20% or more of the outstanding voting securities of the debtor … ." The owner of 100% of the debtor's common stock had transferred the right to vote under a pledge agreement. Nevertheless, the parent is an "affiliate" under section 101(2)(A), because the phrase "with power to vote" modifies only "holds," not "owns" or "controls." *In re Interlink Home Healthcare, Inc.*, 283 B.R. 429 (Bankr. N.D. Tex. 2002).

5.1.bbbb. Creditors have an absolute right to intervene in an adversary proceeding. The Second Circuit rules that section 109(b) grants a creditor the right to intervene as a matter of right in an adversary proceeding, as well as in the bankruptcy case. It follows the ruling of the Third Circuit in *In re Marin Motor Oil*, 689 F.2d 445 (3d Cir. 1982), and departs from the ruling of the Fifth Circuit in *Fuel Oil Supply v. Gulf Oil Corp.*, 762 F.2d 1283 (5th Cir. 1985), the only two court of appeals decisions that had previously addressed the issue. *Term Loan Holder Committee v. Ozer Group, L.L.C. (In re the Caldor Corp.)*, 303 F.3d 161 (2d Cir. 2002).

5.1.cccc. Breach of duty of loyalty provides grounds for denial of confirmation for lack of good faith. The debtor's CEO was also on the payroll of one of its largest creditors under a contract that required the CEO to follow the creditor's instructions regarding the creditors investments. Neither the CEO nor the creditor disclosed the arrangement to the debtor. The undisclosed existence of the agreement was grounds for denial of the debtor's first plan of reorganization and, though later disclosed, was also grounds for denial of confirmation of the second plan. Relying on *Wolf v. Weinstein*, 372 U.S. 633 (1963), the court concludes that the debtor-in-possession, performing the duties of a trustee, owes a fiduciary duty to the estate and that duty devolves upon officers as well. The duty includes the duty of loyalty, which the CEO breached by its loyalty to the creditor, resulting in a variety of actual harms to the debtor and the estate, including denial of confirmation of the first plan and the attendant expense. The breach of duty tainted the restructuring and the debtor's negotiations toward a plan. "The separate boundaries necessary between a debtor and creditor in formulating a chapter 11 plan" were not enforced. *In re Coram Healthcare Corp.*, 271 B.R. 228 (2001).

5.1.dddd. Insolvent debtor owes fiduciary duty to creditors. Before bankruptcy, while the debtor was insolvent, the controlling shareholder caused the debtor to repay bank loans that the shareholder had guaranteed. The trustee sued the shareholder for breach of fiduciary duty. Once the debtor became insolvent, its officers and directors owe unsecured creditors a fiduciary duty, which requires that they "maximize the value of the assets for payment of unsecured creditors." Therefore, the allegation of payment of a debt guaranteed by the controlling shareholder was a sufficient allegation of breach of fiduciary duty. *Official Committee v. Lozinski (In re High Strength Steel, Inc.)*, 269 B.R. 569 (Bankr. D. Del. 2001).

5.1.eeee. Bank's role in collecting insider-guaranteed debt may breach duty to general creditors. Under Pennsylvania law, an entity may be liable for aiding and abetting a breach of fiduciary duty if it has knowledge of the breach and provides substantial assistance or encouragement in effecting the breach. Here, the bank encouraged the debtor's controlling shareholder to cause the debtor to repay bank loans that the shareholder had guaranteed. Accordingly, the bank may be liable for aiding and abetting if its involvement rose to a level of "substantial assistance or encouragement." *Official Committee v. Lozinski (In re High Strength Steel, Inc.)*, 269 B.R. 569 (Bankr. D. Del. 2001).

5.1.ffff. Chapter 11 distribution and dismissal order was improper. The debtor's assets had been liquidated and only cash remained. The bankruptcy court granted the debtor's motion to distribute the cash in accordance with section 507, even though no disclosure statement or plan had been approved, and for dismissal of the case. The B.A.P. rules that the order was improper, holding that the court must follow the procedures of chapter 11, at least where, as here, a creditor had objected to the distribution and dismissal motion. *Ohio Department of Taxation v. Swallen's, Inc. (In re Swallen's, Inc.)*, 269 B.R. 634 (6th Cir. B.A.P., 2001).

5.1.gggg. Insiders are not personally liable for bankruptcy activities. A debtor rejected an equipment lease from Transcolor. Transcolor did not appear at the hearing on the motion to approve the

rejection and did not object. One year later, in its own bankruptcy case, Transcolor sued the insiders of the first debtor for damages arising from the wrongful rejection of the lease. Although the bankruptcy court ultimately grounded its decision dismissing the lawsuit on waiver, estoppel, and *res judicata*, the court also ruled that, "Parties who counsel or influence a debtor to file bankruptcy. . .are not subject to liability in a collateral proceeding brought in a State court for having given such advice, counsel, or persuasion . . ." *Transcolor Corp. v. Cerberus Partners, L.P. (In re Transcolor Corp.)*, 258 B.R. 149 (Bankr. D. Md. 2001).

5.1.hhhh. DIP loan to multiple debtors does not constitute substantive consolidation. The DIP lender entered into a financing agreement with the debtor and its three debtor subsidiaries, under which each would have access to a line of credit and letters of credit and each would be liable under the line of credit for all amounts advanced to all debtors. Each debtor was given a super-priority administrative expense claim against the other debtors, subordinated only to the lender's super-priority claim, to the extent that the debtor made payments to the lender in excess of funds that it received. The Fifth Circuit rejected the objection of an unsecured creditor that the DIP Financing Order resulted in a de facto substantive consolidation of the estates, finding that the availability of the cross-claims maintained the distinction among the assets and liabilities of each of the debtors, and the Financing Order did not combine the assets and liabilities or establish a common pool of funds to pay claims. In addition, the court rules that the absolute priority rule of section 1129(b) does not apply in the pre-plan context. *Clyde Bergemann, Inc. v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.)*, 250 F.3d 955 (5th Cir. 2001).

5.1.iiii. Bankruptcy court may not expand debtor's rights to utility service beyond section 366. The bankruptcy court enjoined the debtor's telecommunications provider from terminating service on account of the debtor's post-petition default in payments to the provider. The district court reversed, on the ground that section 105 could not expand the debtor's right to utility service beyond the protection provided by section 366 of the Bankruptcy Code and that the injunction expanded the debtor's rights and restricted the provider's rights beyond the permissible scope of section 105. *MFS Telecom, Inc. v. Motorola, Inc. (In re Conxus Communications, Inc.)*, 262 B.R. 893 (Del. 2001).

5.1.jjjj. Liquidating chapter 11 debtor might not be subject to WARN Act liability. The debtor health care provider surrendered its certificate of need to the state on the date of bankruptcy but retained its employees for approximately two weeks to prepare assets for sale. Under the circumstances, the debtor-in-possession was not an "employer" within the meaning of the WARN Act and so was not liable for 60 days notice or back pay to employees who were terminated shortly after filing. The court stresses the significance of the debtor's intent to liquidate upon the filing of the chapter 11 petition as a key factor in determining that the debtor-in-possession was not an "employer." *Official Committee of Unsecured Creditors v. United Healthcare System, Inc. (In re United Healthcare System, Inc.)*, 200 F. 3d 170 (3d Cir. 1999).

5.1.kkkk. Debtor is not a fiduciary in plan negotiations. The secured creditor moved to disqualify counsel for the debtor in possession because counsel had previously (but not currently) represented the purchaser/plan proponent. The court denies the disqualification motion on the ground that the debtor, in its role of proposing and obtaining confirmation of a plan, owes no fiduciary duty to the creditors and, indeed, may be adverse to them both by hard bargaining and by invocation of the cram down power. Because the debtor owed no such duty, its counsel would not be disqualified on motion of the creditor. *In re Water's Edge Limited Partnership*, 251 B.R. 1 (Bankr. D. Mass. 2000).

5.1.llll. Court disapproves executive severance and retention program. Because the debtor's union opposed an executive severance program in such a way that might threaten the viability of the reorganization and because the debtor had not consulted with the union before proposing the plan, the court disapproved the plan, noting three features whose revision would result in approval of the plan. The court suggested a mitigation provision (in the event the executive finds other work after termination), subordination to chapter 7 administrative expenses, and payment of the success/emergence bonus all in stock of the reorganized debtor rather than in cash. *In re Geneva Steel Co.*, 236 B.R. 770 (Bankr. D. Utah 1999).

5.1.mmmm. Fraudulent mismanagement resulting in loss to creditors does not breach fiduciary duty. The debtor's directors fraudulently misstated the debtor's assets, allowing it to incur additional credit and prolong its life. During its extended life, losses to creditors mounted. In a careful and thoughtful reading of Delaware law on directors' fiduciary duty to creditors when the debtor is in the vicinity of insolvency, the court rules that the directors did not breach any such duty by their conduct, because the complaint did not allege that the directors did not use the corporate assets in an informed, good faith effort to maximize the corporation's long-term wealth creating capacity. *Steinberg v. Kendig (In re Ben Franklin Retail Stores, Inc.)*, 225 B.R. 646 (Bankr. N.D. Ill. 1998).

5.1.nnnn. Settlement agreement that transfers control is disapproved. The debtor entered into a settlement agreement with a creditor who had moved to shorten exclusivity. The settlement agreement provided for a transfer of control of the debtor to creditor. The court disapproved the settlement on the grounds that the transfer of control could not be accomplished outside of a plan and on the further ground that the agreement compromised issues that were not the subject of the exclusivity motion. *In re Louise's, Inc.*, 211 B.R. 798 (D. Del. 1997).

5.1.oooo. Bankruptcy Court may not appoint members of a committee. On its own motion, the Bankruptcy Court removed all of the attorney members of the tort claimants' committee and reconstituted the committee with creditors. On appeal, the District Court reverses, holding that the Bankruptcy Court does not have *sua sponte* authority to change the membership of a committee and that the sole authority to appoint and remove members of a committee lies with the United States Trustee. *In re Dow Corning Corporation*, 212 B.R. 258 (E.D. Mich. 1997).

5.2 Exclusivity

5.2.a. Joint plan filing did not waive exclusivity. The debtor and the creditors committee filed a joint plan during the debtor's exclusivity period. The filing of the plan with the committee did not waive the debtor's exclusive right to file a plan. The court may terminate exclusivity for cause (which may include the debtor's consent to termination); but the Code does not separately authorize the debtor to terminate it. Moreover, waiver requires a knowing and intentional relinquishment of a right. Waivers should not lightly be implied. *In re Adelphia Commc'ns Corp.*, 352 B.R. 578 (Bankr. S.D.N.Y. 2006).

5.2.b. Proposal of a "new value" plan is grounds for terminating exclusivity. Recognizing the split in authority on the issue before the Supreme Court's decision in *Bank of America v. 203 N. LaSalle St. Partnership*, 526 U.S. 434 (1999), the bankruptcy court concludes that the presence of a competing bidder and the reasoning of LaSalle require that exclusivity be terminated once the debtor has filed a "new value" plan. *In re Situation Management Systems, Inc.*, 252 B.R. 859 (Bankr. D. Mass. 2000).

5.3 Classification

5.3.a. Guaranteed claim might not be substantially similar to other unsecured claims. The debtor bifurcated the real estate secured creditor's claim and classified the unsecured portion separately from other unsecured claims. A nondebtor entity had guaranteed the secured claim. Chapter XI of the Bankruptcy Act addressed only unsecured claims. It permitted separate classification of claims but did not provide a statutory standard. By contrast, Chapter X of the Act addressed secured and unsecured claims and permitted separate classification based on the "nature" of the claims. The rights a claim gives its holder against the debtor, typically priority and security, determine the "nature" of the claim. Section 1122(a) prohibits classification together only of claims that are not "substantially similar". The absence of "nature" from section 1122(a) suggests Congress intended a different classification regime, not based entirely on the holder's right against the debtor. Therefore, a general unsecured claim for which the creditor has an alternative source of repayment, whether a guarantee or collateral, creates a special circumstance that accords the creditor a different status and might actually require separate classification of its claim from other general unsecured claims. *In re Loop 76, LLC*, 465 B.R. 525 (9th Cir. B.A.P. 2012).

5.3.b. Court permits separate classification of general unsecured and bond claims. The plan classified general unsecured claims separately from claims under two series of bonds issued under separate indentures. Some indenture provisions were ambiguous as to which bonds were senior. The plan resolved the ambiguity by treating the bonds equally. In addition, the plan provided for the continued involvement of the indenture trustee, payment of its fees and indemnification for its activities in helping implement the plan. The general unsecured claim class did not accept the plan; the bond class did. The Code does not prohibit separate classification of similar claims so long as the separate classification is not for an improper purpose, such as manipulating class voting or violating basic priority rights. The resolution of potential litigation between bond issues and the special treatment of the indenture trustee are proper purposes for separate classification, which the court approves. *In re Colonial Bancgroup, Inc.*, 2011 Bankr. LEXIS 1984 (Bankr. M.D. Ala. May 20, 2011).

5.3.c. Guaranteed claim might not be substantially similar to other unsecured claims. The debtor proposed a plan in which the real estate secured creditor's claim was bifurcated and the unsecured portion classified separately from other unsecured claims. The secured claim was guaranteed. Section 1122(a) prohibits classification together of claims that are not "substantially similar". Chapter X of the Bankruptcy Act permitted separate classification based on the "nature" of the claims. Chapter XI of the Act addressed only unsecured claims and permitted separate classification without statutory standard. The "nature" of a claim is determined by the rights it gives its holder against the debtor, typically priority and security. The absence of "nature" from section 1122(a) suggests Congress intended a different classification regime. Classification determines voting and distribution. A creditor who has an alternative source of payment need not be concerned about plan recoveries to the same extent as other creditors and therefore might not vote based on the same interests as other creditors with claims of the same nature. Therefore, a general unsecured claim for which the creditor has an alternative source of repayment might not be substantially similar to other general unsecured claims, permitting or requiring separate classification. *In re Loop 76, LLC*, 442 B.R. 713 (Bankr. D. Ariz. 2010), *accord In re Red Mtn. Machinery Co.*, 448 B.R.1 (Bankr. D. Ariz. 2011).

5.3.d. Improper substantive consolidation under a plan may result in improper classification. Based on a widely (but not universally) supported settlement agreement, the plan provided for *de facto* substantive consolidation of the multiple debtor estates, which eliminated both pre- and postpetition intercompany claims. Because the claims were eliminated, they were not classified under the plan and did not vote. The court did not determine whether there were independent grounds for substantive consolidation but confirmed the plan based on the consolidated distribution that the settlement agreement contemplated and on the elimination under the plan of intercompany claims. In the context of a motion for a stay pending appeal, the district court determines that there is a substantial likelihood that the consolidation was improper. It was based on a settlement that had not yet become effective when the bankruptcy court was considering whether to confirm the plan, because it became effective only under the plan. Moreover, for the same reason, the non-classification of intercompany claims improperly eliminated the intercompany claims' plan voting rights. *ACC Bondholder Group v. Adelphia Commc'ns Corp. (In re Adelphia Commc'ns Corp.)*, 2007 U.S. Dist. LEXIS 7416 (S.D.N.Y. Jan. 24, 2007).

5.3.e. Third party release of insurance company is not warranted; separate classification is. The debtor was a law firm that was subject to numerous malpractice claims. The malpractice carrier proposed to contribute a substantial amount to the plan, which would be used to pay separately classified malpractice claims. The court determines that because the insurer had an obligation to pay up to the policy limits to the estate, its contribution under the plan did not provide a basis for a third party release. Similarly, the court disapproves the third party release in favor of the partners, because there was no showing that the partners' contribution was substantial. Nevertheless, the court permits separate classification of the malpractice claims from the general trade claims, because the insurance proceeds were available only to the malpractice claimants. *In re Mahoney Hawkes, LLP*, 289 B.R. 285 (Bankr. D. Mass. 2002).

5.3.f. Unsecured deficiency claim must be classified with general unsecured claims. The Ninth Circuit joins the Second, Fourth, Fifth, Sixth, Eighth, and Eleventh Circuits in ruling that the unsecured deficiency claims created by section 1111(b) may not be classified separately from general unsecured

claims without a legitimate business or economic justification. *Barakat v. The Life Insurance Company of Virginia (In re Barakat)*, 99 F.3d 1520 (9th Cir. 1996).

5.4 Disclosure Statements and Voting

5.4.a. Court enforces vote assignment in subordination agreement. The debtor issued subordinated debt to former shareholders to purchase their shares. In the agreement providing for subordination of their claims, the former shareholders agreed that if a reorganization case were commenced, the debtor's bank "is irrevocably authorized to … take such other actions (including without limitation, voting the Subordinated Debt) as it may deem necessary or advisable." Section 510(a) requires the court to enforce a subordination agreement. The section is not limited to priority issues; its plain terms apply to the entire agreement. Section 1126(a) permits "the holder of a claim" to vote. But it does not preclude assignment of a holder's voting rights. Nor does assignment violate public policy, as protection of creditors' rights to vote is not a fundamental purpose of the Bankruptcy Code. Finally, Rule 3018 permits a creditor to authorize an agent to vote. Construed consistently with Rules 2019 and 3001, which require an "authorized agent" only to produce the instrument empowering it to act, the Rule does not require that the agent act in the principal's interest. Therefore, the bank may, on behalf of the former shareholders, accept a plan that provides no recovery for the shareholders. *Rosenfeld v. Coastal Broadcasting Sys., Inc. (In re Coastal Broadcasting Sys., Inc.)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 91469 (D.N.J. June 28, 2013).

5.4.b. Postpetition negotiation and agreement does not violate section 1125. The debtor and two groups of creditors negotiated and litigated against each other for a year before reaching agreement on a chapter 11 plan, which they embodied in a restructuring support agreement. The agreement required the signing creditors to accept a plan that was consistent with the agreement once the court approved a disclosure statement. The agreement was enforceable by specific performance. Section 1125(b) prohibits postpetition solicitation of plan acceptances before transmittal of a court-approved disclosure statement. Section 1126(e) permits the court to disqualify any acceptance that was not solicited in good faith or in accordance with the Code. The Code's structure contemplates and encourages negotiation, and section 1125 does not prohibit it. Thus, "solicitation" should receive a narrow construction. Negotiation's natural result is agreement. Prohibiting agreement would undercut the incentive to negotiate. Where, as here, the parties were sophisticated and had substantial information before reaching agreement, obtaining a binding commitment to support a plan is not a prohibited solicitation, and a resulting plan acceptance is not in bad faith or in violation of the Code. Therefore, the court does not disqualify the acceptances. *In re Indianapolis Downs, LLC*, 486 B.R. 286 (Bankr. D. Del. 2013).

5.4.c. Approval of a third-party release requires adequate disclosure and evidence of adequate consideration. The debtor's bond indenture trustee re-perfected a lapsed security interest within 90 days before bankruptcy. The debtor in possession sued to avoid the re-perfection as a preference. The debtor in possession and the indenture trustee settled the litigation by allowance of the bonds as secured claim in a substantially reduced amount. The settlement provided for the indenture trustee's release of its contractual indemnification claims against the debtor and for a third-party release of the bondholders' claims against the indenture trustee. However, the settlement was contingent upon confirmation of a plan that incorporated its terms. The court approved the settlement and later approved a disclosure statement, which mentioned the third-party release in the course of describing all plan releases, but did not highlight it or call specific attention to it through boldface, italic, underlined or all-capitals type. The bondholders overwhelmingly accepted the plan, but one bondholder objected to confirmation based on the third-party release. A court may approve a third-party release in a plan if the third party has made an important contribution to the reorganization, the release is essential to confirmation, a large majority of creditors accept the plan, there is a close connection between the claims against the third party and the debtor and the plan provides for payment of substantially all affected claims. Rule 3016(c) requires a disclosure statement to "describe in specific and conspicuous language" any injunction the plan proposes. A third-party release has the same effect as an injunction, so the Rule's requirements apply equally. Here, because the disclosure was not clear and conspicuous, the disclosure statement did not comply with the Rule. Therefore, the plan's acceptance by a large majority of bondholders was inadequately informed and therefore did not satisfy the third requirement for approval of a third-party release. In addition, there was insufficient evidence of what the bondholders received in exchange for the release or whether it was

adequate. *Bank of N.Y. Mellon Trust Co. v. Becker (In re Lower Bucks Hosp.)*, 488 B.R. 303 (E.D. Pa. 2013).

5.4.d. 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.e. 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).

5.4.f. Court may deny disclosure statement approval if the plan is facially nonconfirmable. The debtor proposed a plan and sought approval of a disclosure statement. Creditors challenged the confirmability of the plan on feasibility and good faith grounds. Ordinarily, confirmation issues are reserved for the confirmation hearing and should not be heard at the disclosure statement approval hearing. However, where there are no material facts in dispute, the plan defects cannot be overcome by creditor acceptance of the plan, and the court has given adequate notice that it may consider the issues at the disclosure statement hearing, the court may determine at that hearing that the plan is not confirmable. A court need not go through a needless solicitation and confirmation hearing if matters can be clearly determined earlier. *In re Am. Cap. Equip., LLC*, 688 F.3d 145 (3d Cir. 2012).

5.4.g. Strategic motive to defeat confirmation and absence of bad faith does not support "cause" to change a vote of a claim purchased during the voting period. A single asset real estate debtor proposed a plan to pay its oversecured lender in full over time and artificially impaired the class of general unsecured claims. The unsecured claims class's two creditors accepted the plan. During the voting period, the secured lender purchased one of the claims and moved for authority to change the acceptance to a rejection for the express purpose of defeating the plan by preventing the existence of an impaired consenting class. Rule 3018(a) requires a creditor to show cause to change or withdraw a ballot. "Cause" requires more than a simple change of heart, more than a mere absence of an improper motive and more than a strategic reason. Here, waiting until after a plan is voted before deciding what claims to buy does violence to the plan solicitation process because it diverts attention from negotiation for the best plan for all creditors and permits parties to vie for control of the case outside the plan confirmation process. Therefore, the creditor did not show cause to change its vote. *Beal Bank USA v. Windmill Durango Office, LLC (In re Windmill Durango Office, LLC)*, 481 B.R. 51 (9th Cir. B.A. P. 2012).

5.4.h. Preplan settlement may not bind and "unimpair" a bondholder class. The debtor's bond indenture trustee re-perfected a lapsed security interest within 90 days before bankruptcy. The debtor in possession sued to avoid the re-perfection as a preference. The debtor in possession and the indenture trustee settled the litigation by allowance of the bonds as secured claims in a substantially reduced

amount. The settlement provided for the indenture trustee's release of its contractual indemnification claims against the debtor and for a third party release of the bondholders' claims against the indenture trustee. However, the settlement was contingent upon confirmation of a plan that incorporated its terms. The debtor proposed such a plan, designating the bondholder class as unimpaired. The court approved the settlement. An indenture trustee's settlement of an adversary proceeding may not bind bondholders unless the indenture authorizes the indenture trustee to do so. Here, the indenture did not do so. A class of claims is impaired unless the plan does not alter the legal, contractual or equitable rights of holders of claims in the class. Because the settlement did not alter bondholders' rights, the plan would do so, and the bondholder claim class is therefore impaired. *In re Lower Bucks Hosp.*, 471 B.R. 419 (Bankr. E.D. Pa. 2012).

5.4.i. Approval of a third party release requires adequate disclosure. The debtor's bond indenture trustee re-perfected a lapsed security interest within 90 days before bankruptcy. The debtor in possession sued to avoid the re-perfection as a preference. The debtor in possession and the indenture trustee settled the litigation by allowance of the bonds as secured claim in a substantially reduced amount. The settlement provided for the indenture trustee's release of its contractual indemnification claims against the debtor and for a third party release of the bondholders' claims against the indenture trustee. However, the settlement was contingent upon confirmation of a plan that incorporated its terms. The court approved the settlement and later approved a disclosure statement that did not clearly describe the third party release. The bondholders overwhelmingly accepted the plan, but one bondholder objected to confirmation based on the third party release. A court may approve a third party release in a plan if the third party has made an important contribution to the reorganization, the release is essential to confirmation, a large majority of creditors accept the plan, there is a close connection between the claims against the third party and the debtor and the plan provides for payment of substantially all affected claims. Rule 3016(c) requires a disclosure statement to "describe in specific and conspicuous language" any injunction the plan proposes. A third party release has the same effect as an injunction, so the Rule's requirements apply equally. Here, because the disclosure was inadequate, the disclosure statement did not comply with the Rule. More importantly, the plan's acceptance by a large majority of bondholders was inadequately informed and therefore did not satisfy the third requirement for approval of a third party release. *In re Lower Bucks Hosp.*, 471 B.R. 419 (Bankr. E.D. Pa. 2012).

5.4.j. Subordination agreement vote assignment provision is not enforceable. Under an intercreditor subordination agreement, the junior creditor assigned its bankruptcy voting rights to the senior creditor. Section 510(b) requires the court to enforce a subordination agreement, but not, however, to nullify other Code provisions. A subordination agreement provision that would alter a creditor's substantive rights under the Code is not enforceable. Therefore, the junior creditor may vote its own claim. *In re SW Boston Hotel Venture, LLC*, 460 B.R. 38 (Bankr. D. Mass. 2011).

5.4.k. Section 1129(a)(10)'s single impaired class acceptance requirement applies to each debtor in a joint plan. The 111 jointly administered debtors proposed a single joint chapter 11 plan. The plan did not provide for substantive consolidation of the debtors, so the plan was deemed to be a separate plan for each of them. Every impaired class for which an acceptance or rejection was submitted accepted the plan, though for some of the debtors, there were no acceptances or rejections from any impaired class. Section 1129(a)(10) requires, as a condition to confirmation, that a plan be accepted by at least one impaired class of claims. Under section 102(7), "the singular includes the plural", so the reference in section 1129(a)(10) to "a plan" should not be read to apply on a "per plan", rather than a per debtor, basis, and entity separateness is fundamental. Section 1129's other confirmation conditions also speak in the singular, yet provisions such as subsection (a)(3)'s good faith test and subsection (a)(7)'s best interest test apply per debtor. Read consistently with those paragraphs, subsection (a)(10) should apply per debtor. Finally, joint administration, which has the effect of permitting a joint plan, should not have any substantive effect. Applying section 1129(a)(10)'s acceptance requirement on a per plan basis would have such an effect. Therefore, it applies on a per debtor basis. The court notes that, with proper notice in the disclosure statement or voting instructions, a non-voting class might appropriately be treated as an accepting class. *In re Tribune Co.*, ___ B.R. ___, 2011 WL 5142420 (Bankr. D. Del. Oct. 31, 2011).

5.4.l. Subrogation clause is effective to transfer voting rights. The first mortgage lender and the second mortgage lender agreed in an intercreditor agreement that the first mortgage lender was "subrogated" to the second mortgage lender "with respect to [the second's] claims against Borrower, rights, liens, and security interests, if any, in any of the Borrower's assets … until the Senior Debt shall have been paid in full". The debtor proposed a plan that paid the first over time and gave the second a small payment on the plan's effective date in full satisfaction of the second's claim. The first rejected the plan for both the first and the second. The first had not paid anything to the second. A right to accept or reject a plan is a derivative right that a claim holder possesses. Subrogation may be equitable or contractual. It substitutes one party in place of another with respect to a claim. The subrogee steps into the subrogor's shoes with respect to the claim. Contractual subrogation does not require any payment of the subrogor by the subrogee. The contractual terms govern. Here, the contract made the subrogation effective upon the contract's execution. Therefore, the first succeeds to the second's right to accept or reject the plan. Bankruptcy does not make a subrogation clause's transfer of voting rights unenforceable. Therefore, the first may reject the plan on behalf of the second. *In re Avondale Gateway Center Entitlement, LLC,* 2011 U.S. Dist. LEXIS 41450 (D. Ariz. Apr. 12, 2011).

5.4.m. Class with a single creditor who does not accept the plan is not a non-accepting class. A creditor purchased all the first lien claims during the chapter 11 case. The court designated the creditor's plan rejection under section 1126(e). A class accepts a plan under section 1126 if the plan is accepted by creditors (other than creditors whose acceptances or rejections are designated) "that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by" creditors whose acceptances or rejections are not designated. If a class does not accept the plan, then the section 1129(b) cram down protections apply, requiring the plan to be fair and equitable as to, and not to discriminate unfairly against, that class. Where the court has designated and thus ignores all the claims in a class in calculating the vote, it would be anomalous not to ignore the entire class for voting purposes as well, lest the designation be rendered meaningless. Therefore, section 1129(b) does not apply to a single creditor class whose rejection has been designated. In addition, affirming the court's prior decision in another case, the court determines that if none of the creditors of a class accept or reject the plan, whether by reason of apathy or designation, the class is deemed to accept. *DISH Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79 (2d Cir. 2011).

5.4.n. Modification of plan provision for voting power of new stock requires resolicitation. The debtor proposed a plan that provided for creditors to receive 5,000,000 shares of Class A stock, which represents 90% of the equity interests but only 18% of the voting interests, and for the old stockholder to receive 500,000 shares of Class B stock, which represents 10% of the equity and 82% of the voting interest. The directors are divided into two classes. The Class B shares entitled the old stockholder to elect one of seven directors. After one class rejected the plan, the debtor modified the stock provisions to provide for only one class of directors. The equity split would remain the same, but all stock would vote together as a single class, with the Class B stock having 40% of the voting power. Section 1127 permits a plan proponent to modify a plan before confirmation but requires resolicitation of acceptances if the modification adversely changes the treatment of any class of claims or interests. A plan modification is material if it would motivate a creditor to reconsider its prior acceptance, even if it did not change its prior acceptance. Because the provisions governing corporate governance affect the voting rights of the stock the creditors would receive under the plan, the modification is material and requires resolicitation. *In re Young Broadcasting Inc.*, 430 B.R. 99 (Bankr. S.D.N.Y. 2010).

5.4.o. Class with a single creditor who does not accept the plan is not a non-accepting class. A creditor purchased all the first lien claims during the chapter 11 case. The court designated the creditor's plan rejection under section 1126(e). A class accepts a plan under section 1126 if the plan is accepted by creditors (other than creditors whose acceptances or rejections are designated) "that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by" creditors whose acceptances or rejections are not designated. If a class does not accept the plan, then the section 1129(b) cram down protections apply, requiring the plan to be fair and equitable as to, and not to discriminate unfairly against, that class. It would be anomalous for a class whose sole creditor's rejection has been designated to be entitled to the same protections to which the class would be entitled if the creditor were permitted to accept the plan but did not. Therefore, section 1129(b) does not apply to a

single creditor class whose rejection has been designated. In addition, affirming the court's prior decision in another case, the court determines that if none of the creditors of a class accept or reject the plan, whether by reason of apathy or designation, the class is deemed to accept. *In re DBSD N. Am., Inc.*, 419 B.R. 179 (Bankr. S.D.N.Y. 2009).

5.4.p. Court refuses to designate plan proponents' votes under section 1126(e). The chapter 11 trustee and a creditor group settled their disputes over the creditors' claims against the debtor by agreeing to a liquidating plan term sheet. In the term sheet, the settling creditors agreed to accept the plan. The trustee and the creditors, as co-proponents, filed a plan that embodied the settlement, filed and obtained approval of a disclosure statement, and sought confirmation. The creditors accepted the plan. Their acceptances need not be designated under section 1126(e) as having been improperly solicited. First, section 1125(b) does not require "a creditor intending to jointly propose a plan to draft a disclosure statement, get it approved, and then mail it to himself before agreeing to vote for it." Second, direct plan negotiation, even to resolve disputed claims as part of the plan, is not, under section 1125(b), a "solicitation", a term that should be construed narrowly to include only the specific request to accept a plan. Third, the term sheet agreement did not give the trustee a specific performance right against the creditors, so the creditors could have decided not to accept the plan, once they reviewed the disclosure statement. Finally, the creditors were well informed, so vote designation here would not advance section 1125's policy of encouraging information dissemination before solicitation. *In re The Heritage Org.*, 376 B.R. 783 (Bankr. N.D. Tex. 2007).

5.4.q. A non-voting class has not "accepted" the plan. None of the creditors holding claims in an impaired class returned plan ballots. Section 1129(a)(8) relieves the debtor of meeting the cram-down requirements for an impaired class that "has accepted the plan". Section 1126(c) provides that a class "has accepted a plan if such plan has been accepted by creditors … that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class … ." A class in which none of the creditors accept the plan therefore has not "accepted" the plan as contemplated by section 1129(a)(8). *In re Vita Corp.*, 358 B.R. 749 (Bankr. C.D. Ill. 2007).

5.4.r. Subordination agreement may transfer voting rights. Two creditors agreed in a subordination agreement that the senior creditor could vote the junior creditor's claim in a bankruptcy. Section 1126(a) permits a claim holder to vote a claim, but section 510(a) makes a subordination agreement "enforceable in a case under this title to the same extent [as] under applicable nonbankruptcy law." Rules 3018 and 9010 permit an agent or other representative to vote a claim, and section 1126(a) does not explicitly limit prevent a claim holder from delegating or bargaining away the right. Therefore, the junior creditor's prebankruptcy agreement to permit the senior creditor to vote the claim is enforceable. *Blue Ridge Investors, II, LP v. Wachovia Bank, N.A. (In re Aerosol Packaging, LLC)*, 362 B.R. 43 (Bankr. N.D. Ga. 2007).

5.4.s. Court excludes pre-marked ballots. The creditors committee solicited votes for its plan with a ballot form that the court had approved. Plan opponents sent pre-marked ballots to certain creditors and solicited plan rejections. The pre-marked ballots are improper and may not be counted. A pre-marked ballot implies that the creditor does not have a choice to make. Only a ballot confirming to Official Form 14, with boxes to accept or reject the plan, are acceptable. *Bakes v. Official Comm. of Unsecured Creditors*, 359 B.R. 831 (S.D. Fla. 2007).

5.4.t. Court enjoins misleading plan solicitation. An attorney representing an ad hoc equity committee solicited votes on his website against the plan, using false and misleading statements, such as "there is no downside to shareholders voting 'no.'" Because he purported to represent a committee and sought compensation from the estate, he was a fiduciary and therefore owes a duty to those he purports to represent to present only truthful information, and he is answerable to the court for breach of the duty. Although reluctant to enjoin commercial speech, the court concludes it is appropriate to do so when the speech is false and misleading. In this case, the grounds for injunctive relief were met: if shareholders followed the attorney's recommendation, the plan might not be confirmed, causing significant delay and extra expense; there was a probability of success on the merits against his misleading solicitations; balancing the harms, the attorney had an alternative course of action, truthful solicitation; and it was in

the public interest to enjoin a misleading solicitation. *Official Comm. of Equity Sec. Holders v. The Wilson Law Firm, P.C.*, 334 B.R. 787 (Bankr. N.D. Tex. 2005).

5.4.u. Creditor holding claim subject to pending objection may not vote on a chapter 11 plan. The creditor had obtained a state court judgment against the debtor and filed a proof of claim in the bankruptcy court for the judgment amount. The debtor in possession expressed an intention to appeal the judgment and filed an objection to the creditor's claim. Section 1126(a) permits only a holder of an allowed claim to accept or reject a plan. Section 502(a) provides that a filed claim is allowed unless a party in interest objects. Because of the pending objection, the creditor's claim was not allowed, and the creditor was not entitled to vote. The creditor's alternative was to seek immediate adjudication of the claims objection or to seek temporary allowance of the claim for voting purposes under Bankruptcy Rule 3018(a). *Jacksonville Airport, Inc. v. Mickeldel, Inc.*, 434 F.3d 729 (4th Cir. 2006).

5.4.v. Section 3(a)(9) exemption is not available to amended plan under foreign proceeding. The debtor had commenced an *Acuerdo Preventivo Extrajudicial* (APE) proceeding under Argentine law and obtained all requisite consents and Argentine court approval. It commenced a section 304 ancillary proceeding in the United States to enforce the plan in the U.S. The plan provided retail holders with less favorable treatment than qualified institutional buyers because offering the QIB treatment to retail holders would have required compliance with the registration requirements of U.S. securities laws. The bankruptcy court required equal treatment as a condition to approval. The debtor amended the plan, obtained a new vote and Argentine court approval, and sought approval of the new plan from the U.S. court. Approval required compliance with U.S. securities laws to permit offering and distribution to U.S. retail holders. Section 3(a)(9) of the Securities Act of 1933 is not available as an exemption for this purpose, because the debtor had compensated its financial advisor for the initial solicitation on an incentive basis, contrary to what section 3(a)(9) permits. Even though the subsequent solicitation did not involve incentive compensation to the financial advisor, it was integrated with the prior solicitation and therefore was not exempt under section 3(a)(9). *Argentinian Recovery Co. v. Board of Directors of Multicanal S.A.*, 331 B.R. 537 (S.D.N.Y. 2005).

5.4.w. Prepetition lock-up agreement does not evidence lack of good faith. Before filing chapter 11, the debtor negotiated a lock-up agreement with its principal secured lenders. The agreement provided that the debtor would file chapter 11 and propose a plan containing terms specified in the agreement and that the creditors would provide postpetition financing and support the plan. The plan provided for elimination of equity interests. The debtor's signing the lock-up agreement did not evidence a lack of good faith. Although it limited the debtor's future course of action to seek more recovery for equity, it also provided assurances of postpetition financing and support for a plan. It therefore is proper and does not evidence bad faith that would prevent confirmation. *In re Bush Industries, Inc.*, 315 B.R. 292 (Bankr. N.D.N.Y. 2004).

5.4.x. Section 1129(a)(2) required chapter 11 compliance only by the plan proponent. The major bondholder supported one of two competing plans. Counsel for the bondholder improperly contacted the financial advisor for the unsecured creditors committee. The contact did not constitute a violation of section 1129(a)(2), which requires that the proponent of a plan comply with the applicable provisions of title 11, because the bondholder was not a plan "proponent." *In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213 (Bankr. D.N.J. 2000).

5.4.y. Prepetition solicitation of consents must be clear. The debtor's prepetition solicitation of consents to a prepackaged chapter 11 plan requested that creditors "consent to and support a plan of reorganization under chapter 11" substantially similar to the exchange offer that was proposed, but the solicitation did not include a proposed plan. Based on these facts, the court held that the votes were not acceptances of a plan but simply an agreement to agree on a plan. As a result, the plan could not be confirmed as a prepackaged chapter 11 plan. *In re Pioneer Finance Corp.*, 246 B.R. 626 (Bankr. D. Nev. 2000).

5.4.z. Vote transfer agreement is unenforceable. As part of a subordination agreement, the junior creditor authorized the senior creditor to vote its claim in a chapter 11 case. The agreement was

unenforceable as contrary to the expressed language of section 1126 (a), authorizing the holder of a claim to vote. *Bank of America, N.A. v. North LaSalle St. Ltd. Partnership (In re 203 N. LaSalle St. Ltd. Partnership)*, 246 B.R. 325 (Bankr. N.D. Ill. 2000).

5.4.aa. Adequacy of prepetition disclosure statement is not governed by section 1125. The debtor submitted its prepetition disclosure statement and solicitation materials to the SEC for review, which declared the registration statement effective. In determining whether the disclosure statement was adequate, the court ruled that section 1126(b), governing prepetition disclosure, rather than section 1125, defining "adequate information," is the standard against which the disclosure statement must be judged. *In re Zenith Electronics Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999).

5.4.bb. Disclosure statement description of plan amendments not required for plan participants. Where major players in the chapter 11 case were fully informed about plan amendments that directly affected them, failure of the plan proponent to revise the disclosure statement to describe the amendments for the benefit of those participants is not a grounds for objection to the disclosure statement or to confirmation. *In re Cajun Electric Power Cooperative, Inc.*, 230 B.R. 715 (Bankr. M.D. La. 1999).

5.4.cc. Failure to disclose material information in a disclosure statement may bar discharge. The individual principals of a corporate debtor failed to disclose material financial information in the corporate chapter 11 case. In the individual's subsequent chapter 7 case, the intentional withholding of relevant information in the chapter 11 disclosure statement constituted grounds for denial of discharge under section 727(a)(2). *Peterson v. Scott (In re Scott)*, 172 F.3d 959 (7th Cir. 1999).

5.4.dd. Purchased claims may be voted against a plan. The Ninth Circuit held that the sole secured creditor of a single asset real estate debtor did not act in bad faith when it purchased and voted a majority of the unsecured claims in order to defeat the debtor's proposed reorganization plan. A creditor is permitted to act with "enlightened self-interest" to preserve what it reasonably believes to be its fair share, as long as it has no ulterior motive. The Ninth Circuit also ruled that purchased claims may be voted separately for the purpose of the numerosity requirement of section 1126(c). *Figter Ltd. v. Teachers Insurance and Annuity Association of America (In re Figter Ltd.)*, 118 F.3d 635 (9th Cir. 1997).

5.4.ee. Purchasing claim to vote against a plan is not bad faith. The secured creditor in a single asset real estate case offered to purchase all non-insider unsecured claims outside of the plan, acquired the claims, and voted them against the debtor's plan. Absent a showing of an ulterior motive or an attempt to coerce payment for more than its fair share of the debtor's estate, the creditor's votes on the purchased claims would not be designated under section 1126(e) as cast in bad faith. *255 Park Plaza Associates Ltd. Partnership v. Connecticut General Life Insurance Company (In re 255 Park Plaza Associates Ltd. Partnership)*, 100 F.3d 1214 (6th Cir. 1996).

5.4.ff. Criminal contempt is an appropriate remedy for disclosure and solicitation violations. A creditor improperly solicited rejections of the small business debtor's plan, suggesting that the creditor's own plan, which would follow denial of confirmation of the debtor's plan, would be a better choice. The district court confirmed a criminal contempt sanction by the bankruptcy judge as a remedy for the violation of Section 1125. *Colorado Mountain Express, Inc. v. Aspen Limousine Service, Inc. (In re Colorado Mountain Express, Inc.)*, 198 B.R. 341 (D. Colo. 1996).

5.5 Confirmation, Absolute Priority

5.5.a. Back-up liquidation provision in a plan does not establish feasibility. The debtor's plan provided that if it did not make payments that the plan required, it would be liquidated to make distributions to creditors. The debtor's recent operating history suggested that the debtor would not be able to make the payments. Section 1129(a)(11) requires as a condition to confirmation that confirmation "is not likely to be followed by the liquidation or need for further financial reorganization … unless such liquidation or reorganization is proposed in the plan." This section applies only where the plan is a liquidating plan or the proposed liquidation is likely to yield the payments provided for in the plan; a mere

"drop dead" provision, without more, is not adequate to meet the section's requirement. Therefore, the court denies confirmation. *In re Renegade Holdings, Inc.*, ___ B.R. ___, 2013 Bankr. LEXIS 2193 (Bankr. M.D.N.C. May 29, 2013).

5.5.b. Best interest test applies only to creditors with filed claims. The individual debtor had suffered a substantial fraud judgment that precipitated the bankruptcy. The creditor did not file a claim by the claims bar date. The debtor proposed a plan that did not provide for any recovery on the fraud claim. Section 1129(a)(7), the best interest test, requires that a plan provide for a recovery by a creditor that is not less than the amount the creditor would receive in a hypothetical chapter 7 case. Even though the fraud creditor would have had an opportunity to file a proof of claim after the chapter 11 claims bar date if the case converted to chapter 7, the best interest test applies only to actual creditors with allowed claims in the chapter 11 case. If it applied to all creditors who might conceivably file proofs of claim in a converted chapter 7 case but who did not file them in the chapter 11 case, the test would become unmanageable. Therefore, the plan meets the best interest test and may be confirmed. *Marshall v. Marshall (In re Marshall)*, ___ F.3d ___, 2013 U.S. App. LEXIS 13398 (9th Cir. June 28, 2013).

5.5.c. Court limits plan modification after consummation. The confirmed and consummated plan created a creditor trust to litigate issues remaining after plan confirmation, including claims by and against the estate. The trust agreement provided that the trust terminates five years after confirmation, unless the court issues an order at least six months before the scheduled termination date extending the trust's life. The IRS regulation governing liquidating trusts requires that any extension of a trust's life occur within six months before the trust's termination. Within six months before the trust's termination, the trustee sought to extend the trust's life and either to amend the plan to require that extension orders be issued within, rather than before, six months before the scheduled termination date or to obtain a plan interpretation or clarification that the time period was intended to be within six months, consistent with the IRS regulation. Section 1127(b) permits modification of a confirmed plan only before substantial consummation. Therefore, the court could not amend the plan. An interpretation is a modification where it is directly contrary to the plan language. Therefore, the court denies the trustee's motion to extend the trust's life. *In re Daewoo Motor Am., Inc.*, 488 B.R. 418 (C.D. Cal. 2011).

5.5.d. Absolute priority rule applies to a plan sponsored by an equity holder's spouse. The debtor owns a shopping center, subject to a $10 million mortgage. The debtor's principal owns 100% of the debtor. The principal's wife owns a management company that employs the principal at an annual salary of $500,000 to run the shopping center. The debtor proposes a plan that values the shopping center at $8.2 million and provides a rewritten $8.2 million secured note to the mortgage holder, payment of 15% of allowed unsecured claims over five years and issuance of 100% of the equity to the principal's wife in exchange for a $375,000 new value contribution. The plan proposes to assume the management contract. The secured creditor does not accept the plan. The absolute priority rule entitles non-accepting creditors to full payment before equity holders may receive value under a plan on account of their equity interests. If an equity holder proposes a new value contribution for the equity in the reorganized debtor under a plan that a class of claims does not accept, the valuation of the contribution must be subject to a market test. The equity holder here is the principal, who receives value through his wife's receipt of the reorganized debtor's equity, including through the continuation of his contract with the management company, and the value he receives is at least in part on account of his equity interest in the debtor, through which he controlled the plan's details. Therefore, the plan is subject to the absolute priority rule, and the valuation is subject to a market test. The only appropriate market test is some form of competition, including by permitting the secured lender to credit bid its claim, whether or not exclusivity has been terminated. *In re Castleton Plaza, LP*, 707 F.3d 821 (7th Cir. 2013).

5.5.e. Fifth Circuit permits artificial impairment. The single asset real estate debtor proposes a plan under which the equity owners invested $1.5 million, the single oversecured secured lender would be paid in full over time and the small amount of general unsecured claims would be paid in cash in full three months after the effective date, though it has sufficient cash to pay the unsecured claims in full on the effective date. The secured class rejects the plan; the unsecured class accepts unanimously. The court finds that the reorganized debtor would be able to make all payments under the plan. Section 1129(a)(3) permits plan confirmation only the plan is proposed in good faith, and section 1129(a)(10) requires that

at least one impaired class of claims have accepted the plan. A class is impaired if the plan proposes any alteration of the claim's legal rights. Neither the plan proponent's motive in proposing impairment nor the reorganized debtor's ability to pay the claims without impairment are relevant to determining impairment. Therefore, the plan meets section 1129(a)(10)'s "one impaired accepting class" requirement. A plan proposed with a legitimate and honest purpose to reorganize and with a reasonable prospect of success is proposed in good faith. Here, the equity holders contributed substantial new equity, the debtor had substantial equity in the real property, and the plan was feasible. Therefore, the plan is proposed in good faith, and its artificial impairment of the unsecured claims class does not require a contrary finding. *Western Real Estate Equities, L.L.C. v. Village at Camp Bowie I, L.P. (In re Village at Camp Bowie I, L.P.)*, 710 F.3d 239 (5th Cir. 2013).

5.5.f. Fifth Circuit approves use of *Till* interest rate in chapter 11 cramdown. The hotel debtor's properties are well maintained and managed, revenue exceeded projections in the months before confirmation, the hotel property's value is stable or appreciating, and the debtor's proposed plan is tight but feasible. The plan proposes to repay the undersecured lender's secured claim at an interest rate of prime plus 1.75%. The plurality opinion in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), approved the use in a chapter 13 case of a cramdown interest rate of prime plus a risk factor, generally from 1% to 3%, in part because of the simplicity of the prime-plus approach. It rejected the coerced loan, market, presumptive contract rate and cost of funds approaches. The Court also acknowledged, in footnote 14, that a market approach might be appropriate in a chapter 11 case, if an efficient loan market exists. However, the majority of lower courts have adopted the *Till* prime-plus approach for chapter 11 cases. Without suggesting that the *Till* approach is the only or even the optimal method, the Court of Appeals rules that it was not error for the bankruptcy court here to apply *Till* here. The 1.75% adjustment is appropriate in light of the facts of this case. Therefore, the Court of Appeals affirms the confirmation order. *Wells Fargo Bank N.A. v. Texas Grand Prairie Hotel Realty, L.L.C. (In re Texas Grand Prairie Hotel Realty, L.L.C.)*, 710 F.3d 324 (5th Cir. 2013).

5.5.g. Section 1111(b) election claim includes postpetition attorneys' fees but not postpetition interest. The undersecured creditor made the section 1111(b) election to have its entire claim treated as secured "to the extent that such claim is allowed" under section 502, rather than bifurcated into secured and unsecured portions under section 506(a). The claim includes postpetition contractual interest and contractual attorneys' fees. Section 506(b) allows "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement" to a creditor holding an oversecured claim. But it does not disallow interest or fees, costs or charges to an undersecured or unsecured creditor. Section 502(b) provides the sole grounds for disallowance of a claim. Section 502(b)(2) disallows postpetition interest, and section 502(b)(1) disallows other portions of a claim "to the extent not enforceable under applicable nonbankruptcy law". Attorneys' fees are enforceable under applicable law. Therefore, the creditor's claim is allowed to include attorneys' fees but not postpetition interest, and that amount is the claim that is subject to the section 1111(b) election. *In re Castillo*, 488 B.R. 441 (Bankr. C.D. Cal. 2013).

5.5.h. 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.)*, 486 B.R. 559 (D.S.C. 2013).

5.5.i. A party whose interests are in the zone of interests the statute protects may object to confirmation. The debtor proposed a plan that provided for the debtor to assign liability insurance policies issued by nonsettling insurers to an asbestos trust, despite antiassignment provisions in the policies. The plan proposed to be "insurance neutral"—that is, it would not affect the insurers' rights or defenses under the policy, other than regarding the antiassignment provision—but it limited certain defenses that the

insurers could assert against settling insurers, permitted some claimants to assert direct claims against the insurers, and allowed the trust to pay claims and seek indemnification from the insurers. A party may object in a chapter 11 case if it is a party in interest under section 1109 and meets Article III and federal prudential standing requirements. Section 1109 does not provide an exclusive list of parties who qualify as parties in interest. It applies "to anyone who has a legally protected interest that could be affected" by the case. Because the plan may affect the insurers' rights and defenses, they have standing under section 1109 to object to the plan. Article III standing requires that a party show an injury in fact that is traceable to the proposed court order and may be redressed by a favorable ruling. For the same reasons that the insurers have section 1109 standing, they have Article III standing. A party meets the prudential standing requirement if its interests are in the zone of interests protected by the statutory provision at issue in the case. Here, the insurers' interests meet that requirement. Therefore, they have standing to object to plan confirmation. *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869 (9th Cir. 2012).

5.5.j. Plan that proposes collateral sale may not deprive a secured creditor of the right to credit bid its claim. The lender had a lien on substantially all of the debtor's assets, which were worth less than the claim amount. The debtor's plan proposed a sale of all assets, with the sale proceeds paid to the lender, according to sale and bid procedures that prohibited the lender from credit bidding its secured claim. The lender objected to confirmation. The court may confirm a plan without the acceptance of a class of claims if the plan is fair and equitable as to that class. Under section 1129(b)(ii)(A), a plan is fair and equitable to a class of secured claims if it proposes (i) that the holders of a secured claim retain their lien and receive payments with a present value equal to the amount of the secured claims, "(ii) for the sale, subject to section 363(k)", of the encumbered property free and clear of the lien or "(iii) for the realization by such holders of the indubitable equivalent of such claims." Section 363(k) authorizes the holder of a secured claim to credit bid its claim, unless the court for cause orders otherwise. In construing a statute, the specific governs the general, so as to give effect to every provision. Clause (ii) is a specific provision that governs the general "catch-all" provision of clause (iii). Therefore, even if the result of a sale would be to provide the secured creditor the indubitable equivalent of its claim, the plan must satisfy clause (ii). To do so, section 363(k) must apply, and the secured creditor must be permitted to credit bid, unless the court for cause orders otherwise. Because the debtor did not point to any such cause, the plan does not meet section 1129(b)(2)'s requirements and may not be confirmed. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. ___, 132 S. Ct. 2065 (2012).

5.5.k. Section 1123(a) preempts a private contract restriction, including an anti-assignment provision. The debtor's liability insurance policies each contained an anti-assignment provision. To fund in part an asbestos trust created under section 524(g), the debtor's chapter 11 plan provided for the assignment, over the insurers' objections, of all its rights under the policies to the trust. Section 1123(a) provides that, "Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall … (5) provide adequate means for the plan's implementation, such as … (B) transfer of all or any part of the property of the estate to one or more entities …." Congress may preempt state law by express language or by implication, either by occupying the legislative field or because of a conflict between state and federal law. There is a general presumption, which also applies in bankruptcy, against preemption, but ultimately, Congress's purpose is the guide. The use of "notwithstanding" is a clear indication of Congressional intent to preempt. The phrase "any otherwise applicable law" includes private contracts, which are implemented and enforced under state law. Therefore, section 1123(a)(5)(B) preempts state law that would enforce the policies' anti-assignment provisions, and the plan may provide for the assignment of the policies to the trust. *In re Federal-Mogul Global Inc.*, 684 F.3d 355 (3d Cir. 2012).

5.5.l. Secured claim valuation for plan confirmation purpose is based on present fair market value, not future prospects. At a cash collateral hearing at the beginning of the case, the real estate developer debtor in possession produced an appraisal that showed that the real property collateral securing the first and second lien debt was worth less than the amount secured by the first lien. To support plan confirmation, the debtor prepared a budget and projections showing that over time, the collateral, when developed and sold, would generate net cash proceeds in excess of the first lien debt plus interest. Yet based on the prior appraisal, adjusted downward for sales during the case, the debtor valued the collateral at less than the first lien debt and so proposed to treat the second lien creditor as wholly

unsecured. Section 506(a) requires that the court value property to determine the extent of a creditor's secured claim. The court must determine the value "in light of the purpose of the valuation and of the proposed disposition or use of such property." The plan proposed that the debtor retain the property, develop it and sell it in the ordinary course of its business as a developer, so the court must use the property's fair market value as of the plan confirmation date, rather than a foreclosure or liquidation value. The court rejects a "wait-and-see" approach that would base the value on cash collections over time. The projections do not determine value, as they contemplate the reorganized debtor's investment of labor and capital into producing the returns. The court must not determine future value, under which a junior secured creditor could retain its lien to see how the property performs and collect anything after a senior lien creditor is fully paid, but must determine current value. Based on the collateral's current fair market value, the second lien creditor was out of the money and should be treated as the holder of an unsecured claim. *In re Heritage Highgate, Inc.*, 679 F.3d 132 (3d Cir. 2012).

5.5.m. A chapter 11 plan may strip an underwater lien. The court determined at plan confirmation that the present fair market value of a real estate developer's property was less than the amount of the first lien secured by the property. Under section 506(a), the holder of the second lien had only an unsecured claim. Section 506(d) avoids a lien to the extent it does not secure an allowed secured claim. However, *Dewsnup v. Timm*, 502 U.S. 410 (1992), prohibited avoiding such a lien in a chapter 7 case in which the collateral was being was abandoned to a foreclosure sale outside of the case. By contrast, a chapter 11 plan involves the retention of collateral to use in a reorganized business, and chapter 11, in provisions such as sections 1129(b) and 1111(b), expressly contemplates stripping an underwater lien. Therefore, the plan may properly treat the claim as an unsecured claim under section 506(a) and avoid the lien under section 506(d). *In re Heritage Highgate, Inc.*, 679 F.3d 132 (3d Cir. 2012).

5.5.n. Treasury bonds are not the indubitable equivalent of real estate. The single asset real estate debtor valued the collateral securing the secured lender's $38.3 million claim at $13.5 million. It proposed a plan that would substitute Treasury bonds, to be purchased by an investor in the reorganized debtor, with a face amount of $13.5 million and a total payment stream over 30 years of $38.3 million. The lender made the section 1111(b) election and did not accept the plan. Section 1129(b)(2)(A)(i) permits confirmation if the plan provides for a secured claim holder to retain its lien on the property and receive cash payments with a present value equal to the property's value. Section 1129(b)(2)(A)(iii) permits confirmation if the plan provides for the secured claim holder to receive the indubitable equivalent of its claim. Treasury bonds are not the indubitable equivalent of real estate, because they have a different risk and volatility profile. Substituting Treasury bonds, especially at today's very low interest rates, would deprive the secured claim holder of the possibility of collateral appreciation with general inflation and expose the holder to the risk of collateral deflation, as inflation causes interest rates to rise and bond values to decline. A 30-year maturity exacerbates the problem. If the reorganized debtor defaults, the creditor's Treasury bill collateral would likely be worth substantially less than its real estate collateral. Therefore, the court denies plan confirmation. *In re River East Plaza, LLC*, 669 F.3d 826 (7th Cir. 2012).

5.5.o. Feasibility requires credible evidence, not merely consent, and a "drop dead" provision does not suffice. The debtor proposed a plan to restructure substantial bond debt by issuance of three new bond series in substantially reduced amounts, some bearing pay-in-kind interest and requiring refinancing in seven years. Refinancing would require that three major contingencies, over which the reorganized debtor would have no control, all occur. Creditors overwhelmingly accepted the plan. Section 1129(a)(11) requires that the court find as a condition to confirmation that the plan is feasible, that is, not likely to be followed by liquidation or the need for further financial reorganization unless the plan so provides. Feasibility cannot be negotiated or based on the lack of an objection. The plan proponent must present some credible evidence that the plan, including any required refinancing, is feasible. A "drop dead" plan provision, which provides that the reorganized debtor will liquidate if it is unable to refinance, is insufficient to meet section 1129(a)(9)'s requirement. Therefore, the court denies confirmation. *In re Las Vegas Monorail Co.*, 462 B.R. 795 (Bankr. D. Nev. 2011)

5.5.p. A debtor may use artificial impairment to meet the consenting class requirement of section 1129(a)(10). The single asset real estate debtor owed $32 million to a single secured creditor, who had purchased the claim to acquire the real estate, and $60,000 to general unsecured creditors. The

real estate was worth $34 million, and the debtor had adequate cash to pay unsecured creditors in full upon confirmation. The debtor's plan proposed to pay the secured claim over five years and to pay the unsecured claims over three months after the effective date. The secured class rejected the plan; the unsecured class and the equity class accepted. Section 1129(a)(10) requires as a condition to confirmation that at least one impaired class of claims accept the plan. The plan's proposal to pay unsecured claims over three months was an artificial impairment; that is, it was a minor impairment that was not required by the debtor's cash position. Section 1129(a)(10) does not distinguish between kinds of impairment, and Congress intended to give "impairment" the broadest possible meaning. Therefore, artificial impairment does not vitiate acceptance for purposes of applying section 1129(a)(10). A court may deny confirmation of a plan that artificially impairs a class under section 1129(a)(3) for not being proposed in good faith. "Good faith" requires only a legitimate purpose to reorganize in a way that has a reasonable chance of success. The Code's language permits the debtor to use artificial impairment to obtain confirmation and implicitly recognizes a debtor's need for negotiating leverage with its creditors to preserve value for equity. Compliance with explicit and implicit Code provisions supports a finding of good faith. The creditor's motive and consequent refusal to negotiate as a creditor in this case further supports the propriety of the debtor's actions. *In re Village at Camp Bowie I, L.P.*, 454 B.R. 702 (Bankr. N.D. Tex. 2011).

5.5.q. All about post-petition interest under a chapter 11 plan. The liquidation plan proposed payment or satisfaction in full of claims in various classes of senior and subordinated bonds and payment of postpetition interest from any surplus before holders of equity interests would receive any distribution. Section 1129(a)(7) requires as a condition to plan confirmation that holders of claims and interests receive at least as much as they would in a hypothetical liquidation under chapter 7. Payment of holders of claims of more than they would receive in a chapter 7 case violates section 1129(a)(7) as to holders of interests, because the interest holders would receive more in the chapter 7 case. In a chapter 7 case, holders of claims are entitled under section 726(a)(5) to payment of postpetition interest on their allowed claims "at the legal rate from the date of the filing of the petition". The reference to "the" legal rate (rather than "a" legal rate) implies the rate on judgments, not the contractual rate. Payment of interest on judgments is a procedural matter that is governed by the forum's law. These factors point to use of the federal judgment rate. Use of that rate promotes fairness among creditors and administrative efficiency, because it provides a simple rule that reduces litigation and delay. The effect of a choice of a rate on recovery on claims or interests is not an appropriate consideration, because the statute's plain language requires selection of the federal judgment rate. The federal judgment rate is variable. The rate in effect on the petition date applies, because section 726(a)(5) refers to that date as the date from which interest runs. Interest compounds only annually, despite any contractual provision for more frequent compounding, because the federal judgment rate so provides. Therefore, a plan that provides for interest under the plan at a higher rate violates section 1129(a)(7) as to interest holders. A subordination agreement does not affect the rate for which the debtor is liable, though it may affect intercreditor issues. Section 510(a) requires the court to enforce a contractual subordination provision to the extent enforceable under applicable nonbankruptcy law. Therefore, the Rule of Explicitness, which applies under New York law, applies in a bankruptcy case. In this case, the indenture was explicit and permits the senior creditors to receive their full contractual interest from the distribution to subordinated noteholders' plan distribution, despite their inability to recover the interest from the debtor. *In re Wash. Mut., Inc.*, 461 B.R. 200 (Bankr. D. Del. 2011).

5.5.r. Note trading by creditors who participate in plan negotiations does not prevent plan confirmation for lack of good faith but may subject the claims to equitable disallowance. Holders of large positions in the debtor's senior notes participated in plan negotiations with the debtor and the major adverse parties. After a year of litigation and intermittent negotiations, the parties reached a settlement that the participating noteholders supported. Their participation in the negotiations resulted in greater recoveries for creditors in the case. The settlement did not entitle them to any greater distribution than other holders of claims in the same class. The noteholders were subject to confidentiality agreements, and they refrained from trading while negotiations were ongoing. However, when negotiations broke off, the debtor disclosed material information, though not information about the existence or terms of the negotiations, and the noteholders traded actively. Section 1129(a)(3) permits plan confirmation only if the plan is proposed in good faith and not by any means forbidden by law. This requires that the

plan is consistent with the Code's purposes, that it was proposed with honesty and that there is fundamental fairness in dealing with creditors. Here, the plan did not favor the participating noteholders, and the noteholders' conduct improved recoveries. Therefore, any trading in which the noteholders engaged did not prevent the plan from being proposed in good faith and not by means forbidden by law. However, if the trading were improper, the court may consider equitable disallowance of the noteholders' claims. Section 510(c) permits subordination "under principles of equitable subordination". Section 510(c)'s reference only to subordination does not limit the section's reach. Principles of equitable subordination, derived from *Pepper v. Litton*, 308 U.S. 295 (1939), also permit disallowance for inequitable conduct, despite section 502(b)'s limitation of the grounds for claims disallowance under that section. Besides, violation of the securities laws in connection with the case might constitute sufficient grounds for equitable disallowance, and the debtor independently might have a defense to the claims of noteholders who violated the securities laws. Use of material nonpublic information in trading violates the securities laws under either the classical theory, violating a trust or fiduciary relationship with the debtor, or the misappropriation theory, under which the trader appropriates to his own use information that belongs to the debtor. Here, the fact and terms of negotiations was material nonpublic information because of the significance of the negotiations to the value of the notes. The participating noteholders could be considered insiders because they received material nonpublic information and because they held blocking positions in their classes. Therefore, even though the plan may be confirmed despite the trading, the court finds colorable claims for equitable disallowance, based on the trading, and the estate may seek equitable disallowance of their claims. *In re Wash. Mut., Inc.*, 461 B.R. 200 (Bankr. D. Del. 2011).

5.5.s. Court permits plan modification to extend a liquidating trust's life. The confirmed chapter 11 plan provided for the transfer to a liquidating trust, with a limited life, of a cause of action to generate additional creditor recoveries. Due to state court litigation delays, the trust was set to expire before the litigation could conclude. The liquidating trustee moved for an order modifying the plan to extend the trust's life. Since confirmation, the trust made only one payment, based on a pre-confirmation agreement. Section 1127(b) permits post-confirmation modification only if the plan has not been substantially consummated. Under section 1101(2), a plan has been substantially consummated if all property proposed by the plan to be transferred has been transferred, the debtor has assumed management of the business (if any) and plan distributions have commenced. Transfer of property differs from distributions to creditors under the plan. Here, the cause of action was transferred to the trust, though no plan distributions had been made. A court may permit only a modification that does not upset creditors' expectations and that complies with all applicable chapter 11 provisions, including sections 1122, 1123, 1125 and 1129. Here, the modification need resulted from unforeseeable circumstances and will not prejudice creditors. Therefore, the court permits the extension of the trust's life. *In re Boylan Int'l Ltd.*, 452 B.R. 43 (Bankr. S.D.N.Y. 2011).

5.5.t. A cram down plan sale requires that the secured creditor be permitted to credit bid. Section 363(k) provides that at a sale under section 363(b), a secured creditor may credit bid its claim, unless the court orders otherwise. Section 1129(b)(1) requires that a plan confirmed without the acceptance of one or more classes be fair and equitable as to the non-accepting class. Section 1129(b)(2)(A) provides that the fair and equitable requirement as to a class of secured claims includes the requirement that the plan provide "(i)(I) that the holders of such claims retain the liens secured by such claims, whether the property … is retained by the debtor or transferred … (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens … or (iii) for the realization by such holders of the indubitable equivalent of such claims". The secured lenders here had a lien on all of the debtor's assets. The debtor filed both a plan that provided for the sale at a public auction of all its assets free and clear of liens and a motion for approval of bid procedures for the plan sale, with a stalking horse asset purchase agreement at a price substantially below the lenders' claim amount. The bid procedures motion sought to preclude the lenders from credit bidding their claims, arguing that a plan providing for a sale free and clear, with proceeds paid to the secured creditors, could be confirmed under clause (iii). The lenders objected. What constitutes indubitable equivalent under clause (iii) depends on the market value of the lenders' collateral. A bankruptcy sale may result in a below market value price for several reasons. If lenders are not satisfied that cash bids at an auction adequately reflect market value, they may protect themselves by a credit bid. Moreover, the specific controls the general, and permitting cram down under clause (iii) in a way that violates clauses (i)

or (ii) would improperly render the latter clauses superfluous. *River Rd. Hotel P'ners, LLC v. Amalgamated Bank*, 651 F.3d 642 (7th Cir. 2011).

5.5.u. Insurer whose liability policies are assigned to a mass tort trust has standing to object to confirmation. The debtor was subject to numerous asbestos claims and a limited number of silicosis claims. The debtor's plan proposed the establishment of a silicosis claims trust and the assignment of the debtor's liability insurance policies to the trust, with full preservation of the insurer's defenses, including coverage defenses. The policies contained anti-assignment provisions. The insurer objected to the assignment of the policies as well as to other plan provisions that the insurer argued would increase the insurer's exposure in fact, even without any modification of the policies. Standing to object requires at a minimum Article III standing, which requires a concrete, distinct and palpable actual or imminent injury in fact. Section 1109(b) also requires that the objector be a "party in interest", which is "anyone who has a legally protected interest that could be affected by a bankruptcy proceeding". This standard is essentially co-extensive with the Article III standard. The increase in exposure, even though uncertain and contingent, as well as the administrative cost that the insurer would have to incur to defend against the possible increase, constitutes a tangible disadvantage to the insurer that provides the basis for standing as a party in interest. Although the appellate "person aggrieved" standing standard may be more stringent than "party in interest" standard, a party may appeal an adverse ruling on "party in interest" standing, even if it could not appeal the decision on the merits. Otherwise, the party could never obtain recourse for an improper exclusion from the bankruptcy case. Therefore, the insurer may appeal. The court remands to the bankruptcy court for the determination of the insurer's objection. *In re Global Industrial Techs., Inc.*, 645 F.3d 201 (3d Cir. 2011).

5.5.v. Terminating exclusivity provides a market test for a new value plan. The debtor filed a new value cram down plan, which provided for the old equity holders to purchase the stock of the reorganized debtor at a set price. The debtor did not market the company to determine the price but relied on expert testimony. The largest creditor sought exclusivity termination so that it could file its own plan, offered to pay more for the reorganized debtor's equity and objected to confirmation of the debtor's plan. Where the debtor proposes a new value cram down plan, the value of the new equity issued under the plan is subject to a market test, under *In re 203 N. Lasalle St. P'shp*, 526 U.S. 434 (1999). The market test may be provided either by competing bids or competing plan proposals. Here, the court chooses the latter, denies confirmation and terminates exclusivity to permit the creditor to file a competing plan. *H.G. Roebuck & Son, Inc. v. Alter Comm'ns, Inc.*, 2011 U.S. Dist. LEXIS 59781 (D. Md. June 3, 2011).

5.5.w. Liquidating plan fails best interest test. The plan provided for the debtor's liquidation, for the appointment of a liquidating trustee to pursue claims for the creditors' benefit, for the appointment of a plan committee to oversee the trustee's conduct, with authority to bring claims that the trustee decided not to pursue and for distribution largely in accordance with the chapter 7 distribution scheme. The trustee's fees were largely contingent and were not capped by the statutory maximum that applies to a chapter 7 trustee's fees. The plan authorized the trustee and the committee to retain professionals. The best interest test of section 1129(a)(7) does not permit confirmation if the distribution under the plan to any nonaccepting creditor is less than the creditor would receive in a hypothetical chapter 7 case. The principal difference between the plan distributions and a hypothetical chapter 7 distribution involves the fees of the trustee's and the committee's professionals. The difference in the trustees' professional fees is speculative and therefore does not prevent confirmation under the best interest test. However, the committee's professionals, especially if the committee pursues litigation that the trustee refuses to pursue, is predictably higher than the fees that would be incurred in a chapter 7 case. Therefore, the plan does not meet the best interest test. *In re Colonial Bancgroup, Inc.*, 2011 Bankr. LEXIS 1984 (Bankr. M.D. Ala. May 20, 2011).

5.5.x. Court designates vote of competitor that bought claims and rejected plan to acquire debtor. The debtor proposed a plan under which its first lien note holders would receive modified notes and its second lien note holders would receive substantially all the reorganized debtor's equity. After the debtor filed the plan, a competitor purchased all of the debtor's first lien notes at par and rejected the plan. In purchasing the claims, the competitor intended to acquire the debtor, not to recover as a creditor. Section 1126(e) permits a court to designate an entity whose acceptance or rejection of a plan was not in good faith. Courts should use the power sparingly. Merely purchasing claims to defeat a plan or mere selfishness amount to bad faith. To find absence of good faith, the court must find an ulterior motive beyond self-interested protection of the claim, such as a quest to obtain a non-ratable better deal, to acquire an interest in the debtor's property or to further

the creditor's own business interests by destroying the debtor's business. The analysis is factually intensive, and the conclusion must be based on the totality of the circumstances. Here, the creditor did not seek maximum recovery on its claim but advancement of its strategic objective of acquiring the debtor's business, which shows an absence of good faith in rejecting the plan. Even though the creditor held all the claims in the class, the competitor's rejection of the plan to further its acquisition interest was not consistent with its interest as a creditor in enhancing recoveries. The court therefore designates the creditor's rejection of the plan. *DISH Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79 (2d Cir. 2011).

5.5.y. Senior creditor class may not distribute collateral proceeds to equity holders when a junior creditor class does not accept the plan. The debtor proposed a plan under which its first lien note holders would receive modified notes, its second lien note holders would receive most of the reorganized debtor's equity, unsecured creditors would receive a nominal amount of equity and the existing shareholder would receive the balance of the equity in "satisfaction, release, and discharge" of the existing equity interests to induce the shareholder to continue to lend its expertise to the reorganized enterprise. The debtor's overall value was insufficient to pay the senior creditors in full, so neither the junior creditors nor the equity holders would have received anything if the senior creditors had not permitted the distribution. The unsecured claims class did not accept the plan, and an unsecured creditor objected to confirmation. The court may confirm a plan that an unsecured claim class has not accepted only if the plan is fair and equitable to the non-accepting class. Section 1129(b)(2)(B) codifies in part the fair and equitable rule; it requires that the plan provide for full satisfaction of the unsecured claims or that the holders of equity interests not receive or retain any property under the plan on account of their interests. The shares that the former equity holders would receive are property. They are received under the plan, not directly from the second lien lenders after they received their own distribution under the plan, and the plan made clear that the distribution was on account of—that is, because of—the old equity interests. A plan might provide for distribution to new equity to old equity on account of a new value contribution, but the contribution must be in money or money's worth, not the promise of future services. The distribution here was, if anything, on account of future services, that is, the shareholder's continuing involvement in the management of the reorganized debtor. Finally, the fair and equitable rule applies to distribution of "any property", whether or not it is property subject to a senior creditor's lien, if the distribution is under the plan. Therefore, the court could not confirm the plan. *DISH Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79 (2d Cir. 2011).

5.5.z. Disparate plan treatments violate equal treatment rule, but a third party release may be required as a condition to distribution under the plan. The plan provided that holders of claims above a specified amount in one class would be entitled to subscribe to a rights offering.. The plan excluded holders of small claims in the class from the subscription right because of issues of administrative convenience. The plan also provided that holders of claims in all classes would release third parties, but if the creditor opted out of the release on its ballot, the creditor would not receive any consideration under the plan. Finally, the plan provided for holders of claims in a third class to receive cash, or at the holder's election, stock in the reorganized debtor. Some claims in the third class were disputed at the time of voting and therefore were not provided a ballot. Section 1123(a)(4) requires that a plan provide the same treatment for each holder of a claim in a class, unless the holder elects less favorable treatment. A claim may be classified separately for administrative convenience under section 1122(b), but not treated differently within the class. Therefore, depriving holders of small claims of the subscription right for administrative convenience violates the equal treatment rule. Depriving a creditor who does not grant a release of distributions under a plan does not violate the equal treatment rule. A creditor who refuses to grant a release retains potential value and thereby may receive less favorable plan distribution treatment, as long as the decision is the creditor's and all creditors in the class have the same election. Depriving a holder of a disputed claim of the election to receive stock violates the equal treatment rule. Once the claim is allowed, its holder is entitled to the same treatment as holders of claims that were allowed at the time of balloting. *In re Wash. Mut., Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011).

5.5.aa. *Res judicata* might not bar a debtor in possession in a second case from challenging lease that the debtor in possession assumed in a prior case. The debtor leased land to a contractor, who built a store for the debtor and leased the store and subleased the land back to the debtor. The debtor filed chapter 11 and confirmed a reorganization plan that provided for the reorganized debtor's continued operation. During the chapter 11 case, it assumed both leases and the sublease, because it intended to continue to operate the

store. The reorganization was unsuccessful, and the reorganized debtor filed a second chapter 11 case 18 months after confirmation in its first case. The debtor's plan in the second case provided for liquidation and appointment of a plan administrator. The administrator challenged the characterization of the leases, arguing that they constituted a disguised secured financing. *Res judicata* bars relitigation of a final judgment involving the same parties or their privies. A successor in interest may be in privity with a prior party if their substantive legal relationship is complete. Although a bankruptcy estate succeeds to a debtor's interests, the trustee (or debtor in possession) as representative of the estate and creditors may have different interests from those of the debtor. Here, the reorganized debtor succeeded to the interests of the first debtor in possession, but the second debtor in possession (and therefore the plan administrator) had different incentives and therefore different interests from the first debtor in possession. The first debtor in possession and reorganized debtor wanted to continue operating the store; the second one was interested only in maximizing recovery for creditors. Therefore, they were not in privity, and the administrator was not barred by *res judicata* from challenging the lease. *In re Montgomery Ward, LLC*, 634 F.3d 732 (3d Cir. 2011).

5.5.bb. Court may rely on intrinsic value in the absence of a market, but deferred cash payment cram down requires payments. The debtor owned a single parcel of undeveloped land. It proposed a plan that valued the property at substantially more than the secured debt and provided that interest would continue to accrue for three years. During the three years, the debtor would maintain the property and pay taxes and insurance and would attempt to refinance or sell and would pay principal and accrued interest only from proceeds. If it were unable to refinance or sell, the secured creditor could resort to all available remedies. There was no market for undeveloped land, so the debtor relied on intrinsic value. A court may use intrinsic value, even when the lack of a market is not caused solely by the debtor's bankruptcy, just as it may rely on an intrinsic interest rate that might be unavailable to a reorganizing debtor in the market. Section 1129(b)(1) permits nonconsensual plan confirmation if the plan treatment is fair and equitable to the nonconsenting class. Section 1129(b)(2) contains additional requirements, not merely illustrations, for nonconsensual confirmation. Section 1129(b)(2)(A)(i) permits cram down based on deferred cash payments. The debtor's plan here does not provide for deferred cash payments to the creditor during the three-year period and so does not meet the cram down requirement. The appellate court remands for the bankruptcy court to determine whether the plan meets the indubitable equivalent requirement of section 1129(b)(2)(A)(iii). *East West Bank v. Ravello Landing, LLC*, 2010 U.S. Dist. LEXIS 101007 (D. Nev. Sept. 7, 2010).

5.5.cc. Duty to maximize value under a plan is not absolute. The debtor had guaranteed its parent's lender's claim for up to $75 million. The debtor had contracted prepetition for a sale through a plan of its principal asset for more than enough to pay all claims, including the guarantee claim, but for less than other offers for the asset. The proceeds to equity would not be enough to pay the parent's full liability to the lender. The debtor's equity holders accepted the plan. The lender objected to confirmation on the ground that the debtor had not maximized the estate's value. A debtor in possession ordinarily has a duty to maximize the estate's value. But stakeholders may accept less than optimal treatment under a plan. The court reaches this result even without distinguishing between the duty of the debtor in possession, acting with all the duties of a trustee, and the duty of the debtor, who may propose a plan and who does not have such duties, nor between a duty to maximize value and a duty to attempt to maximize value. *In re Texas Rangers Baseball P'ners*, 434 B.R. 393 (Bankr. N.D. Tex. 2010).

5.5.dd. Nonimpairment under section 1124(1) requires that a creditor's post-effective date remedy be left unaffected. The debtor guaranteed a portion of the debtor's parent's loan. The loan agreement with the debtor and its parent provided that the lender would have the right to approve any sale of the debtor's principal asset. The debtor proposed a plan that provided for a sale of its principal asset and payment in cash in full of the guaranteed portion of the loan without the lender's consent. Section 1124(1) provides that a class of claims is not impaired if the plan does not alter the legal, equitable or contractual rights to which the claim entitles its holder. Section 1124(1) is prospective. It requires that the plan preserve the creditor's rights after consummation. However, because the sale is consummated at, not after, the effective date, the lender may not exercise the consent rights. But if the breach of the approval provision damaged the lender, its rights against the debtor and its parent to assert a claim must be preserved for the class not to be impaired. *In re Texas Rangers Baseball P'ners*, 434 B.R. 393 (Bankr. N.D. Tex. 2010).

5.5.ee. 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.ff. 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).

5.5.gg. Absolute priority rule does not apply in an individual chapter 11 case. The individual chapter 11 debtor operated a small business as a sole proprietorship but got into financial trouble from real estate investments. The debtor proposed a plan that left him the business but paid his general unsecured creditors only 10%. One creditor in that class rejected the plan; none accepted, but none objected to confirmation. Section 1129 permits plan confirmation where fewer than all classes have accepted the plan if the plan is "fair and equitable" as to the nonaccepting class. Under section 1129(b)(2)(B), for a class of unsecured claims, "fair and equitable" requires that the plan provide that claims receive full payment or that equity not receive or retain any property, except in an individual case, "the debtor may retain property included in the estate under section 1115". Section 1115 provides that in an individual case, "in addition to property specified in section 541", property of the estate includes property acquired postpetition and postpetition earnings. These provisions were added in 2005 as part of a legislative package that attempted to make the rules governing payments to creditors in an individual chapter 11 case parallel those in a chapter 13 case. Reading section 1115 narrowly, to exclude property that becomes property of the estate under section 541, would require the debtor to devote section 541 property to the plan, unlike in a chapter 13 case. Reading it to include section 541 property (and thus to exclude section 541 property from the absolute priority rule of section 1129(b)(2)(B)) makes the provision consistent with chapter 13. Therefore, the court confirms the plan. *In re Shat*, 424 B.R. 854 (Bankr. D. Nev. 2010).

5.5.hh. Court denies confirmation sua sponte under section 1129(d) for tax avoidance. A single individual controlled both the shell corporation debtor and its sole creditor, who held its unsecured claim through a convoluted series of insider transactions involving additional affiliated corporations. The debtor's sole asset was it net operating loss carryovers. It proposed a plan that would convert the creditor's debt to equity. The disclosure statement made clear that the purpose was to allow the debtor to preserve and to be able to use the NOL. Not surprisingly, the creditor accepted the plan. The IRS did not object to confirmation, but the U.S. trustee did. Section 1129(d) provides, "on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes". Section 307 authorizes the U.S. trustee to appear and be heard on any issue, and section 105 permits the court to take action sua sponte despite a provision requiring an issue to be raised by a party in interest. As the U.S. trustee is the congressionally mandated watchdog in bankruptcy cases, the U.S. trustee is a party in interest who may object to confirmation on tax avoidance grounds under section 1129(d). The plan's principal purpose was tax avoidance, but the plan also was not proposed in good faith, because it did not have a valid reorganization purpose at all, such as preserving a going concern or maximizing value for creditors. Therefore, the court denies confirmation and dismissed the case. *In re S. Beach Secs., Inc.*, 606 F.3d 366 (7th Cir. 2010).

5.5.ii. A cram down plan sale does not require that the secured creditor be permitted to credit bid. Section 363(k) provides that at a sale under section 363(b), a secured creditor may credit bid its claim, unless the court orders otherwise. Section 1129(b)(1) requires that a plan confirmed without the acceptance of one or more classes be fair and equitable as to the non-accepting class. Section 1129(b)(2)(A) provides that the fair and equitable requirement as to a class of secured claims includes the requirement that the plan provide "(i)(I) that the holders of such claims retain the liens secured by such claims, whether the property … is retained by the debtor or transferred … (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens … or (iii) for the realization by such holders of the indubitable equivalent of such claims". The secured lenders here had a lien on all of the debtor's assets. The debtor filed a plan that provided for the sale at a public auction of all its assets free and clear of liens. It also filed a motion for approval of bid procedures for the plan sale, with a stalking horse asset purchase agreement at a price substantially below the lenders' claim. The bid procedures motion sought to preclude the lenders from credit bidding their claims, arguing that a plan providing for a sale free and clear, with proceeds paid to the secured creditors, could be confirmed under clause (iii). The lenders objected. The three clauses of section 1129(b)(2)(A) are connected by "or", which is not exclusive, so the court may confirm the plan if any one of the clauses applies. Although a specific statutory provision prevails over a general one, clause (iii) is not a general provision but a broad catchall that provides an alternative to a sale under clause (ii). As such, clause (ii) does not limit the use of clause (iii) to effect a sale. Clause (iii) requires only that the secured creditors receive the "indubitable equivalent" of their claims. It does not prescribe a specific procedure; nor is credit bidding required for a secured creditor to receive the indubitable equivalent. Therefore, the bid procedures need not permit credit bidding for the plan sale to comply with the section 1129(b)(2)(A) cram down requirements. A vigorous dissent argues that the entire structure of the treatment of secured claims under sections 363(k), 1111(b) and 1129(b)(2)(A) does not permit evasion in the context of a straight plan sale to a third party of the secured creditor's credit bidding protection. *In re Phila. Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010).

5.5.jj. Court designates vote of competitor that bought claims and rejected plan to acquire debtor. The debtor proposed a plan under which its first lien note holders would receive modified notes and its second lien note holders would receive substantially all the reorganized debtor's equity. After the debtor filed the plan, a competitor purchased all of the debtor's first lien notes at par and rejected the plan. In purchasing the claims, the competitor intended to acquire the debtor, not to recover as a creditor. Section 1126(e) permits a court to designate an entity whose acceptance or rejection of a plan was not in good faith. Absence of good faith may be found where the creditor seeks personal advantage not available to other holders of claims of the same class or has an ulterior motive that is not related to its interest as a creditor. For example, a court may designate a vote where the creditor is using its position to assume control of the debtor, put the debtor out of business or gain competitive advantage, destroy the debtor out of malice or obtain benefits from an agreement with a third party that depends on the debtor's failure to reorganize. Even though it held all the claims in the class, the competitor's rejection of the plan to further its acquisition interest was not consistent with its interest as a creditor in enhancing recoveries. The court therefore designates its rejection. *In re DBSD N. Am., Inc.*, 421 B.R. 133 (Bankr. S.D.N.Y. 2009), *aff'd, Sprint Nextel Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 2010 U.S. Dist. LEXIS 33253 (S.D.N.Y. Mar. 24, 2010).

5.5.kk. Section 1123(a)(5) preempts only nonbankruptcy law relating to financial condition. The county in which the debtor taxicab company operated regulated taxi operations by issuance of fleet personal vehicle licenses and individual personal vehicle licenses. For each, the county imposed operational and financial requirements, but for fleets, it also imposed additional requirements relating to the availability of taxicab service within the county. The county also restricted the number of fleet licenses that could be transferred to individuals. The debtor's plan proposed to distribute a substantial number of its fleet licenses to individuals without the county's approval. Section 1123(a)(5) provides, "Notwithstanding any other applicable nonbankruptcy law, a plan shall … provide adequate means for the plan's implementation". The introductory phrase shows clear Congressional intent to preempt state and local law but does not address the scope of preemption. Section 1142(a) contains similar preemptive language, "Notwithstanding any otherwise applicable nonbankruptcy law relating to financial condition", in authorizing the debtor to carry out the plan. Therefore, it makes sense to apply section 1142(a)'s scope of preemption to section 1123(a)(5). So limited, section 1123(a)(5) does not preempt laws regulating public health, safety or welfare. Although

the county's taxicab regulations deal with financing stability and insurance, overall they are an exercise of the police power to regulate the adequate provision of safe and available taxicab service in the county. As such, they do not relate to financial condition and are not preempted. *Montgomery County v. Barwood, Inc.*, 422 B.R. 40 (D. Md. 2009).

5.5.ll. Court confirms plan that does not determine relative distributions between common stock and securities law damage claims. The debtor in possession liquidated its tangible assets during the case; the intangible assets remained to be liquidated or collected and distributed under the plan. The plan created a class of equity security holders and a class of claims for damages arising from violations of the securities laws with respect to the debtor's common stock but did not specify the relative treatment of the two classes, leaving that for the court to determine by an adversary proceeding if there were more than sufficient assets to pay all unsecured claims in full. The bankruptcy court approved this provision only after the parties failed to reach agreement on a formula for the allowance and therefore the relative distributions between the two classes. Section 1123(a)(3) requires that a plan specify the treatment of any impaired class of claims or interests. This plan provision's vagueness does not violate section 1123(a)(3). It identified the source of distributions, the proportionate share of distributions between the two classes based on the allowance of their claims and interests and the respective priority of distributions. Such specificity does not differ materially from a "pot" plan, where distributions on particular claims are based on the total amount of all allowed claims, which are determined separately from the plan confirmation process. The plan therefore meets the requirements of section 1123(a)(3). *Schaefer v. Superior Offshore Int'l, Inc. (In re Superior Offshore Int'l, Inc.)*, 591 F.3d 350 (5th Cir. 2009).

5.5.mm. "Indubitable equivalent" permits cash-out cramdown of secured claims based on bankruptcy court valuation. One affiliated debtor was an operating lumber business; the other was a single purpose entity that owned timberland that secured bonds. The debtors proposed a joint plan that provided for the transfer of each debtor's assets to new companies created and owned by two plan sponsors. One plan sponsor was unrelated to the debtors. The other held a large unsecured claim against the operating debtor. The plan provided for the sponsors to fund cash sufficient to pay the secured bonds the value of the timberland and provide working capital and to convert the sponsor's unsecured claim to equity. The plan classified the bonds into a secured claim class and an unsecured deficiency claim class, separate from other unsecured claims. Neither bond class accepted the plan. The bankruptcy court heard extensive valuation testimony and valued the timberland collateral at less than the amount owing on the bonds. The court may confirm a plan over the nonacceptance of a class of secured claims if the plan is fair and equitable, which requires at a minimum under section 1129(b)(2)(A) that the plan provide (i) deferred cash payments to the secured claim holder of a present value equal to the allowed amount of the claim, (ii) sale of the collateral, subject to section 363(k), which authorizes a credit bid or (iii) for the realization by the holder of the indubitable equivalent of the claim. The property transfer to the new entities is a "sale" under clause (ii). However, clause (ii) is not the exclusive means of permitting a cramdown sale. Therefore, a plan that provides for a sale may be confirmed if it meets clause (iii). Clause (iii) permits a cash payment. The secured claim cramdown provision focuses on principal repayment and time value of money. Cash satisfies both these focuses. Therefore, the court properly confirmed the plan. *Bank of N.Y. Trust Co., N.A. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

5.5.nn. Court confirms plan that provides additional distribution by secured creditors to only certain trade creditors. A senior secured lender group held valid secured claims in an amount greater than the reorganized debtor's value. The debtor proposed a plan that provided for distribution of new secured debt and 100% of the reorganized debtor's equity to the secured lenders (resulting in an approximately 42% recovery), cash to holders of general unsecured claim equal to approximately 9% of the claims and nothing for equity. In addition, the secured lenders, who would become the reorganized debtor's equity owners, offered an additional distribution to trade creditors who did not object to confirmation and who agreed to release the debtor and the secured lenders from any claims arising during the cases or from plan confirmation. The distribution's purpose was to enhance future supply to the reorganized debtor by engendering good will among suppliers and protecting some suppliers from their own financial distress and possible failures. Any additional distribution amounts that were not paid to trade creditors who did not consent would be paid to the secured lenders. The plan provides for the plan administrator to make the trade creditor distribution and for the court to resolve any disputes relating to

the distribution. Section 1123(a)(4) requires equal treatment under a plan of each claim in a class. On the other hand, a creditor may dispose of its recovery from the estate in any way it chooses, without regard to the Bankruptcy Code's restrictions. The plan's involvement of the plan administration and the court in connection with the distribution are immaterial and do not make the distribution one that is "under the plan" so that it would violate section 1123(a)(4). In addition, excising the additional distribution provision would not enhance recoveries to any class except the secured lenders, who were providing the additional distribution. Therefore, the court confirms the plan. *In re Journal Register Co.*, 407 B.R. 520 (Bankr. S.D.N.Y. 2009).

5.5.oo. Compromise combined plan distribution improperly effects substantive consolidation. The related debtors had numerous intercompany claims, and many creditors' claims could be asserted against more than one debtor. The plan compromised both of these issues, among others, by allowing multi-debtor claims at 130% of face amount against the parent debtor, disallowing the claims against the other debtors and providing for distribution of the aggregate assets of the debtors among all claims against them, pro rata, based on the allowed amounts of the claims. Each creditor class voted separately, and all but one accepted the plan. Substantive consolidation combines the assets and liabilities of separate entities and distributes the combined assets among creditors of all the consolidated entities. It is an equitable remedy to address harms a debtor has caused by disregarding separateness or entangling its affairs. It should be used sparingly. Although the aggregation here was a result of a compromise settlement and did not erase intercompany claims, it had the same adverse effect on some creditors as an ordinary consolidation and therefore effects a substantive consolidation without the requisite showing of need. Section 1123(a)(4) requires that each claim in a class receive the same treatment, except to the extent the holder of a claim elects less favorable treatment. The 130% settlement provides more advantageous treatment to the multi-debtor creditors within an accepting class and less favorable treatment to the creditors in the nonaccepting class. Thus, the plan violates section 1123(a)(4). *Schroeder v. New Century Liquidating Trust (In re New Century TS Holdings, Inc.*, 407 B.R. 576 (D. Del. 2009).

5.5.pp. Compromise combined plan distribution does not effect substantive consolidation. The related debtors had numerous intercompany claims, and many creditors' claims could be asserted against more than one debtor. The plan compromised both of these issues, among others, by allowing multi-debtor claims at 130% of face amount against the parent debtor, disallowing the claims against the other debtors and providing for distribution of the aggregate assets of the debtors among all claims against them, pro rata, based on the allowed amounts of the claims. Each creditor class voted separately, and all but one accepted the plan. Substantive consolidation combines the assets and liabilities of separate entities and distributes the combined assets among creditors of all the consolidated entities. The plan here is not a substantive consolidation. The plan recognizes and preserves each debtor's separateness but pools assets and liabilities and adjusts claims to compromise difficult disputed issues. Section 1123(a)(4) requires that each claim in a class receive the same treatment, except to the extent the holder of a claim elects less favorable treatment. The 130% settlement does not provide more advantageous treatment to certain creditors within a class. Because the multi-debtor creditors would have had 100% claims against more than one debtor, accepting a 130% claim against only one debtor results in less favorable treatment and does not violate section 1123(a)(4). *In re New Century TS Holdings, Inc.*, 390 B.R. 140 (Bankr. D. Del. 2008).

5.5.qq. Court approves substantive consolidation under a plan. Creditors filed an involuntary petition against one of 19 related debtors, which consented to relief under chapter 11. Two related debtors and the 16 subsidiaries of the three principal debtors filed chapter 11 cases six months later. The debtors shared all shareholders, directors and officers. Corporate formalities were not observed for intercompany dealings, and most of the subsidiaries were only "minute books" on a shelf. The debtors conducted the same business operations under similar names. The creditors dealt with the debtors as though they were a single entity, and the debtors' books and records were incapable of being untangled. Only the lead parent debtor paid operating expenses of all debtors. A secured creditor had a lien on all debtors' assets to secure a claim substantially in excess of their value and agreed to waive its deficiency claim so that unsecured creditors could obtain a recovery under the plan. Substantive consolidation is appropriate where creditors dealt with the entities as a single economic unit and did not rely on their separate identity

in extending credit and where the debtors' affairs are so entangled that consolidation will benefit all creditors. Here, the facts satisfied the first factor, creditor reliance. They also satisfied the second factor, because the books were entangled and, more importantly, all creditors benefited because the principal secured creditor waived its deficiency claim under the substantive consolidation plan to permit unsecured creditors to obtain some recovery. *Windels Marx Lane & Mittendorf, LLP v. Source Enterps., Inc. (In re Source Enterps., Inc.)*, 392 B.R. 541 (S.D.N.Y. 2008).

5.5.rr. Cram down on an 1111(b)-electing secured creditor requires payment of the creditor's full allowed claim upon an early sale. The debtor's plan crammed down the secured creditor, who had made a section 1111(b) election. The plan provided a note equal to the value of the real property collateral (the creditor's allowed secured claim) with a market interest rate and a 40-year level payment amortization. The note did not address payment upon an earlier sale of the collateral, but the plan provided that the creditor would retain its lien until payment in full of the full face amount of the creditor's allowed claim. The debtor argued that an early sale would thus require an "1111(b) premium" payment equal to the difference between the full allowed claim and the amounts paid to the creditor as of the sale date, but the plan did not expressly so provide. To confirm a plan under section 1129(b) for a secured creditor who has made the section 1111(b) election, the plan must provide for the creditor to retain its lien and for cash payments equal to the full allowed amount of the claim with a present value equal to the allowed secured claim (the collateral value). The plan can accomplish the latter by a below-market interest rate, but the note must secure the full allowed claim, not only the collateral value. The note must also provide that any payments, including the below-market interest payments, are applied to the note's face amount. However, the court does not address whether all such payments must be applied to the note's face amount or if there is a point at which the present value analysis requires that some of the payments be treated as interest. The court also requires the note to provide for the payment of the section 1111(b) premium but does not address whether setting the note's face amount at the full amount of the allowed claim accomplishes the same result. *Gen. Elec. Credit Equities, Inc. v. Brice Rd. Develops., LLC (In re Brice Rd. Develops. LLC)*, 392 B.R. 274 (6th Cir. B.A.P. 2008).

5.5.ss. Compromise combined plan distribution does not effect substantive consolidation. The related debtors had numerous intercompany claims, and many creditors' claims could be asserted against more than one debtor. The plan compromised both of these issues, among others, by allowing multi-debtor claims at 130% of face amount against the parent debtor, disallowing the claims against the other debtors and providing for distribution of the aggregate assets of the debtors among all claims against them, pro rata, based on the allowed amounts of the claims. Each creditor class voted separately, and all but one accepted the plan. Substantive consolidation combines the assets and liabilities of separate entities and distributes the combined assets among creditors of all the consolidated entities. The plan here is not a substantive consolidation. The plan recognizes and preserves each debtor's separateness but pools assets and liabilities and adjusts claims to compromise difficult disputed issues. In addition, the 130% settlement does not provide more advantageous treatment to certain creditors within a class. Section 1123(a)(4) requires that each claim in a class receive the same treatment, except to the extent the holder of a claim elects less favorable treatment. Because the multi-debtor creditors would have had 100% claims against more than one debtor, accepting a 130% claim against only one debtor results in less favorable treatment and does not violate section 1123(a)(4). *In re New Century TS Holdings, Inc.*, 390 B.R. 140 (Bankr. D. Del. 2008).

5.5.tt. A due-on-sale clause is not a lien for purposes of section 1129(b)(2)(A). Legislation authorizes the FCC to sell C-block and F-block spectrum licenses to qualified licensees for a small cash payment and an installment note secured by the licenses. The regulations governing the program require repayment of the note if the debtor sells the licenses to a licensee who is not qualified for the installment payment program. The debtor's plan proposed to transfer the licenses to such a non-qualified licensee, subject to the lien. The FCC did not accept the plan. The court may confirm a plan that a secured creditor does not accept if the plan provides for the creditor to "retain the lien" securing the claim. The Bankruptcy Code preempts any federal regulations that attempt to restrict the bankruptcy court's ability to adjust debts, though not regulations that govern post-confirmation conduct or operations. A "lien" is a charge against or interest in property. The due-on-sale regulation is a payment term, just like any other term specifying the time of payment of an obligation, not an interest in the licenses. Therefore, the plan's

license transfer without satisfying the due-on-sale regulation does not violate the requirement that the plan provide for the creditor to "retain" the lien. *Airadigm Comm'ns, Inc. v. Fed. Comm'ns Comm'n (In re Airadigm Comm'ns, Inc.)*, 519 F.3d 640 (7th Cir. 2008).

5.5.uu. Confirmation revocation is discretionary but requires the court to protect entities that acquired rights under the plan. The debtors confirmed a "pot" plan, which provided a fixed distribution to unsecured creditors, to be allocated among them based on the total amount of allowed claims. The disclosure statement estimated the amount that would be allowed, with caveats that it could not assure that would be the final amount and that the plan proponents would not update the disclosure statement before confirmation. The debtors announced 49 days after confirmation that the allowed claims estimate had increased by over 25%. A noteholder group, alleging the debtors knew of the increase before confirmation, sued on the 180th day after confirmation to set aside confirmation as having been procured by fraud. Section 1144 permits but does not require a court to revoke confirmation if it was procured by fraud. However, it requires that any revocation order "contain such provisions as are necessary to protect any entity acquiring rights in good faith reliance on the order of confirmation". If a court cannot do so, it may not revoke confirmation. Because the complex transactions implemented under the confirmed plan here, including consummation of exit financing and distributions of stock to unsecured creditors, cannot be unwound, the court may not revoke confirmation. In addition, a court should dismiss a challenge to confirmation as equitably moot upon a finding of substantial consummation, unless granting relief will not affect the debtor's reemergence and will not unravel complex transactions, among other things. Here, revocation would "knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation". Moreover, by waiting 131 days after the debtors announced the claims estimate revision, the noteholders did not act with the required diligence. Accordingly, the court dismisses the complaint as equitably moot. *Varde Investment P'ners, L.P. v. Comair, Inc. (In re Delta Air Lines, Inc.)*, 385 B.R. 518 (Bankr. S.D.N.Y. 2008).

5.5.vv. Court must consider the possible outcomes of nonbankruptcy civil litigation in determining feasibility. A creditor sued a debtor and his closely-held corporation in state court. The state court found the debtor not personally liable, but the creditor appealed. While the appeal was pending, the bankruptcy court disallowed the creditor's claim, subject to reconsideration. In considering confirmation of the debtor's 100% payment chapter 11 plan, the bankruptcy court must consider the likely future events that could affect the debtor's ability to perform the plan, such as the possibility that the state appellate court might reverse. It may not determine feasibility based solely on the disallowance of the creditor's claim. Although the court cannot predict the appeal's outcome with certainty, it may not ignore the pendency of litigation. The court need not, however, delay confirmation until the state court resolves the litigation, so long as it considers the consequences of the possible outcomes of the state court litigation. *Sherman v. Harbin (In re Harbin)*, 486 F.3d 510 (9th Cir. 2007).

5.5.ww. Release of creditor plan proponent for plan implementation activities is impermissible. The major secured creditor obtained confirmation of its own plan that provided for a trustee to sell the debtor's real estate, and, if the sale were not consummated within a certain time, for the secured creditor to foreclose. The plan released the creditor from all existing claims, including a fraudulent transfer claim that the debtor had asserted, in exchange for which the secured creditor distributed some of its collateral sales proceeds to pay certain administrative and priority claims. Section 1123(b)(3)(A) permits a plan to release the estate's claims. In judging a release, the court ordinarily defers to the judgment of the trustee, as the fiduciary administering the estate. Here, however, the creditor, who is not acting as a fiduciary, proposed to release itself. Such a release requires a higher standard of review. In addition, the plan proposed a general release of the creditor, including for claims arising from the breach of the plan or for negligence or malfeasance in plan implementation. Because a plan is a contract, it "should be enforceable and amenable to damages". The release is inconsistent with the Bankruptcy Code and renders the plan unconfirmable. *Whispering Pines Estates, Inc. v. Flash Island, Inc. (In re Whispering Pines Estates, Inc.)*, 370 B.R. 452 (1st Cir. B.A.P. 2007).

5.5.xx. Creditor plan may transfer non-profit debtor's property without compliance with state law transfer procedures. State non-profit corporation laws typically impose procedural restrictions, such as a super-majority board vote or court or Attorney General approval, on a non-profit corporation's transfer of

substantially all of its assets. Section 1129(a)(16) requires, as a confirmation condition, compliance with those restrictions. Here, however, a creditor seeks confirmation of a plan providing for transfer of the debtor's property to a new entity. The debtor objects. The property transfer under the creditor's plan is an involuntary transfer to which the state law restriction does not apply. Otherwise, for example, a creditor could not foreclose on a non-profit's assets without compliance with the restrictions. Therefore, the restrictions do not apply to the creditor's plan. *In re Machne Menachem, Inc.*, 371 B.R. 63 (Bankr. M.D. Pa. 2006).

5.5.yy. Individual debtor may retain property even under a cram down plan. The individual debtor's plan proposed payment on allowed secured, priority, and general unsecured claims of all disposable income over 10 years. The payments were not likely to pay unsecured claims in full. The class of unsecured claims rejected the plan. BAPCPA amended the absolute priority rule in section 1129(b)(2)(B(ii) to permit a debtor to retain "property included in the estate under section 1115", which includes all post-petition earnings. As such, the debtor may retain his petition date property and his postpetition earnings without violating the absolute priority rule's general prohibition on the debtor receiving or retaining any property if unsecured claims are not paid in full. *In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007).

5.5.zz. Court sets cram-down parameters for undeveloped real estate plan. The debtor owned undeveloped real estate. The debtor and its principal secured creditor each proposed a plan. The debtor's plan provided for equal payments on the creditor's claim of principal and interest at the three-year Treasury bill rate plus 200 basis points, to be funded by the debtor's general partner, for 30 months, during which the debtor would market and sell the property. Unsecured claims would be paid immediately. The bankruptcy court confirms the plan over the creditor's objection. The absolute priority rule does not require that secured claims be paid before unsecured claims, just that they be fully provided for before providing for unsecured claims. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), does not require use of a market rate for cram down in a chapter 11 case if there is no market for a comparable loan, but the court must take evidence to determine whether such a market exists. If there is no market, then the court must use *Till*'s "prime-plus" method, unless the court makes findings on the evidence that it is appropriate to use a different base rate. *Mercury Cap. Corp. v. Milford Conn. Assocs., L.P.*, 354 B.R. 1 (D. Conn. 2006).

5.5.aaa. Granting releases only to creditors who accept a plan may violate the "equal treatment" rule. The plan was the product of a widely (but not universally) supported settlement agreement. It granted releases to creditors in certain classes who accepted the plan but not to those who did not. Otherwise, it provided the same distribution to all creditors in those classes. Section 1123(a)(4) does not permit different treatment of creditors based on whether they accept the plan. A release is valuable consideration. Therefore, in the context of a motion for a stay pending appeal, the district court determines that there is a substantial likelihood that granting the release only to accepting creditors may violate the equal treatment rule of section 1123(a)(4). *ACC Bondholder Group v. Adelphia Commc'ns Corp. (In re Adelphia Commc'ns Corp.)*, 2007 U.S. Dist. LEXIS 7416 (S.D.N.Y. Jan. 24, 2007).

5.5.bbb. Section 1144 does not bar post-confirmation action against non-debtors for damages from confirmation. Two years after they vigorously contested plan confirmation on valuation grounds, junior creditors sued senior creditors and the debtor's chief financial officer for money damages for fraud in connection with the projections and valuations that the debtor presented at the confirmation hearing. Although section 1144, which provides that confirmation may be revoked only for fraud and only if the challenge is brought within 180 days after confirmation, bars any action against the reorganized debtor, it does not bar claims against the senior creditors. Action against creditors for damages does not affect the reorganized debtor, would not upset the plan, and does not "redivide the pie." *Haskell v. Goldman, Sachs & Co. (In re Genesis Health Ventures, Inc.)*, 355 B.R. 438 (Bankr. D. Del. 2006).

5.5.ccc. Surplus funds may be directed to charity. The plan provided for a liquidating trust, which would administer any assets or claims of the debtor. The liquidating trust generated a surplus after paying all allowed claims in full with interest. The plan expressly cancelled all of the common stockholders' interests but permitted a distribution of any surplus to preferred stockholders, who later waived the distribution during the post-confirmation administration. The plan could not be modified to provide for distribution of the surplus, because section 1127 prohibits modification after substantial consummation.

The surplus funds are not "unclaimed funds" subject to escheat, because they are not abandoned or unclaimed by any rightful owner or someone who is entitled to them. Under the *cy pres* doctrine, therefore, the court may direct their disposition, taking into account the suggestions of the trustee and her counsel, whose efforts helped generate the surplus. *In re Xpedior Inc.*, 354 B.R. 210 (Bankr. N.D. Ill. 2006).

5.5.ddd. The absolute priority rule requires payment of unsecured postpetition default interest in a solvent case. Section 1129(b) permits confirmation over an unsecured claims class's plan nonacceptance only if the plan is fair and equitable, which requires that either unsecured claims are paid in full or no junior class receives or retains any consideration under the plan. Payment in full requires payment of postpetition interest. A court may allow payment of only nondefault rate interest, based on equitable considerations, when the debtor is not solvent. Equitable considerations are limited, however, to the terms of the Bankruptcy Code and are further limited when the debtor is solvent. In that case, there is a presumption that postpetition default rate interest should be paid on unsecured claims, which may, however, be rebutted in limited circumstances, which the court does not specify. *Official Comm. of Unsecured Creditors v. Dow Corning Corp. (In re Dow Corning Corp.)*, 456 F.3d 668 (6th Cir. 2006).

5.5.eee. Only the district court may estimate tort claims for a plan distribution cap. The debtor's proposed plan distributed a fixed amount to a settlement trust as the sole source of payment of all tort claims. Confirmation with the cap would have the effect of limiting the distribution on the tort claims, so confirmation requires a determination that the aggregate amount of the tort claims does not exceed the proposed distribution. The debtor sought an estimate of the aggregate amount of the claims for purposes of limiting distribution under the plan. Only the district court may determine the amount of personal injury tort claims for purposes of distribution. Because the plan had the effect of limiting distribution to the aggregate estimated amount of the claims, the estimation would be for purposes of distribution, not just for allowance. The bankruptcy court may recommend a methodology to the district court. The methodology would not require mini-trials for each of the 129 claims but might entail the employment of an expert to develop a matrix or the use of advisory jury trials to develop a range of possible recoveries. However, estimation for confirmation and voting purposes involves less drastic effects on the claimants and will be permitted in the bankruptcy court with less exacting procedures. *In re Roman Catholic Archbishop of Portland in Oregon*, 339 B.R. 215 (Bankr. D. Ore. 2006).

5.5.fff. Post-confirmation action against debtor for damages from confirmation is barred. Two years after they vigorously contested plan confirmation on valuation grounds, junior creditors sued the reorganized debtor, senior creditors, and the debtor's chief financial officer for money damages for fraud in connection with the projections and valuations that the debtor presented at the confirmation hearing. The action against the reorganized debtor was barred by section 1144, which provides that confirmation may be revoked only for fraud and only if the challenge is brought within 180 days after confirmation. Although this action did not seek to revoke confirmation, its claim against the debtor for money damages in favor of prior junior creditors would, if successful, effectively "redivide the pie" and therefore constitutes an impermissible attack on the confirmation order. Finally, because valuation issues necessarily are litigated at confirmation and were in fact litigated in this case, with the plaintiffs here as active participants, *res judicata* bars any relitigation in this later action. However, the claims against the senior creditors are not necessarily similarly barred. The bankruptcy court should separately consider whether section 1144 should also bar claims against them. In addition, the junior creditors alleged that new evidence was disclosed only after confirmation and could not have been discovered before confirmation. The bankruptcy court did not adequately consider those allegations in ruling on the motion to dismiss, so the case is remanded for further consideration. *Haskell v. Goldman, Sachs & Co. (In re Genesis Health Ventures, Inc.)*, 340 B.R. 729 (D. Del. 2006), *aff'g in part and rev'g in part* 324 B.R. 510 (Bankr. D. Del. 2005).

5.5.ggg. Settlement with SEC for securities fraud does not violate the absolute priority rule. The debtors disclosed that their financial statements were materially false, leading to withdrawal of their auditor's opinion, defaults on their credit facilities, shareholder lawsuits, government investigations, and ultimately, chapter 11. The SEC filed a proof of claim in the case for penalties and disgorgement. The debtor in possession reached a settlement with the SEC and the Department of Justice. The Department of Justice agreed not to indict the debtor corporation, and the debtor in possession made a payment of $715 million to an SEC restitution fund for the benefit of defrauded shareholders. Unsecured creditors in

the chapter 11 cases were not likely to receive payment in full of their claims. Nevertheless, the settlement was reasonable and should be approved. It did not violate the absolute priority rule by allowing shareholders to receive value from the estate on account of their interests before creditors were paid in full. (The district court affirms the bankruptcy court's opinion approving the settlement, reported at 327 B.R. 143 (Bankr. S.D.N.Y. 2005), without adding additional reasons of its own.) *Adelphia Trade Claims Commc'ns v. Adelphia Comm. Corp.*, 337 B.R. 475 (S.D.N.Y. 2006).

5.5.hhh. Third Circuit rejects "squeeze play" cram down based on *SPM Mfg*. The debtor's plan provided for less than full payment to classes 6 and 7, both general unsecured claims classes, and distribution of warrants to class 12, the equity class. But if class 6 did not accept the plan, class 7 would be entitled to the warrants but would immediately transfer them to the equity holder. Class 6 rejected, and the creditors' committee objected to confirmation. The plan did not meet the literal terms of the absolute priority rule in section 1129(b)(2)(B), because a class of unsecured claims (class 6) did not accept the plan, yet a junior class (class 12) received something on account of its equity interests. Although this is not literally the "squeeze play" (senior class gives up value to equity squeezing out an intermediate unsecured claims class) that the legislative history condemns, the literal language of the statute, supported by other legislative history, does not permit it. Nor does *In re SPM Mfg. Co.*, 984 F.2d 1305 (1st Cir. 1993), authorize the cram down. That case differed because it was a chapter 7, so section 1129(b) did not apply, and it was a secured creditor that transferred (carved out) a portion of its collateral for the unsecured class. Although permissible there, it does not meet the requirements of the absolute priority rule. *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir. 2005).

5.5.iii. Court uses formula rate for chapter 11 cram down. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), required the use of a formula rate ("prime" plus a risk factor) for the interest rate on an obligation imposed under a chapter 13 plan cram down. However, it noted in footnote 14 that the same rate might not be appropriate in a chapter 11 case if an efficient market exists to determine the rate. In this chapter 11 case, the restructured loan was unusual, and no market would exist for this kind of loan. Therefore, the court applies *Till* and imposes a rate of prime plus 1% under the formula approach. *In re Cantwell*, 336 B.R. 688 (Bankr. D.N.J. 2006).

5.5.jjj. Court rejects the market as a source for valuing a reorganizing debtor or its new securities. The court addresses the appropriate interest rate to use for valuing the securities issued under the plan and the valuation of the reorganized debtor under the plan. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), required a formula approach—a risk-free rate (prime) plus a risk factor—to determine the appropriate interest rate on debt issued under a chapter 13 secured creditor cramdown plan. Footnote 14 suggested (but did not hold) that a rate determined by an efficient market might be appropriate for valuing securities issued in a chapter 11 cramdown plan. The court here rejects *Till*'s suggestion. What the market is willing to pay for the new debt is not relevant, because the market systematically undervalues emerging companies, and because *Till*, by rejecting a "forced loan" approach, rejected looking to the market for what it would charge. Similarly, the court does not look to the current market for the debtor's securities to imply what the market believes the reorganized debtor will be worth. Uncertainties over the final plan terms and the timing and certainty of confirmation and effective date, as well as uncertainty over the general condition of the market at an unknown future effective date, depress the current market value. In addition, the market adds a taint for bankruptcy and does not adequately appreciate the added value that the chapter 11 process (including deleveraging, contract rejection, and other dispute resolution) and court approval of the plan add. The court instead finds guidance in *Till* and uses a formula approach. In a chapter 11 case, the risk factor will depend, however, on the nature of the securities (secured or unsecured, nature of collateral, debt or equity, debt to equity ratio, and the terms of the plan, among other things), not on a fixed 1% to 3% adder, which the Supreme Court adopted only for a consumer car loan. *In re Mirant Corp*., 334 B.R. 800 (Bankr. N.D. Tex. 2005).

5.5.kkk. Revocation of confirmation is subject to equitable considerations. The court had confirmed a prepackaged plan that converted all of the debtor's bond debt to 100% of the equity of the reorganized debtor, but left the old shareholder with warrants for 10% of the reorganized company. Shortly after confirmation, the reorganized debtor issued additional stock in a public offering. Confirmation was based in part on the CFO's testimony about the debtor's financial performance in the quarter immediately

before bankruptcy and the reorganized debtor's expected financial performance. As it turned out, the reorganized debtor did much better than the testimony suggested. A former shareholder, who had objected to confirmation, sued under section 1144 to revoke confirmation, alleging that confirmation was procured by the CFO's fraudulent testimony. Section 1144 requires an order revoking confirmation to include provisions to protect any entity acquiring rights in good faith reliance on the confirmation order. The court here could not provide such protection because of the consummation of the plan, the trading in new stock issued under the plan, and the issuance of new stock to the public. Revocation is discretionary, based on equitable principles, including principles similar to those underlying equitable mootness, and on whether the court can protect those who acquired rights in good faith reliance on confirmation. Here, the court could not provide such protection, so the court denies revocation. However, the former stockholder also sought damages for fraud. The court allows the former stockholder to amend his complaint to assert any claim he might have, without deciding whether there is any such claim. The court does not mention whether any such claim would be barred under principles of claim preclusion or issue preclusion, based on the stockholder's participation in the confirmation hearing. It also does not mention the 180-day bar in section 1144. *Salsberg v. Trico Marine Servs., Inc. (In re Trico Marine Servs., Inc.*, 337 B.R. 811 (Bankr. S.D.N.Y 2006).

5.5.lll. Distribution delay based on disputed allowance of claim or interest does not violate the equal treatment requirement. The debtor's plan provided for interim distributions to holders of allowed claims or interests but delayed distribution on any interest that was subject to an examiner's investigation as to issues that might affect the validity or allowability of the interest. There was only one such interest. The provision for delay did not violate section 1123(a)(4)'s requirement that a plan provide equal treatment for each claim or interest in a particular class. *Enron Corp. v. New Power Co. (In re New Power Co.)*, 438 F.3d 1113 (11th Cir. 2006).

5.5.mmm. Section 1142(b) order is limited to plan provisions. The debtor casino was subject to disciplinary proceedings before the state licensing board. During the chapter 11 case, the debtor, the creditors, and the board reached agreement on a plan that was based on a dismissal of the disciplinary proceedings. Three of the four board members testified at the confirmation hearing that they would not pursue the disciplinary proceedings, and the court confirmed the plan as feasible. A short time later, they resigned from the board and were replaced by new members who re-instituted the disciplinary proceeding. The bankruptcy court could not enjoin the proceedings under section 1142(b). The plan did not include the agreement not to pursue the disciplinary proceedings, and the court's power under section 1142(b) is limited to the terms of the plan. It does not create substantive rights that are not already contained in the plan. *Village of Rosemont v. Jaffe (In re Emerald Casino, Inc.)*, 334 B.R. 378 (N.D. Ill. 2005).

5.5.nnn. Coerced loan cram down interest rate may be appropriate for chapter 11. Before the decision in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), the bankruptcy court used the coerced loan approach in determining the cram down interest rate, imposing the 6-year Treasury rate plus 3.75%. On appeal, the Sixth Circuit focuses on *Till*'s footnote 14, which suggests that "it might make sense to ask what rate an efficient market would produce," rather than the "prime plus" approach required for chapter 13 cram downs. The court determines that the coerced loan approach, based on testimony about the market rate for a coerced loan, is an appropriate method of determining the cram down interest rate in chapter 11. *Bank of Montreal v. Official Comm. of Unsecured Creditors (In re American HomePatient, Inc.)*, 420 F.3d 559 (6th Cir. 2005).

5.5.ooo. Enforcement of foreign plan under section 304 requires equal treatment of creditors. The debtor had commenced an *Acuerdo Preventivo Extrajudicial* (APE) proceeding under Argentine law and obtained all requisite consents and Argentine court approval. It commenced a section 304 ancillary proceeding in the United States to enforce the plan in the U.S. The plan provided retail holders with less favorable treatment than qualified institutional buyers because offering the QIB treatment to retail holders would have required compliance with the registration requirements of U.S. securities laws. The bankruptcy court required equal treatment as a condition to approval. The debtor sought an order under section 304 that would have given full force and effect to the *APE* proceeding. Such an order requires an amendment to the plan to provide for equal treatment of creditors in the same class (here, bondholders), resolicitation of the plan in accordance with Argentine law, and approval of the amended plan by the Argentine court.

This equal treatment requires not only the same plan distributions, but also compliance with U.S. securities laws for distribution of the consideration, either by registration or the availability of a registration exemption, which had to be demonstrated to the court. *Argentinian Recovery Co. LLC v. Board of Directors of Multicanal S.A.*, 331 B.R. 537 (S.D.N.Y. 2005).

5.5.ppp. Debtor's former attorney is not an insider. The debtor's former law firm did not represent the debtor in its chapter 11 case. It voted its claim in favor of the debtor's plan. The law firm is not an insider for purposes of determining under section 1129(a)(10) whether the plan has been accepted by the requisite votes, not counting the votes of insiders. Although the law firm did not come within the listed relationships in the "insider" definition, those relationships are illustrative, not limiting. A person may be an insider if it exercises control over the debtor because of an affinity, rather than solely because of long business dealings between the parties. This relationship with the attorney was at arm's-length and did not give the law firm control. In addition, attorneys are not automatically considered insiders. *In re Premiere Network Servs., Inc.*, 333 B.R. 126 (Bankr. N.D. Tex. 2005).

5.5.qqq. Post-confirmation action against debtor for damages from confirmation is barred. Two years after they vigorously contested plan confirmation on valuation grounds, junior creditors sued the reorganized debtor, senior creditors, and the debtor's chief financial officer for money damages for fraud in connection with the projections and valuations that the debtor presented at the confirmation hearing. The action was barred by section 1144, which requires that a confirmation may be revoked only for fraud and only if the challenge is brought within 180 days after confirmation. Although this action did not seek to revoke the confirmation order, its claim against the debtor for money damages in favor of prior junior creditors would, if successful, effectively "redivide the pie" and therefore constitutes an impermissible attack on the confirmation order. In addition, any claim against the debtor was barred by the discharge, which operates as to any claims that arose before the date of confirmation. Finally, because valuation issues necessarily are litigated at confirmation and were in fact litigated in this case, with the plaintiffs here as active participants, *res judicata* bars any relitigation in this later action. *Haskell v. Goldman, Sachs & Co. (In re Genesis Health Ventures, Inc.)*, 324 B.R. 510 (Bankr. D. Del. 2005).

5.5.rrr. Vacating a confirmed chapter 11 plan does not vacate the confirmation order or the discharge. A creditor obtained confirmation of a chapter 11 plan that provided conditions to the effective date, including certain due diligence and no material adverse change in the debtor's business. The plan provided that if the conditions were not met, the plan proponent could move to vacate the confirmation order, which would nullify the plan and the discharge. The confirmation order discharged the debtor of all claims that arose before the confirmation date. The conditions were not satisfied, the debtor's management resigned, and a trustee was appointed. The trustee held an auction for the debtor's assets, which were purchased by the debtor's insiders. The trustee subsequently moved to vacate the confirmation order. The court issued an order vacating only the plan, not the order. The creditor subsequently sued the asset purchaser for the previously discharged claim. The court dismisses the suit, because the order vacating the plan did not vacate the confirmation order, which contained the discharge. Moreover, the order could not properly vacate the confirmation order, because the plan permitted only the proponent to move to vacate the order. Any other party not authorized by the plan to vacate the confirmation order must use section 1144, which requires an adversary proceeding and proof that the order was obtained by fraud. *Mickowski v. Visi-Trak Worldwide, LLC*, 415 F.3d 501 (6th Cir. 2005).

5.5.sss. Cows are not the indubitable equivalent of cash. The debtor's dairy cows were destroyed by a faulty electric fence, and the debtor's operation failed. The debtor in possession recovered from the fencing company and proposed a plan that would use the cash recovery to purchase replacement cows and restart the operation. The bank, who had a security interest in the cash proceeds of the settlement, objected that the plan did not meet the requirements of section 1129(b)(2)(A)(iii), which requires that a plan that crams down a secured creditor provide the creditor the indubitable equivalent of its claim and lien. Because the creditor's collateral had been converted to cash, the creditor was entitled to the cash. A lien on cows would be too risky because, among other things, there would be no equity cushion in case of adverse business events. The court therefore denies plan confirmation. *Wiersma v. O.H. Kruse Grain & Milling (In re Wiersma)*, 324 B.R. 92 (B.A.P. 9th Cir. 2005).

5.5.ttt. Plan may not provide for senior creditors to transfer value to a junior class over non-acceptance by an intervening class. The chapter 11 plan provided a distribution of warrants to equity, but if one of two classes of unsecured claims did not accept the plan, then the warrants would be distributed to the other, accepting class, who would automatically waive the distribution in favor of the equity class. The plan violates the absolute priority rule and section 1129(b)(2)(B)(ii), which prohibits a junior class from receiving any distribution if a senior non-accepting unsecured class does not receive payment in full. *In re SPM Mfg. Corp.*, 984 F.2d 1305 (1st Cir. 1993), does not support the plan's treatment of the non-accepting unsecured class here. That case was under chapter 7, in which the absolute priority rule does not apply, and the property involved in *SPM* was the senior creditor's collateral, not unencumbered property of the estate. Thus, the agreement there was more analogous to a "carve out," under which a secured creditor may dispose of the property without restriction once it receives it. By contrast, the absolute priority rule does not permit a senior class to distribute under a plan any of its recovery to a junior class over the non-acceptance by an intervening class. Accordingly, the court denies plan confirmation. *In re Armstrong World Indus., Inc.*, 320 B.R. 523 (D. Del. 2005).

5.5.uuu. Similar claims must receive equal treatment under a plan. Claims received different treatment under the plan based on when they were asserted against the debtor, whether they had been settled, and whether their holders had accepted the plan. Such difference in treatment violates section 1123(a)(4)'s requirement of equal treatment of similarly situated claims in chapter 11 cases. The treatment must be based on the nature of the claimants' rights against the debtor. Although the difference in treatment resulted from prepetition payments in connection with the solicitation of votes for a prepackaged plan, the court must consider the entire package, including the prepetition payments, in determining whether the claims receive equal treatment. *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir. 2004).

5.5.vvv. Section 1129(a)(3)'s good faith provision requires proper plan formulation procedure, not any particular outcome. The debtor's plan provided for conversion of a substantial portion of the secured claims to equity and the elimination of prepetition equity interests. As part of the debtor's prepetition plan negotiations, it negotiated for and obtained agreement from its secured lenders to a release of insider shareholders' debts to the debtor, which arose from their purchase of stock, and to a four-year employment contract for the retiring Chairman and CEO, who was the debtor's principal shareholder and who agreed to waive a three-year severance claim under his existing employment contract. The directors breach their fiduciary duty to shareholders by negotiating for special consideration for only certain of the shareholders and not treating all shareholders equally. The plan therefore did not meet the requirement of section 1129(a)(3) that it be proposed in good faith and not by any means forbidden by law: the breach of fiduciary duty is forbidden by state corporate governance law. The debtor's amendment of the plan to eliminate the special treatment did not cure the lack of good faith, because section 1129(a)(3) focuses on the procedure by which the plan was formulated and proposed, not on the plan's substantive terms. The violation of law tainted the plan formulation process, and the plan could not be confirmed without reformulation of the plan in good faith and not by any means forbidden by law. *In re Bush Indus., Inc.*, 315 B.R. 292 (Bankr. N.D.N.Y. 2004).

5.5.www. Artificial impairment may disqualify consenting class. An asbestos prepackaged plan set up a prepetition trust for participating asbestos claimants, but left each of them with a "stub" claim so that they could vote for the plan. Although artificial impairment may be permissible in a commercial context, in the prepackaged asbestos context, the prepetition payment resulted in the stub claimants not representing the true will of impaired creditors. Since the purpose of section 1129(a)(10), requiring the consent of at least one impaired class, appears to be to require consent from creditors representing those who are affected by the plan, the form of artificial impairment here did not appear to satisfy the monitoring function of section 1129(a)(10), and the case was remanded for further consideration of the artificial impairment issue. *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir. 2004).

5.5.xxx. Nonimpairment and reinstatement eliminates effect of default as to all parties, not just the debtor. The holders of the senior secured notes were entitled to a prepayment penalty upon default and acceleration. The holders of the subordinated secured notes had agreed not to receive payment on their notes while any amounts remained owing under the senior notes. The debtor's plan provided for cure

and reinstatement of the senior notes, thereby erasing the effect of the default and relieving the debtor of the prepayment penalty obligation. The senior note holders were not entitled to recover the prepayment penalty from the subordinated note holders' recovery, because the de-acceleration and reinstatement of the senior notes entirely eliminated the prepayment penalty obligation as to all parties, not just as to the debtor. *MW Post Portfolio Fund Ltd. v. Norwest Bank Minnesota (In re ONCO Inv. Co.)*, 316 B.R. 163 (Bankr. D. Del. 2004).

5.5.yyy. Confirmation valuation must include non-saleable assets. The Equity Committee objected to confirmation of the trustee's plan, in part because shareholders had not accepted the plan and, based on the Committee's valuation, the distribution to creditors exceeded the allowed amounts of their claims. In valuing the reorganized debtor for confirmation and absolute priority rule purposes, the court includes assets that a hypothetical purchaser would not buy, such as the value of the debtor's tax net operating losses, cash on hand, and litigation claims. Although a purchaser would not pay for them, they provided value available for distribution under the plan to creditors and shareholders. Therefore, they are included in the confirmation valuation. *In re Coram Healthcare Corp.*, 315 B.R 321 (Bankr. D. Del. 2004).

5.5.zzz. Absolute priority rule may require payment of postpetition interest. The chapter 11 trustee sought confirmation of a plan under section 1129(b), over the objection and non-acceptance by equity holders, who claimed that creditors who received 100% of the stock of the reorganized debtor were being overpaid. Under the absolute priority rule, unsecured creditors may be entitled to payment of postpetition interest before holders of claims or interests in junior classes are entitled to any recovery. Taking into consideration the provision of section 506(b), under which an oversecured creditor is entitled to the allowance of postpetition interest at the contract rate, section 726(a)(5), under which unsecured creditors are entitled to postpetition interest at the legal rate before shareholders may recover, and section 1124, under which an unimpaired class of claims is entitled to postpetition interest as a condition to non-impairment, the court concludes that the provisions of section 502(b)(2), disallowing postpetition interest, is not controlling. Therefore, payment of postpetition interest on unsecured claims is not prohibited and may be required. The interest rate allowed must be based on the facts and circumstances of the case. In this case, owing to the misconduct of some of the holders of the unsecured claims, which benefited other holders as well, the court allows interest only at the legal rate, not the contract rate. *In re Coram Healthcare Corp.*, 315 B.R 321 (Bankr. D. Del. 2004).

5.5.aaaa. Chapter 11 plan may not eliminate setoff right. The debtor's chapter 11 plan provided for allowance of the IRS's tax claim and payment over six years, without acknowledging the IRS's claimed setoff right. Despite the plan's language, and recognizing the split in the case law on this issue, the court permitted the IRS to offset a tax debt it owed the debtor in partial satisfaction of the allowed claim. Section 553(a) preserves the right of setoff, "except as otherwise provided . . . in sections 362 and 363." Therefore, the discharge, which is found in section 1141, does not trump the preserved setoff right. *In re Ronnie Dowdy, Inc.*, 314 B.R. 182 (Bankr. E.D. Ark. 2004).

5.5.bbbb. Reinstatement under section 1124(2) does not waive default rate interest. The debtor defaulted under its mortgage before bankruptcy. It sold the mortgaged property during the case for more than the amounts owing on the secured claim and proposed a plan that would leave the secured class unimpaired under section 1124(2) by reinstating the mortgage and paying it off with non-default rate interest. Under Second Circuit law, reinstatement under section 1124(2) does not undo the effects of the prior default, so interest would be allowed at the default rate. *In re 139-141 Owners Corp.*, 313 B.R. 364 (S.D.N.Y. 2004).

5.5.cccc. Liquidated debtor that proposes to engage in business may receive a discharge. Section 1141(d)(3) denies a discharge to a corporate debtor that liquidates substantially all its assets and does not engage in business after plan consummation. In this case, the corporate debtor had sold its assets and ceased business operations before its chapter 11 case. Its plan provided for distribution to creditors of litigation proceeds and for the debtor to recommence business operations. Its disclosure statement set forth a business plan and showed that the reorganized debtor will have the ability to operate. The debtor may therefore receive a discharge, because it will engage in business after consummation. *In re Global Water Techs., Inc.*, 311 B.R. 896 (Bankr. D. Colo. 2004).

5.5.dddd. 180-day deadline to revoke confirmation is absolute, but might not bar dismissal. The debtor lied on her bankruptcy schedules about her income and assets, but in a way that would have put a creditor on notice of the lie. 180 days after confirmation of the debtor's chapter 13 plan, creditors moved to revoke confirmation on the ground that it was obtained by fraud. Later, the creditors also moved to revoke confirmation on the ground that the debtor lied about her debts and was ineligible for chapter 13 under its debt limits. The 180-day deadline to seek revocation of confirmation is absolute, despite the debtor's fraud, and fraud is the only ground to obtain revocation. In this case, although the debtor obtained confirmation by fraud about her assets and income, those issues could have been litigated at the confirmation hearing, because the creditors, had they been diligent in investigating, would have uncovered the lie. Nor can they evade the 180-day limit by seeking revocation under section 105(a) or under Rule 9024 (incorporating Fed. R. Civ. P. 60), which expressly bars its use to revoke confirmation. They could, however, seek dismissal or conversion under section 1307 more than 180 days after confirmation based on the lie about debts and eligibility, because dismissal is not time-limited, and there was nothing that would have put the creditor on notice of the lie. Therefore, *res judicata* did not apply. Chapter 11's dismissal provision is the same as chapter 13's for these purposes. *Duplessis v. Valenti (In re Valenti)*, 310 B.R. 138 (9th Cir. B.A.P. 2004).

5.5.eeee. Asset allocation between chapter 11 estate and parallel Belgian proceeding does not render plan unconfirmable. The creditor's claim against the debtor was subordinated under section 510(b) as a securities sale rescission claim. The claim was not so subordinated in a parallel Belgian Concordat proceeding. The liquidating plan in the case provided for allocation of the assets of the estate to the Belgian proceeding in an amount only sufficient to pay priority claims in the Belgian Concordat. The rest of the assets would be distributed to creditors in the chapter 11 case. Because this particular creditor's claim was subordinated, it would receive nothing, even though it could have shared equally with other general creditors in the Belgian Concordat. The court finds that the plan is proposed in good faith. In addition, the plan does not discriminate unfairly against the subordinated creditor's claim, because in the chapter 11 case, the claim was not of the same priority as the general unsecured claims. *In re Lernout & Hauspie Speech Prods., N.V.*, 301 B.R. 651 (Bankr. D. Del. 2003), affirmed, *Stonington Partners, Inc. v. Official Committee (In re Lernout & Hauspie Speech Prods. N.V.)*, 308 B.R. 672 (D. Del. 2004).

5.5.ffff. A chapter 11 plan does not broadly preempt non-bankruptcy law. Section 1123(a)(5) requires a plan to provide adequate means for the plan's implementation, that is found "notwithstanding any otherwise applicable non-bankruptcy law." The debtor had argued that this clause preempted state regulatory laws that required regulatory approval of certain corporate transactions. The Ninth Circuit disagrees. It imports into this clause a limitation that is found in a comparable clause in section 1142(a), which limits the preemption of non-bankruptcy laws to those related to financial condition. Therefore, section 1123(a)(5) does not preempt applicable non-bankruptcy laws that require specific state authorization for corporate restructuring transactions. *Pacific Gas and Electric Co. v. California*, 350 F.3d 932 (9th Cir. 2003).

5.5.gggg. The best interest test encompasses potential post-liquidation recoveries. The debtor is a homeowners association created under California law, which requires the existence of a homeowner association in a condominium development. The association may not be dissolved. The creditor obtained a judgment against the debtor, which drove the debtor into bankruptcy. Because of the debtor's perpetual existence, the creditor after a hypothetical chapter 7 case could recover all post petition interest at the statutory rate. Accordingly, a plan that did not provide for payment in full of the creditor's claim with interest did not meet the best interest test of section 1129(a)(7). *In re Oak Park Calabasas Condominium Assoc.*, 302 B.R. 665 (Bankr. C.D. Cal. 2003).

5.5.hhhh. Asset allocation between chapter 11 estate and parallel Belgian proceeding does not render plan unconfirmable. The creditor's claim against the debtor was subordinated under section 510(b) as a securities sale rescission claim. The claim was not so subordinated in a parallel Belgian Concordat proceeding. The liquidating plan in the case provided for allocation of the assets of the estate to the Belgian proceeding in an amount only sufficient to pay priority claims in the Belgian Concordat. The rest of the assets would be distributed to creditors in the chapter 11 case. Because this particular creditor's claim was subordinated, it would receive nothing, even though it could have shared

equally with other general creditors in the Belgian Concordat. The court finds that the plan is proposed in good faith. In addition, the plan does not discriminate unfairly against the subordinated creditor's claim, because in the chapter 11 case, the claim was not of the same priority as the general unsecured claims. *In re Lernout & Hauspie Speech Products, N.V.,* 301 B.R. 651 (Bankr. D. Del. 2003).

5.5.iiii. A claim is not impaired by disallowance. The plan proposed to pay the landlord's claim in its full allowed amount, as capped under section 502(b)(6). The landlord argued that because the Code capped the claim, it altered the legal and contractual rights to which the claim entitled the landlord and so impaired the claim. The court of appeals rules that the claim is impaired by statute, not by the plan, and that the plan need leave unaltered only the claim to which the Bankruptcy Code entitles the creditor. The court of appeals also notes that the 1994 amendment that repealed section 1124(3) was intended only to prevent cash-out of a claim without payment of post-petition interest and did not limit the scope of section 1124(1), under which the claim in this case was not impaired. *Solow v. PPI Enterprizes (U.S.), Inc. (In re PPI Enterprizes (U.S.), Inc.)*, 324 F.3d 197 (3d Cir. 2003).

5.5.jjjj. Leaving claim unimpaired to capture non-default interest rate is not bad faith. The debtors were in default under a mortgage and filed bankruptcy on the eve of foreclosure. During the case, the debtors sold the property free and clear of the creditor's lien, and the subsequent plan provided for payment in full of the creditor's secured claim and unsecured deficiency, with interest through date of payment at the non-default rate. Other unsecured creditors received payment in full with interest at 10%, and the surplus was returned to the debtors. The secured creditor challenged the plan, arguing that it was not proposed in good faith because it was crafted solely to let the debtors take advantage of the non-impairment rule and recover the surplus. The Ninth Circuit rejects a *per se* rule of good faith, reaffirming its prior rulings that good faith must be based on the totality of the circumstances. In this case, the debtors were permitted to nullify the consequences of the default, thereby avoiding the default interest rate, under *In re Entz-White Lumber and Supply, Inc.*, 850 F.2d 1338 (9th Cir. 1988). Therefore, a plan that did so did not use the Code for a purpose for which it was not intended, and the plan was filed in good faith. *Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070 (9th Cir. 2002).

5.5.kkkk. Substantive consolidation authorized by section 1123(a)(5). The debtor's reorganization plan proposed substantive consolidation of several of the jointly administered debtors' estates. Though the equity committee challenged consolidation on the grounds that *Grupo Mexicano*, 527 U.S. 308 (1999), prohibits a bankruptcy court from imposing an equitable remedy such as substantive consolidation that did not exist in 1789, the court sidesteps the issue. The court authorizes substantive consolidation under a plan under section 1123(a)(5)(C), which requires a plan to provide adequate means for its implementation, such as "(C) merger or consolidation of the debtor with one or more persons." Thus, the court finds direct statutory authority for consolidation under a plan. What is more, the court rules that because of the "notwithstanding" clause in section 1125(a)(5)(C), the debtors need not comply with applicable state law governing mergers to effect a consolidation under a plan. Finally, if there is a legitimate basis for substantive consolidation, the best interest test of section 1129(a)(7) must be applied on a consolidated basis. *In re Stone & Webster, Inc.*, 286 B.R. 532 (Bankr. D Del. 2002).

5.5.llll. Substantive consolidation under a plan requires creditor vote. Where a plan proposes substantive consolidation of more than one debtor, confirmation requires the affirmative vote of each class of creditors, counted before consolidation. *In re Central European Industrial Dev. Co. LLC*, 288 B.R. 572 (Bankr. N.D. Cal. 2003).

5.5.mmmm. Plan may not enjoin withholding tax collection. The sole shareholder and principal officer of the debtor needed relief from the IRS' collection efforts on the responsible person penalty for non-payment of withholding taxes in order for the reorganization plan to succeed. The plan enjoined the IRS from collecting the tax as long as the debtor was current on repayment. The Fifth Circuit rules the plan provision illegal and beyond the jurisdiction of the bankruptcy court. Although the injunction might be related to the bankruptcy case, the court rules that the more specific provisions of section 505, which authorize determination of taxes and protection from tax collections related to the debtor, controls the more general grant of jurisdiction. Because section 505 does not provide for jurisdiction over responsible person penalty liability, the plan could not enjoin collection. The Fifth Circuit concludes that the Supreme

Court's decision in *United States v. Energy Resources Co., Inc.*, 495 U.S. 545 (1990), does not apply, because that case dealt only with the allocation of payments under a plan, not with an injunction. *United States v. Prescription Home Healthcare, Inc. (In re Prescription Home Healthcare, Inc.)*, 316 F.3d 542 (5th Cir. 2002).

5.5.nnnn. Plan effective date may not be unreasonably delayed. The debtor proposed a plan whose effective date would occur only after completion of litigation over the allowability of the claim of the major creditor. Such a delay is not reasonable and unacceptably places the risk on the creditor. The effective date must be within a reasonable time after confirmation and cannot be delayed indefinitely. *In re Central European Industrial Dev. Co. LLC*, 288 B.R. 572 (Bankr. N.D. Cal. 2003).

5.5.oooo. Debtor may enforce confirmed plan against non-debtor plan proponent. After the non-debtor plan proponent failed to purchase the debtor's assets as provided in the confirmed plan, the debtor sold the assets to a third party and sued the proponent for the loss. The court rules that under section 1141, the plan is binding on the debtor and the plan proponent, that it has the same effect as a contract between them, and that the debtor has standing to enforce that obligation where the proponent has signed the plan and committed to performance under the plan. *Shenandoah Realty Partners, L.P. v. Ascend Health Care, Inc. (In re Shenandoah Realty Partners, L.P.)*, 287 B.R. 867 (Bankr. W.D. Va. 2002).

5.5.pppp. Plan provisions preempt state law. In the Pacific Gas and Electric chapter 11 case, the district court gives a very broad reading to section 1123(a)(5), which requires a plan to provide adequate means for its execution, including by transfer of assets or issuance of debt, "notwithstanding any otherwise applicable non-bankruptcy law." As a result, all of the requirements of the California Public Utilities Code that restricts a utility's transfer of assets or issuance of debt are preempted by the chapter 11 plan. The court does not require any showing of necessity or any balancing of interests. Preemption applies broadly, by force of statute. *In re Pacific Gas & Electric Co.*, 283 B.R. 41 (N.D. Cal. 2002).

5.5.qqqq. Ninth Circuit B.A.P. explains claim preclusion under a plan. In a lengthy opinion analyzing the applicability of the Restatement (Second) of Judgments, the Ninth Circuit B.A.P. rules that a preference action against a secured creditor is not barred by either claim preclusion or issue preclusion by reason of an order confirming a chapter 11 plan. The plan preserved the right to pursue avoiding power actions belonging to the estate and vested the right in a disbursing agent for the benefit of unsecured creditors. The B.A.P. attempts to apply the "plaintiff vs. defendant" rules of the Restatement (Second) to the collective proceeding that is a chapter 11 case. It concludes that unless the plan directly addresses the two-party dispute that is the subject of the subsequent litigation, the subsequent litigation comes under the Restatement's exceptions to the general rules against claim splitting and may be pursued. *The Alary Corp. v. Sims (In re Associated Vintage Group, Inc.)*, 283 B.R. 549 (9th Cir. B.A.P. 2002).

5.5.rrrr. Section 1123(a)(5) does not automatically preempt contrary state laws. Ruling at the disclosure statement hearing stage, Judge Montali decides that Pacific Gas & Electric Company's plan, which provides for transfers of assets and issuance of security without state PUC approval under applicable state statutes cannot be confirmed without a showing that preemption of the state statutes is necessary for the debtor's reorganization. He rejects the argument that the "notwithstanding any otherwise applicable non-bankruptcy law" introduction to section 1123(a) creates express federal preemption of contrary state laws, by contrasting it with other preemption provisions in the bankruptcy code that are specifically tailored to specific purposes, such as preemption of *ipso facto* clauses and bankruptcy anti-discrimination provisions. He also rejects the implied preemption argument. He concludes that the extent to which a plan may preempt state law depends on whether the state law prevents or hinders a reorganization and must be decided in the particular context of the case at issue. *In re Pacific Gas & Electric Co.*, 273 B.R. 795 (Bankr. N.D. Cal. 2002).

5.5.ssss. Chapter 11 plan stamp tax exemption applies to pre-plan sales. Affirming the bankruptcy court, 254 B.R. 306 (Bankr. D. Del. 2001), the district court rules that sales before confirmation or even proposal of a plan may get the benefit of the transfer tax exemption of section 1146(c), as long as the sales are an essential component of plan confirmation. *Baltimore County v. Hechinger Investment Co. (In re Hechinger Investment Co.)*, 276 B.R. 43 (D. Del. 2002).

5.5.tttt. International union is not equity holder in local union debtor. Relying on another non-profit entity case, *In re Wabash Valley Power Ass'n*, 72 F.3d 1305 (7th Cir. 1995), the Ninth Circuit rules that an equity interest has three components: control, profit share, and ownership of corporate assets. The court finds that the international union has none of these three attributes, primarily as a result of the National Labor Relations Act. Therefore, the continued affiliation of the local union with the international after a reorganization in which creditors are not paid in full does not violate that absolute priority rule. What is more, the local union is not required to raise its dues to its members or sever its ties to its international (thereby reducing the expense of affiliation with the international) in order to increase distribution to general unsecured creditors. *Security Farms v. General Teamsters Local 890 (In re General Teamsters Local 890)*, 265 F.3d 869 (9th Cir. 2001).

5.5.uuuu. Plan unfairly discriminates against separately classified unsecured claims. The debtor's subordinated debt was subordinated only to the senior bank lender but was pari passu with other unsecured claims, including trade claims. The plan separately classified the subordinated debt, providing for a recovery of approximately 1%, while unsecured trade would receive 100% recovery. Upon objection by the subordinated debt holders, the bankruptcy court rules that separate classification of unsecured claims is permissible to permit separate treatment of the claims in the two classes where the separate treatment was designed to preserve and enhance value of assets, such as by securing the continuing loyalty of trade creditors. However, the court rejects the disparate treatment of the classes in this case, relying on Bruce Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L.J. 227 (1998). Applying Professor Markell's analysis, the court determines that the discrimination between the two classes is unfair. Moreover the court rejects the argument that the senior secured lender which held a lien on all of the assets of the debtor, could direct payment to any junior class it chose, regardless of the limits of section 1129(b). *In re Sentry Operating Co.*, 264 B.R. 850 (Bankr. S. D. Tex. 2001).

5.5.vvvv. "Drop dead" plan provision does not automatically meet feasibility requirement. Section 1129(a)(11) imposes as a condition to plan confirmation that the court find that "confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, or the debtor ..., unless such liquidation or reorganization is proposed in the plan." Relying on this provision, the debtor proposed liquidation, in the form of a "drop dead" provision that would permit the secured lender to foreclose immediately upon a default, so that post-confirmation default and subsequent liquidation would be "proposed in the plan." The Eighth Circuit rules that the "drop dead" provision does not *per se* meet the "unless" requirement of section 1129(a)(11). *Danny Thomas Properties II Limited Partnership v. Beal Bank, S.S.B.*, 241 F.3d 960 (8th Cir. 2001).

5.5.wwww. Reorganization value is tested only at the effective date. The junior subordinated creditor argued that it should have received warrants or some other form of consideration under the plan in the event that the value of the reorganized company grew after the effective date to a value sufficient to pay the senior creditors in full. Rejecting this contention, the Third Circuit rules that the bankruptcy estate is evaluated as of the effective date of the plan, after which increases or decreases in value are irrelevant to compliance with section 1129(b). *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000).

5.5.xxxx. Exoneration clause in a plan is not an impermissible third party release. The reorganization plan provided for exoneration of all participants in the reorganization case for any acts or omissions in or related to the case or the plan or its confirmation, except for willful misconduct or gross negligence. The Third Circuit concludes that the exoneration provision is not an impermissible third party release because the beneficiaries of the exoneration are protected by a limited immunity in connection with their service in the chapter 11 case, and the contours of that limited immunity tracks the limitations of the exoneration clause. In particular, committee members have both a fiduciary duty to committee constituents and a concomitant grant of immunity that limits liability to willful misconduct or ultra vires acts. *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000).

5.5.yyyy. "Artificial" impairment does not defeat confirmation. Because of the 1994 amendment to section 1124, acceptance by an impaired class, no matter how little it may be impaired, complies with section 1129(a)(10) (at least one class has accepted the plan). The plan proponent is under no obligation to leave a class unimpaired, even though it could economically afford to do so, and its failure to do so

does not invalidate the class' acceptance of the plan for purposes of applying section 1129(a)(10). *In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213 (Bankr. D.N.J. 2000).

5.5.zzzz. Release of claim constitutes a transfer of property. In applying the fair and equitable rule of section 1129(b)(2)(B), the estate's release of a claim against a creditor or shareholder constitutes a transfer of property, which must be tested under the standards of *In re 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999). *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000).

5.5.aaaaa. "Unfair discrimination" depends on percentage recovery or risk of recovery. Professor Markell recently proposed a modified test for unfair discrimination between two classes of the same priority where the plan's treatment results in either a materially lower percentage recovery or a materially greater risk to the recovery. Bruce A. Markell, "A New Perspective on Unfair Discrimination in Chapter 11," 72 Am. Bankr. L.J. 227 (1998). *In re Dow Corning Corp.*, 244 B.R. 696 (Bankr. E.D. Mich. 1999), adopted the test. Now, the bankruptcy court in New Jersey also adopts the test in preference to the former test, which looked to consistency of treatment for a rational or legitimate basis for discrimination between the classes. Based on this test, the court confirms a plan that provides a recovery to former noteholders in new notes and stock valued at 76% of their claims while general unsecured trade claims receive 80% in cash over time. *In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213 (Bankr. D.N.J. 2000).

5.5.bbbbb. Channeling injunction authorized in consumer fraud case. In the chapter 11 reorganization of American Family Enterprises, the District Court approved a channeling injunction to protect various entities that made substantial contributions to the consumer repayment fund, relying on similar rulings in mass personal injury tort cases. *In re American Family Enterprises*, 256 B.R. 377 (D.N.J. 2000).

5.5.ccccc. Plan with greater likelihood of success would be confirmed. Where two competing plans were both confirmable, the court confirmed the plan that had a greater likelihood of success, based on its lower operating leverage, the greater reliability and achievability of its financial forecasts, a reduced risk of licensing, and an increased availability of cash for capital improvement to enhance performance. *In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213 (Bankr. D.N.J. 2000).

5.5.ddddd. Chapter 11 confirmation order may be revoked for fraud on the court. This single asset real estate debtor had received several expressions of interest in its property, before confirmation, at a price that substantially exceeded the amount owing on the mortgage. It did not disclose these expressions of interest to the court but instead obtained confirmation of a plan that paid the mortgagee less than in full. After confirmation, the debtor sold the property for substantially more. The Sixth Circuit rules that confirmation was properly revoked, on the grounds that the revocation for fraud provision in section 1144 applies equally to fraud on the court as well as to fraud on creditors. Moreover, the court affirms an award of attorney's fees because the fraud was upon the court. *Tenn-FLA Partners v. First Union National Bank (In re Tenn-FLA Partners)*, 226 F.3d 746 (6th Cir. 2000).

5.5.eeeee. Court confirms single asset real estate cram down plan. The debtor's chapter 11 plan provided for the sale of the general partnership interest in the partnership debtor to an insider for $1.4 million, payment of the secured lender's claim at the value of the property (which was substantially less than the amount owing), and payment of nominal consideration to unsecured creditors. Over the secured creditor's objection, the court holds that the sale of the equity in the partnership is not a sale of the property, so that the credit bid provision of section 363(k) does not apply. The court also rules that net rents paid during the case do not reduce the secured creditor's secured claim but are in addition to the value of the underlying property. In addition, the court determines that the sale of the equity to the son-in-law of the general partner does not implicate the new value corollary, because the plan proponent did not own equity in the debtor. Finally, the court permits separate classification of the unsecured deficiency claim on the ground that the creditor's interest differs substantially from the interests of the unsecured creditors. *Beal Bank, S.S.B. v. Waters Edge Limited Partnership*, 248 B.R. 668 (D. Mass. 2000).

5.5.fffff. Best interest test requires calculation of interest at statutory rate on Federal judgments. In applying the best interest test of section 1129(a)(7) in an insolvent case, the court must

apply the rate of interest fixed by 28 U.S.C. § 1961(a) in determining "interest at the legal rate from the petition date" on allowed claims under section 726(a)(5). *In re Dow Corning Corporation*, 237 B.R. 380 (Bankr. E.D. Mich. 1999).

5.5.ggggg. Post-confirmation interest on state tax claims runs at market, not statutory, rate. Joining the Ninth and Eleventh Circuits, the Fifth Circuit rules that the discount rate to be applied to deferred payment's of a priority state tax claim under section 1129(a)(9)(C) is the market rate of interest on a loan of comparable duration, not the statutory interest rate provided under the state tax statute. *Mississippi State Tax Commission v. Lambert (In re Lambert)*, 194 F.3d 679 (5th Cir. 1999).

5.5.hhhhh. Plan proponent's purchase of certain trade claims under a plan violates equal treatment rule. The plan provided for the proponent to purchase only certain designated trade claims for their full amount, to sell those claims to a secured creditor for the same amount, and to pay the secured creditor approximately that amount under the plan. This left other general unsecured creditors without any recovery. This plan violates section 1123(a)(4) of the Bankruptcy Code, which requires the same treatment for each claim or interest of a particular class. However, where members of a class were offered two different options, the fact that some select one and some select the other does not amount to prohibited different treatment. *In re Cajun Electric Power Cooperative, Inc.*, 230 B.R. 715 (Bankr. M.D. La. 1999).

5.5.iiiii. A municipality does not have holders of interests. The bankruptcy court confirmed the municipal debtor's plan over the non-acceptance of the class of unsecured creditors because the debtor did not have any equity security holders that could be characterized as holders of "interests." As such, there was no class junior to the class of unsecured creditors. *In re Corcoran Hospital Dist.*, 233 B.R. 449 (Bankr. E.D. Cal. 1999).

5.5.jjjjj. Plan confirmation denied as securities fraud. The publicly-traded debtor lost all of its assets in a foreclosure sale. Using notes, it then acquired nonperforming assets from investors hoping to liquidate their failed positions, offering them access to the public securities markets for their interest through a chapter 11 plan. Shortly after making the acquisitions, it filed chapter 11 and proposed a plan to issue stock in exchange for the notes. The court denied confirmation under section 1129(d) on the ground that the principal purpose of the plan was the avoidance of the application of section 5 of the Securities Act. *In Main Street A.C., Inc.*, 234 B.R. 771 (Bankr. N.D. Cal. 1999).

5.5.kkkkk. An individual may not fund a chapter 11 plan from future income. The court denies confirmation of the individual's chapter 11 plan on the grounds that it is to be funded out of the debtor's future income rather than out of property of the estate, on the grounds that postpetition income is not property of the estate and it would hamper the debtor's fresh start to commit postpetition income to a chapter 11 plan. The court relies on its prior decision, *In re Flor*, 166 B.R. 512 (Bankr. D. Conn. 1994), *affd.*, 3:94CV1130 (D. Conn. March 25, 1995), *appeal dism.* 79 F.3d 281 (2d Cir. 1996), in which the bankruptcy court concluded that such a plan is against public policy. *In re Gibbs*, 230 B.R. 471 (Bankr. D. Conn. 1999).

5.5.lllll. A debtor labor union does not have any equity interests. A class of creditors voted against the union's chapter 11 plan. The court confirmed the plan, even though the creditor was not paid in full, because the labor union as with other non-profit organizations, did not have equity security holders who would receive or retain any consideration under the plan. *In re General Teamsters, Warehousemen and Helpers Union Local 890*, 225 B.R. 719 (Bankr. N.D. Cal. 1998).

5.5.mmmmm. Plan-related expense payments permissible before court approval. One of three competing plan proponents advanced chapter 11 costs and expenses to an unofficial committee before plan confirmation, with no strings attached. The payments do not violate section 1129(a)(4) which requires that any such payment "has been approved by, or is subject to the approval of, the court as reasonable," because the section does not require approval before payment, only before plan confirmation. The court cautions against a tough standard on approving such payments when they do not come out of the estate. The court also determines that because the payments were not on account of the committee members' claims or interests, the payments did not violate section 1123(a)(4), which requires

a plan to "provide the same treatment for each claim or interest of a particular class." *Mabey v. Southwestern Electric Power Co. (In re Cajun Electric Cooperative Power, Inc.)*, 150 F.3d 503 (5th Cir. 1998).

5.5.nnnnn. Second Circuit rejects new value corollary. In a single asset real estate case, the Second Circuit holds that the new value corollary may be satisfied only if "no other party seeks to file a plan or where the market for the property is adequately tested," reasoning that permitting the debtor to file a plan funded by the equity holders when those conditions have not been met permits the equity holders to participate "on account of" their prior subordinate position, contrary to section 1129(b)(2)(B)(ii). The court reasoned that if those conditions were not met, the new value contribution by former equity holders is not "necessary, " as required by the new value corollary. *Coltex Loops Central Three Partners, L.P. v. BT/SAP Pool C Associates, L.P. (In re Coltex Loops Central Three Partners, L.P.)*, 138 F.3d 39 (2d Cir. 1998).

5.5.ooooo. Plan effective date may not be delayed. A plan may not fix the effective date as one year after a confirmation in order to allow the debtor to collect accounts receivable to have adequate funds to make payments under the plan. The delay is unreasonable, especially because interest does not typically begin running under a plan until the effective date. *In re Potomac Ironworks, Inc.*, 217 B.R. 170 (Bankr. D. Md. 1997).

5.5.ppppp. Seventh Circuit affirms availability of new value corollary. The Seventh Circuit has affirmed the survival of the new value corollary to the absolute priority rule. The secured lender was owed $93,000,000, the secured portion was $55,000,000. The debtor's partners would contribute $3,0000,000 the day after the effective date and make five annual installments of $625,000. The bankruptcy court found that the new value corollary was available and that the contribution was substantial and necessary for the reorganization. The Court of Appeals affirmed. *In re 203 North La Salle Street Partnership*, 126 F.3d 955 (7th Cir. 1997).

5.5.qqqqq. Feasibility requirement eased. The debtor's plan provided for payments to the secured lender over ten years and provided that the lender could foreclose if there was any subsequent default in payment. The debtor's projections showed the probability of a default in year seven. The plan was held to meet the feasibility requirement of section 1129(a)(11) because, despite the projection of a possible default, an absolute certainty was not required, and a plan meets the requirements of section 1129(a)(11) if further "liquidation or reorganization is proposed in the plan." *In re 203 North La Salle Street Partnership*, 126 F.3d 955 (7th Cir. 1997).

5.5.rrrrr. Appeal from order confirming plan not moot. The debtor confirmed and consummated a cram-down plan. The secured lender appealed. Finding that the transactions that had occurred could be reversed "without significant harm to third parties" the Court of Appeals refused to dismiss the appeal as moot. *In re 203 North La Salle Street Partnership*, 126 F.3d 955 (7th Cir. 1997).

5.5.sssss. Chapter 12 plan may strip down a lien. In a case of first impression in the courts of appeals, the Eighth Circuit holds that a chapter 12 plan may provide for stripping down an undersecured creditor's lien to the value of the collateral. The court distinguishes *Dewsnup v. Timm*, 502 U.S. 410 (1992) as dealing only with section 506(d) in a chapter 7 case and *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993) as dealing only with the limitation on restructuring a home mortgage in a chapter 13 case. Because the language of chapter 12 is so similar to the comparable language of chapters 11 and 13, this ruling should allow strip down of liens under both of those chapters as well (other than home mortgages in chapter 13). *Harmon v. United States*, 101 F.3d 574 (8th Cir. 1996).

5.5.ttttt. New value contribution held *de minimis*. A new value contribution of $32,000 in a single asset real estate case in which the secured claim was $4.3 million dollars and the total secured claims were approximately $5 million dollars was *de minimis* as a matter of law and therefore failed to meet the requirement that new value be "substantial." *Liberty National Enterprises v. Ambanc La Mesa Limited Partnership (In re Ambanc La Mesa Limited Partnership)*, 115 F.3d 650 (9th Cir. 1997).

5.5.uuuuu. Sale of property under plan renders appeal from confirmation order moot. The Sixth Circuit joins the Ninth and Eleventh Circuits in holding that sale of property under a plan (here, a single asset real estate case) renders moot an appeal from an order confirming the plan, even though the debtor's principal secured creditor, who was the plan proponent, is a party to the appeal. *255 Park Plaza Associates Ltd. Partnership v. Connecticut General Life Insurance Company (In re 255 Park Plaza Associates Ltd. Partnership)*, 100 F.3d 1214 (6th Cir. 1996).

5.5.vvvvv. Third Circuit adopts "equitable mootness" doctrine. The Third Circuit has adopted the doctrine of "equitable mootness" on an appeal from disallowance of an administrative priority claim as part of an order of confirmation of a chapter 11. The Circuit adopts a five-factor test for equitable mootness: (1) substantial consummation of the plan (2) stay pending appeal (3) effect on rights of parties not before the court (4) effect on the success of the plan, and (5) public policy of finality of bankruptcy judgments. *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a. Bankruptcy court may recharacterize a claim as an equity interest. The debtor's shareholders made a series of loans to the debtor, which the debtor repaid while insolvent within two years before bankruptcy. The trustee sought to recharacterize the loans as equity investments in the debtor and then to avoid the repayment as a fraudulent transfer. The trustee may avoid a transfer that the debtor made while insolvent within two years before bankruptcy if the debtor did not receive reasonably equivalent value. "Value" includes satisfaction of an antecedent debt, although it does not include a return of an equity investment. A debt is a liability on a claim. A claim is a right to payment. Applicable nonbankruptcy law determines whether there is a right to payment or only an equity investment. Therefore, the court must examine the transaction and apply nonbankruptcy law to determine whether the shareholders' loans gave rise to a right to payment, that is, whether to recharacterize what purported to be loans as equity investments. Recharacterization, which determines a loan's character, thus differs from equitable subordination, which determines whether an acknowledged loan or other claim should be subordinated to other claims. *Official Committee of Unsecured Creditors v. Hancock Park Capital II, L.P. (In re Fitness Holdings Int'l, Inc.)*, 714 F.3d 1141 (9th Cir. 2013).

6.1.b. Court applies adequate protection payments from rents to reduce lender's unsecured deficiency claim. During the single asset real estate chapter 11 case, as adequate protection, the debtor in possession paid excess rents to the undersecured mortgage lender, who had a perfected security in the real property and the rents. Section 506(a) bifurcates the lender's claim into a secured and an unsecured portion. Section 506(b) allows postpetition interest only on an oversecured claim. *U.S. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988), does not permit payment of postpetition interest on an undersecured claim. Under section 552(b), postpetition rents are additional collateral, decreasing the undersecured lender's deficiency. If retained as cash collateral, they would reduce and perhaps eventually eliminate the lender's unsecured deficiency claim and could then start applying to postpetition interest. Therefore, the court applies the adequate protection payment to reduce the lender's unsecured deficiency claim. *In re Lichtin/Wade, L.L.C.*, 487 B.R. 665 (Bankr. E.D.N.C. 2013).

6.1.c. Bankruptcy Code preempts state law anti-deficiency statute. The secured creditor filed a proof of claim that bifurcated the claim into secured and unsecured portions and then stipulated with the trustee for stay relief to permit foreclosure. At the foreclosure sale, the creditor bid the amount of the secured claim. The debtor received a discharge about 30 days later. Later, the trustee objected to the creditor's unsecured claim on the basis of a state statute that bars a post-foreclosure deficiency claim against a debtor if the creditor does not commence an action for the deficiency against the person liable on the claim within 90 days after the foreclosure. Federal law preempts state law when the federal law so thoroughly occupies a field as to imply that Congress left no room for state legislation in the field (field preemption) or when the state law poses an obstacle to the accomplishment of the federal law's purposes (conflict preemption). Here, requiring the creditor to proceed in state court would be inconsistent with the Congressional purpose that claims in a bankruptcy case be addressed in the case in the bankruptcy court.

In addition, the automatic stay that was in effect at the time of the foreclosure and the discharge injunction that took effect later prevented the creditor from complying with the state law, creating a conflict between state and federal law. Therefore, the Bankruptcy Code preempts the state law, so the court allows the creditor's unsecured deficiency claim without the creditor's compliance with the state law anti-deficiency statute's procedure. *Pierce v. Carson (In re Rader)*, 488 B.R. 406 (9th Cir. B.A.P. 2013).

6.1.d. Environmental remediation obligation for which the creditor has agreed to accept reimbursement is a claim. The debtor sold environmentally contaminated property to the creditor years before bankruptcy. It entered into agreements with the creditor and the state environmental protection agency providing for the creditor to remediate the property and for allocation of remediation expenses among the debtor, the creditor and the agency. The creditor did not complete remediation before the debtor filed its chapter 11 case. In the bankruptcy, the debtor rejected the agreements. The creditor filed a proof of claim and sought specific performance of the debtor's obligations under the agreements. A claim is a right to payment or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment". If paying for or reimbursing a third party for the remediation costs cannot be used to satisfy an environmental remediation obligation, such as is the case under the Resource Recovery and Conservation Act of 1976 (RCRA), then the obligation might not be a claim. Here, however, the creditor and the agency had expressly agreed to accept payment from the debtor to satisfy the debtor's obligations. Thus, the creditor had a claim, which could be discharged under the plan, and was not entitled to specific performance. *Route 21 Assocs. of Belleville, Inc. v. MHC, Inc.*, 486 B.R. 75 (S.D.N.Y. 2012).

6.1.e. Court disallows creditor's claim for unpaid environmental remediation costs for which the creditor is jointly liable with the debtor. The debtor sold environmentally contaminated property to the creditor years before bankruptcy. It entered into agreements with the creditor and the state environmental protection agency providing for the creditor to remediate the property and for allocation of remediation expenses among the debtor, the creditor and the agency. The creditor did not complete remediation before the debtor filed its chapter 11 case. In the bankruptcy, the debtor rejected the agreements. The creditor and the agency each filed a proof of claim, and the creditor sought specific performance of the debtor's obligations under the agreements. The creditor and the agency agreed to treat their claims as a single claim and to work out between themselves the allocation of any distribution on the claims. Under section 502(e)(1)(B), a claim for reimbursement or contribution of one who is liable with the debtor (a codebtor) is disallowed if the claim is contingent at the time of allowance. "Reimbursement is construed broadly to include indemnification. A reimbursement claim is contingent if the codebtor has not yet paid the amount for which it seeks reimbursement, even though it might later be entitled to reimbursement after it pays the amount. Here, because the creditor was directly liable with the debtor for remediation and had not yet paid all of the remediation expenses that it had agreed to share with the debtor, its reimbursement claim would be allowed only for the amount it had paid to date, not for any future payment obligations. The creditor's agreement with the agency to combine and share the distribution on their claims underscores this result. *Route 21 Assocs. of Belleville, Inc. v. MHC, Inc.*, 486 B.R. 75 (S.D.N.Y. 2012).

6.1.f. WARN Act unforeseen circumstances exception applies to layoffs following an unplanned bankruptcy filing. The debtor manufactured swing sets and go-carts. An asset-backed lender provided financing, secured by receivables and inventory, with advances equal to 80% of receivables. The debtor's private equity sponsor had provided additional equity financing over several years, as needed, and never indicated an intention not to continue to do so. In April, it was required to recall a substantial number of go-carts. In June, three major customers postponed a major swing set order. The debtor made every effort to continue in business and met with some limited success and positive movement from customers and suppliers. As a precaution, however, it consulted bankruptcy counsel in early August. In mid-August, the lender reduced the advance rate to 50% and in the first week of September, stopped advances altogether. The private equity sponsor refused any further investment. Within two days, the debtor filed bankruptcy and gave layoff notices to its employees, immediately terminating their employment. The WARN Act requires an employer to give 60 days' notice of a mass layoff or to pay 60 days' compensation to the employees. The Act's purpose is to soften the blow on employees of a planned or foreseeable mass layoff, allow them to adjust and seek new employment or retraining. Thus, it does not apply where the layoffs are caused by circumstances that are not reasonably foreseeable, such as "when caused by some sudden,

dramatic, and unexpected action or condition outside the employer's control". Thus, where an adverse condition is only possible but not probable, notice is not required. Here, the sudden and unexpected termination of financing caused the shutdown and layoffs, which were not planned or within the debtor's control. Therefore, the unforeseen circumstances exception applies. *Angles v. Flexible Flyer Liquidating Trust (In re FF Acquisition Corp.)*, ___ F.3d ___, 2013 U.S. App. LEXIS 2850 (5th Cir. Feb. 11, 2013).

6.1.g. 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.h. 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*,702 F.3d 903 (7th Cir. 2012).

6.1.i. Section 502(b)(7) applies to all employment termination claims, whether arising in contract or tort. Before bankruptcy, the debtor fired an at-will employee, who then sued. The employee obtained a jury verdict for back pay, front pay and emotional distress damages in an amount substantially in excess of the employee's annual salary. The debtor filed bankruptcy soon thereafter. The employee filed a proof of claim for the jury verdict amount. Section 502(b)(7) limits "the claim of an employee for damages resulting from the termination of an employment contract." Employment under an at-will arrangement is employment under a contract, though one terminable at any time. Therefore, employment termination does not breach the contract, even though it may violate other employee rights. Section 502(b)(7) applies to damages "resulting from" termination, not only to damages for breach of an employment contract. Here, the damages that the employee suffered from wrongful termination resulted from the termination of his employment, which also was a termination of his employment contract. As such, the damage claim is covered by the claim allowance limitation in section 502(b)(7). *Belson v. Olson Rug Co.*, 483 B.R. 660 (N.D. Ill. 2012).

6.1.j. Section 509(a) does not preempt equitable subrogation for a lender who is not a co-debtor. Shortly before bankruptcy, the debtor transferred his heavily encumbered Florida real property to his father. The father financed the purchase with two new mortgage loans, the proceeds of which were used to satisfy all of the liens against the property. However, the deed to the father, the mortgages to the new lenders and the lien releases from the old lenders were not recorded until after the debtor's

bankruptcy. The trustee avoided the transfer to the father as a fraudulent transfer and then sought to avoid the two new mortgage loans under section 544(a)(3) as unperfected liens. Section 509(a) subrogates "an entity that is liable with the debtor on … a claim of a creditor against the debtor, and that pays such claim … to the rights of such creditor." By its terms, it does not apply to the new lenders. Although their loans paid off the prior liens on the debtor's real property, they were not "liable with the debtor on" those prior claims. Therefore, section 509(a) does not preempt applicable nonbankruptcy subrogation law as it might apply to the lenders. Under Florida law, a creditor may equitably subrogate to another's claim and position if the creditor made the payment to protect its own interest, did not act as a volunteer, was not primarily liable on the underlying debt and paid off the entire existing debt and if subrogation would not work an injustice to third parties. Here, the lenders paid the prior claims to enable them to have senior mortgages; a new mortgagee who pays off a prior mortgage is not a "volunteer;" the new lenders were not liable on the existing debt; and the new lenders paid the prior claims in full. Finally, subrogation would not work an injustice to the trustee's rights, because it merely substitutes the new lenders for the old lenders, whose claims were unavoidable. Subrogation makes the trustee no worse off and is permitted. *Anderson v. SunTrust Mortgage, Inc. (In re Judd)*, 471 B.R. 830 (D.S.C. 2012).

6.1.k. Third Circuit extends *Grossman's* to postpetition, pre-confirmation claims. A consumer purchased the debtor's product during the debtor's chapter 11 case. The product manifested a defect three years after plan confirmation. Under *In re M. Frenville & Co.*, 744 F.2d 332 (3d Cir. 1984), the consumer did not have a claim as of plan confirmation, because the product defect had not yet become manifest. Determining when a claim arises requires balancing the goals of giving a reorganizing debtor a fresh start with protecting individuals who might not know yet that they have suffered injury. Based on such a balancing, *In re Grossman's Inc.*, 607 F.3d 114 (3d Cir. 2010), overruled *Frenville* four years after plan confirmation in this case, stating the rule that a claim arises upon the exposure to a product or upon conduct that gives rise to an injury. Section 1141(d) discharges a debtor from all claims that arose before plan confirmation. Applying *Grossman's* only to claims that arise before bankruptcy would defeat the fresh start goal for a debtor who otherwise receives a discharge of all claims that arise before confirmation. The court therefore extends *Grossman's* to apply to a claim that arises upon the pre-confirmation exposure to a product or conduct that gives rise to an injury. *Wright v. Owens Corning*, 679 F.3d 101 (3d Cir. 2012).

6.1.l. Section 502(d) may disallow a transferred claim. In its statement of financial affairs, the debtor had listed a creditor, among others, as a recipient of a payment within 90 days before bankruptcy. The creditor transferred its claim during the debtor's bankruptcy. After plan confirmation, the liquidating trustee brought a preference avoidance action against the creditor and obtained a judgment. The trustee then objected under section 502(d) to the claim in the transferee's hands. Section 502(d) requires the court to "disallow any claim of any entity … that is a transferee of a transfer avoidable under section [547], unless such entity or transferee has paid the amount, or turned over such property, for which such entity or transferee is liable". The language focuses on the claim, not the holder. Section 502(d) provides the estate with an affirmative defense, which is not destroyed by a transfer of the claim. A transfer does not change the claim's nature, only the holder. A different rule would permit a creditor who had received a voidable transfer to "wash" its claim by transfer, and a transferee can protect itself by obtaining an indemnity. Finally, in this case, the statement of affairs put all potential transferees on notice of which claims transferors might be subject to avoidance actions. Therefore, section 502(d) applies equally to a transferred claim even though the claim transferor is liable to return an avoidance transfer, and the court disallows the claim. *In re KB Toys, Inc.*, 470 B.R. 331 (Bankr. D. Del. 2012).

6.1.m. A prepetition forum's choice of law rules apply to a proof of claim. A client filed a malpractice claim against its former law firm in Connecticut, where the claim had accrued. While the action was pending, the law firm filed bankruptcy in New York. The client filed a proof of claim. The action in Connecticut was timely under its statute of limitations but would not have been timely under New York's statute of limitations. To prevent forum shopping to gain a longer statute of limitations, New York has a "borrowing statute", which is a choice of law rule that requires a New York court to apply the shorter statute of limitations of New York or the state where the cause of action accrued. Under *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941), a choice of law rule is part of a state's substantive law. A federal court sitting in diversity must apply the choice of law rule of the state where it sits. Bankruptcy courts must do the same when addressing state-law rights. A plaintiff may choose a forum based on its

substantive law, including its choice of law rules. So when a defendant obtains a venue transfer from one federal court to another, the transferor court's state choice of law rules follow the action to the transferee court. When the defendant files a bankruptcy case, effectively forcing the plaintiff to continue the action in the bankruptcy court by filing a proof of claim, the rule is the same. Accordingly, Connecticut's choice of law rules applied to the court's adjudication of the client's proof of claim in the New York bankruptcy court. The court distinguishes some broad language in its prior decision in *In re Gaston & Snow*, 243 F.3d 599 (2d Cir. 2001), by noting the difference between the estate's collection action against a third party there and the proof of claim by a third party against the estate here. *Statek Corp. v. Devel. Spec., Inc. (In re Coudert Bros. LLP)*, 673 F.3d 180 (2d Cir. 2012).

6.1.n. Agent with only general authorization may file a proof of claim. The creditor purchased a loan from another lender, who was also the agent under the loan agreement. The loan agreement authorized the agent to enforce and pursue all rights and remedies under the loan agreement. The creditor had not seen the loan agreement before the claims filing bar date. The creditor received a letter from the agent shortly after the debtors filed their cases saying that the agent was "continuing to act as authorized agent under the [loan agreement] in connection with those proceedings and was actively pursuing all avenues of recovery" and that it would "proceed on behalf of the lenders … in these cases". In conversations before the bar date between the creditor and the agent, the creditor understood the agent to say that it would take whatever action necessary or appropriate to protect the creditor's interests, though the agent never used the word "agent" nor said expressly that it would file a proof of claim for the creditor. The debtors objected to the agent's proof of claim for the creditor. Rule 3001(b) permits a creditor's authorized agent to file a proof of claim for the creditor. The Rule looks to nonbankruptcy agency law to determine whether the filer is an authorized agent, but the creditor must authorize the agent before the bar date. Establishment of an agency relationship requires only "assent", not express authorization. Rule 3001(b) does not require that the authorization expressly authorize the filing of a proof of claim. Requiring such "magic words" would be burdensome and impractical and would unduly prejudice unwary creditors. Here, the agency provision in the loan agreement did not authorize the agent to file the proof of claim for the creditor, because the creditor had not seen (and therefore had not assented to) the provision before the bar date. But the general assent reflected in the agent's letter and later conversations gave adequate authorization for the agent to file the proof of claim for the creditor. *Palmdale Hills Prop., LLC v. Lehman Comm'l Paper, Inc. (In re Palmdale Hills Prop., LLC)*, 457 B.R. 29 (9th Cir. B.A. P. 2011).

6.1.o. State law determines recharacterization. The debtor signed a loan agreement that required repayment only from an oil royalty interest or from the proceeds of any future equity offering. After bankruptcy, the debtor objected to the allowance of a claim under the loan agreement on the ground that the agreement granted only an equity interest. Section 502(b)(1) requires disallowance of a claim that is not enforceable under applicable nonbankruptcy law. Under *Butner v. U.S.*, 440 U.S. 54 (1979), applicable law is state law unless federal bankruptcy policy requires a different result. Although some courts have found authority to recharacterize claims as equity interests under section 105(a), state law that recharacterizes an equity investment dressed up as a claim is a sufficient basis for the bankruptcy court to reach the same result under section 502(b)(1). *Grossman v. Lothian Oil Inc. (In re Lothian Oil Inc.)*, 650 F.3d 539 (5th Cir. 2011).

6.1.p. The court should use probabilities in estimating a claim to establish a disputed claims reserve. The creditor filed a proof of claim, to which the debtor in possession objected. The objection involved only contested issues of law, not of fact. To facilitate plan distributions, the debtor in possession sought an order estimating the claim for purposes of setting a distribution reserve. Section 502(c) permits a court to estimate "for purposes of allowance … any contingent or unliquidated claim, the fixing or liquidation of which … would unduly delay the administration of the case." Neither the Code nor the Rules provides any procedures for estimation, except that the court is bound by the legal rules governing the claim. Claim estimation may be used to determine voting rights, gauging plan feasibility, determining the likely aggregate amount of a related series of claims, fixing a distribution reserve or allowing a claim. Estimation permits the court to achieve reorganization or distribution without waiting until all disputes are resolved. An "all or nothing" approach estimates the claim at the full amount or at zero, depending on whether the claimant proves its case by a preponderance of the evidence. Because an estimation for reserves can effectively prevent a claimant's recovery and because the trier of fact or an appellate court

may disagree with a bankruptcy court's determination of factual or legal issues, a probabilistic approach is superior. Therefore, the bankruptcy court should allow for that possibility in setting a reserve. In this case, the court determines that the claim should be disallowed but acknowledges a 10% to 15% probability that an appellate court will disagree. Fixing the reserve too low would unfairly penalize the creditor; fixing it too high would require other stakeholders to wait longer than they should before they receive their full distributions. The court therefore fixes the distribution reserve based on estimating the claim at 30% of its face amount. *In re Chemtura Corp.*, 448 B.R. 635 (Bankr. S.D.N.Y. 2011).

6.1.q. Debtor-employer's post-withdrawal MEPPA liability is an administrative expense to the extent of postpetition employment. The debtor retained its union employees for the 18 months after the petition date during which it operated. During the 18-month period, the debtor made all required contributions to its multi-employer pension plan. When it sold all its assets and terminated its employees, it was deemed to withdraw from the plan, incurring withdrawal liability under the Multi-Employer Pension Plan Amendments to ERISA. The amount of withdrawal liability is based on a combination of factors, including the number of employees that the employer has in the plan and the accrued actuarial obligations to those employees over the preceding five years relative to all other employees in the plan and the amount by which the plan is underfunded. Withdrawal liability protects remaining employers from liability for the full underfunding. Section 503(b)(1) allows as administrative expenses the actual and necessary costs and expenses of preserving the estate. Employee compensation for postpetition services, including the employer's obligation to pay benefits, is an administrative expense. Therefore, the portion of the withdrawal liability attributable to postpetition services is entitled to allowance as an administrative expense, even though the amount of the liability is subject to numerous factors beyond the debtor in possession's control and benefits other employees and other employers by enhancing the multi-employer plan. A debtor in possession assumes that risk and the obligation to fund by continuing employment of its employees after bankruptcy. Making all required contributions alone is insufficient, because the full cost of the pension benefit includes the funding of any accumulated deficit. Accordingly, the court must determine the amount attributable to postpetition services, which will be allowed as an administrative expense. *In re Marcal Paper Mills, Inc.*, 650 F.3d 311 (3d Cir. 2011).

6.1.r. ADEA claim is subject to section 502(b)(7) employment contract damages cap. An employee filed a proof of claim against the debtor under the Age Discrimination in Employment Act for wrongful termination on the basis of age discrimination. Section 502(b)(7) caps the allowability of a claim for damages resulting from the termination of an employment contract. The claimant was an employee subject to an employment contract. Therefore, his claim for termination of his employment is subject to the cap, even though the termination was not the result of a breach of the contract. *In re Fairpoint Comm'ns, Inc.*, 445 B.R. 271 (Bankr. S.D.N.Y. 2011).

6.1.s. Debtor's financial sponsor/owner is not liable for WARN Act violations. A private equity firm owned 70% of the debtor's stock and designated nearly all of its directors, who were firm employees, as were many of the officers. When the debtor encountered financial difficulties, it began a restructuring program, with its board's involvement, which would have resulted in numerous layoffs. However, before the debtor could implement the plan, the bank froze the debtor's revolving credit line and demanded the appointment of a chief restructuring officer. The CRO directed mass layoffs without compliance with the WARN ACT and, within two weeks, the board authorized and the debtor filed a bankruptcy petition. Employees sued the private equity firm for liability under the WARN Act as a control person. Under WARN, an employer must give employees who are subject to a mass layoff either 60 days' notice or pay in lieu of notice. A parent corporation may be considered a "single employer" with the actual employer, depending on relevant factors, including (i) common ownership, (ii) common directors or officers, (iii) *de facto* exercise of control, (iv) unity of personnel policies from a common source and (v) dependency of operations. Although the employees showed common ownership, directors and officers, they did not show the presence of the other factors. The private equity firm controlled the debtor through its directors after the appointment of the CRO, but the CRO made all decisions relating to the restructuring, including the layoffs. Therefore, the firm was not liable for WARN Act violations. *Manning v. DHP Holdings II Corp. (In re DHP Holdings II Corp.)*, 447 B.R. 418 (Bankr. D. Del. 2010).

6.1.t. Rabbi trust beneficiaries who were wrongfully denied prepetition payment are not entitled to a constructive trust. A company that the debtor acquired had established a deferred compensation plan for its senior executives, under which the compensation the executives deferred was held in a rabbi trust. The funds in a rabbi trust are held as part of the employer's general assets and are available to the employer's general creditors. The executives have no cognizable property interest in the trust assets and have only general unsecured claims against the employer for the benefits. After the debtor's acquisition, it wrongfully refused to pay the executives amounts to which they were entitled under the plan terms, in violation of ERISA. The executives sought imposition of a constructive trust in their favor on the trust assets. ERISA provides the exclusive basis for claims against an employer for denial of benefits under an employee benefit plan. The imposition of a constructive trust is only a remedy, not a substantive claim and is therefore not barred by ERISA. Imposition of a constructive trust requires wrongful conduct by the defendant and tracing of the assets subject to the trust. Here, the debtor's denial of payments to the executives was wrongful, but the executives were not entitled to trace funds into a trust. Because the executives had no interest in the rabbi trust, there were no funds that in good conscience belonged to them and that could be traced into a constructive trust. *In re Wash. Mut., Inc.*, 450 B.R. 490 (Bankr. D. Del. 2011).

6.1.u. Court denies reclamation claims in toto under section 546(c). The debtor's prepetition lenders had a security interest on the debtor's inventory. The debtor in possession financing proceeds were used to repay the prepetition lenders; the financing was secured by the inventory. Soon after bankruptcy, the debtor in possession obtained an order requiring suppliers asserting reclamation claims to file demands within 20 days after the petition date. The order did not limit the suppliers' right to pursue any other remedies or affect their right to recover goods. Suppliers promptly sent letters to the DIP demanding return of goods supplied within 45 days before the petition date and filed proofs of claim but took no other action to reclaim goods. Reclamation is a nonbankruptcy remedy, grounded generally in U.C.C. section 2–702, which makes the reclaiming seller's rights subject to the rights of a good faith purchaser. The right is limited to a right to reclaim. It does not include a right to possession or to a lien and does not give a right to proceeds of the goods. It is not self-effectuating; the seller must take action, including identifying the goods. A secured party is a purchaser under the U.C.C. Therefore, the sellers' reclamation rights were subject to the prepetition inventory security interest and to the transfer of a security interest to the postpetition lenders. Section 546(c) subordinates the trustee's avoiding powers to a seller's reclamation right under nonbankruptcy law. It does not grant such a right or an administrative expense priority for or a lien to secure a reclamation claim. The 2005 amendments to section 546(c) eliminated the court's authority to grant an administrative expense priority claim for or lien to secure a reclamation claim that the court denied. Therefore, the sellers have only general unsecured claims. *In re Circuit City Stores, Inc.*, 441 B.R. 496 (Bankr. E.D. Va. 2010).

6.1.v. DCF valuation is a commercially reasonable determinant under section 562 for a repo agreement. Before bankruptcy, the debtor repo'd mortgage loans to the creditor and defaulted on the repo agreement, and the creditor terminated the repo agreement and retained the collateral. On the termination date, the market for mortgages was completely dysfunctional. The creditor filed a proof of claim for damages, asserting its damage claim based on the value of the mortgage loan portfolio as of the first date on which the creditor could have sold the portfolio for a reasonable price. Section 562 requires that damages resulting from the termination of a repo agreement be measured as of the earlier of the rejection or termination date or, "if there are not any commercially reasonable determinants of value as of" such date, then "as of the earliest subsequent date or dates on which there are commercially reasonable determinants of value". The phrase "any commercially reasonable determinants" permits a court to review any determinant, not just a market value, in determining whether damages may be measured as of the earlier of rejection or termination dates and in measuring damages. Here, the court used a discounted cash flow analysis, which it determined, based on expert testimony, should approximate the market value except in unusual circumstances. Although the market value is a preferred method to determine value, a discounted cash flow valuation is appropriate when the market is dysfunctional. An alternative method is preferred so as to prevent moral hazard, which could result if the creditor were allowed to delay the valuation date and thereby see which way the market moved before selecting a valuation date. *Crédit Agricole Corp. and Inv. Bank v. Am. Home Mortgage Holdings, Inc. (In re Am. Home Mortgage Holdings, Inc.)*, 637 F.3d 246 (3d Cir. 2011).

6.1.w. Section 1111(b) converts unsecured nonrecourse claim to recourse only for purposes of allowance, voting and distribution. The debtor leased land to a contractor, who built a store for the debtor and leased the store and subleased the land back to the debtor. The contractor mortgaged the leasehold interest, and the debtor pledged the fee to secure a nonrecourse guarantee. The debtor filed chapter 11 and confirmed a reorganization plan, under which the mortgagee confirmed that its claim was fully satisfied. The reorganization was unsuccessful, and the reorganized debtor filed a second chapter 11 case 18 months after confirmation in its first case. The mortgagee filed a proof of claim for amounts owing and unpaid under the mortgage. Section 1111(b) provides that a nonrecourse claim "shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse", with exceptions not relevant here. Section 1111(b) affects only allowance, voting and distribution in the chapter 11 case. It does not convert a nonrecourse claim into a recourse claim for any other purpose or change the nature or terms of the security interest. Therefore, the mortgagee's unsecured claim in the second case is disallowed. *In re Montgomery Ward, LLC*, 634 F.3d 732 (3d Cir. 2011).

6.1.x. Failure to make unallocated prepetition mortgage escrow payments creates a prepetition claim. The chapter 13 debtor fell behind on his mortgage payments before bankruptcy, including payments for principal, interest and escrow for taxes and insurance. The lender could use the escrow amounts for payment of taxes and insurance, and they served as additional collateral for the loan. The mortgage required the debtor to make the escrow payments and permitted the lender to declare a default and foreclose on the mortgage based on missed escrow payments. Before bankruptcy, the lender had made tax and insurance payments in an amount that exceeded the escrow account balance by about $3500, but the total missed prepetition escrow payments totaled about $5300. As permitted under the Real Estate Settlement Procedures Act (RESPA), the lender recalculated the debtor's postpetition escrow payments to make up the $1800 prepetition shortfall (although it was unclear whether the $1800 would be required for postpetition tax and insurance payments that would come due before the next annual escrow payment adjustment). A "claim" is a right to payment, whether or not contingent. Although the debtor was not yet liable to the lender on the petition date for postpetition tax and insurance that the lender had not yet paid, the lender's claim for such payments was contingent as of the petition date on its paying those amounts. Accordingly, the lender's claim for the missed prepetition escrow payments was a prepetition claim that should have been included in the lender's proof of claim, and the lender's effort to collect them after bankruptcy through an adjustment in the monthly escrow violated the automatic stay. A dissent argues that RESPA permits the adjustment and that the majority's ruling unnecessarily and therefore improperly places RESPA and the Bankruptcy Code in direct conflict. Neither opinion addresses whether the requirement to make escrow payments was solely a requirement for the debtor to post additional collateral, rather than a right to payment itself, or whether such an analysis would make any difference in the application of the definition of "claim" or of the automatic stay to the facts. *In re Rodriguez*, 629 F.3d 136 (3d Cir. 2010).

6.1.y. Minority shareholders' buyout order gives rise to a claim. The debtor's minority shareholders sued the debtor and the majority shareholders for dissolution. Under applicable state corporate law, the debtor and the majority agreed to purchase the minority's shares. After an appraisal proceeding, the state court issued an order requiring the debtor to purchase the shares at a fixed price by a deadline, failing which the corporation would be dissolved, and the shareholders would receive from the corporation the actual value of the shares. Shortly before the deadline, the debtor filed a chapter 11 case. A claim is a right to payment, whether or not matured or contingent. Although the debtor effectively had an "option" before bankruptcy to purchase the shares or dissolve, and the minority shareholders retained their shares until the commencement of the case, the minority shareholders had a noncontingent right to payment, whether of the appraised value or of the actual value, and therefore had a claim, not an equity interest. *The Minority Voting Trust v. Orange County Nursery, Inc. (In re Orange County Nursery, Inc.)*, 439 B.R. 144 (C.D. Cal. 2010).

6.1.z. Section 502(e) disallows distributors' product liability contribution claims. The debtor manufactured chemicals, which it sold through distributors. Claiming injury from the chemicals, end users sued the debtor and its distributors. The debtor proposed a chapter 11 case that provided a separate distribution reserve for the plaintiffs' claims. The distributors filed proofs of claims for contribution for

liability to the plaintiffs in pending and in settled cases and for their defense costs, though not all plaintiffs filed proofs of claim. Section 502(e)(1)(B) requires disallowance of "any claim for reimbursement or contribution of an entity that is liable with the debtor … to the extent that such claim … is contingent as of the time of allowance or disallowance". This provision is intended to prevent competition for the debtor's limited assets between the principal creditor and the co-debtor. Still, the co-liability condition is unlimited, and its satisfaction does not depend on how the principal and contribution claims are treated under a plan, whether the co-liability is automatic upon the co-debtor's liability or whether the principal creditor has filed a proof of claim. The contingency condition is not satisfied by the non-contingency of the principal creditor's claim against the co-debtor. It is satisfied only once the co-debtor has actually paid the principal creditor's claim. Until then, the debtor's contribution liability is contingent. Therefore, section 502(e)(1)(B) disallows the distributors' claims for contribution except for claims that they have already paid to plaintiffs. It does not disallow their claims against the debtor for defense costs. The debtor is not liable with the distributors for their attorneys' fees and other costs, so section 502(e)(1)(B) does not disallow those claims. *In re Chemtura Corp.*, 436 B.R. 286 (Bankr. S.D.N.Y. 2010).

6.1.aa. Court disallows CERCLA PRP's claim against the debtor except to the extent that the claimant has actually made payments. The debtor in possession agreed to allow the EPA's claims against the debtor, in an agreed amount, for future remediation costs related to several polluted sites. Potentially responsible parties (PRPs) filed claims against the debtor for future expenses they would incur in remediating those same sites. CERCLA makes PRPs jointly and severally liable for remediation costs and gives a PRP who has resolved its liability to the EPA for remediation costs a claim for contribution against other PRPs. In addition, CERCLA allows a PRP who has incurred remediation costs to claim directly against another PRP. Section 502(e)(1)(B) disallows a contingent claim for contribution or reimbursement of an entity that is liable with the debtor. Until the claimant actually pays the amount for which it is liable with the debtor, its claim against the debtor remains contingent, even if it has acknowledged liability on the claim to the principal creditor or entered into an agreement to pay. Other events may intervene, particularly in the environmental remediation context, that may result in the claimant's not actually paying the claim. Moreover, allowance of the claim may result in the debtor's double payment, on the principal creditor's claim and on the claimant's claim, since they both address the same amount. A claimant is liable with the debtor on a debt, even if the liability arises under a different statutory basis, if the claimant's payment of the principal creditor would reduce the debtor's liability to the principal creditor. That situation applies under CERCLA, so the claimant here is liable with the debtor. Finally, a claim is for reimbursement whenever it seeks payment to the claimant of amounts that the claimant has expended or will expend, even if the statutory basis for reimbursement does not use the term "reimbursement". Here, that is precisely what the claimant seeks under its proof of claim, in addition to claims under CERCLA expressly for contribution. Therefore, the claimant's claim is disallowed except to the extent that the claimant has already made payments on the debt. *In re Lyondell Chem. Co.*, 2011 Bankr. LEXIS 10 (Bankr. S.D.N.Y. Jan. 4, 2011).

6.1.bb. WARN Act unforeseen circumstances applies to layoff following unplanned bankruptcy filing. The debtor manufactured swing sets and go-carts. An asset-backed lender provided financing, secured by receivables and inventory, with advances equal to 80% of receivables. Its private equity sponsor had provided additional equity financing over several years, as needed, and never indicated an intention not to continue to do so. In April, it was required to recall a substantial number of go-carts. In June, three major customers postponed a major swing set order. The debtor made every effort to continue in business and met with some limited success and positive movement from customers and suppliers. As a precaution, however, it consulted bankruptcy counsel in early August. In mid-August, the lender reduced the advance rate to 50% and in the first week of September, stopped advances altogether. The private equity sponsor refused any further investment. Within two days, the debtor filed bankruptcy and gave layoff notices to its employees, immediately terminating their employment. The WARN Act requires an employer to give 60 days' notice of a mass layoff or to pay 60 days' compensation to the employees. The Act's purpose is to soften the blow on employees of a planned or foreseeable mass layoff, allow them to adjust and seek new employment or retraining. Thus, it does not apply where the layoffs were caused by unforeseeable circumstances. Here, the termination of financing caused the layoffs, which were not planned. The consultation with bankruptcy counsel a month before the layoffs did not make the layoffs foreseeable, because the debtor was still trying to preserve the business and believed it might succeed until it lost all its financing. Therefore, the unforeseen

circumstances exception applies. *Angles v. Flexible Flyer Liquidating Trust (In re FF Acquisition Corp.)*, 438 B.R. 886 (Bankr. N.D. Miss. 2010).

6.1.cc. 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).

6.1.dd. Third Circuit overrules *Frenville*. The plaintiff purchased product that contained asbestos from the debtor home improvement center in 1977. The debtor filed its chapter 11 case in 1997 and confirmed a plan in 1998. In 2006, the plaintiff manifested injury caused by asbestos and brought a claim against the debtor's successor, who defended on the ground that the claim had been discharged. Relying on *In re M. Frenville Co.*, 744 F.2d 332 (3d Cir, 1984), the bankruptcy court and the district ruled that the claim had not yet arisen at the time of bankruptcy and therefore was not discharged. *Frenville* held that a claim arises for purposes of the Bankruptcy Code when applicable nonbankruptcy law gives the claimant a right to payment. In this case, applicable law gave the plaintiff a right to payment in 2006, when the injury manifested itself. The Third Circuit reviews the extensive criticism of *Frenville* over 25 years and the refusal of any of its sister circuits to follow it. The court determines that *Frenville*'s reading of the definition of "claim" focused too much on "right to payment" and not enough on "contingent", "unliquidated" and "unmatured" and so overrules it. In the absence of the *Frenville* test, the court must adopt a different analysis or test for when a claim arises. The court reviews the tests used in the case law, divided roughly into the "conduct" test and the "prepetition relationship" test. It finds a consensus "that a prerequisite for recognizing a 'claim' is that the claimant's exposure to a product giving rise to the 'claim' occurred pre-petition, even though the injury manifested after the reorganization" and holds that a claim arises in a personal injury case "when an individual is exposed pre-petition to a product or other conduct giving rise to an injury". The court limits the scope of the dischargeability, however, by fundamental principles of due process and notice. *Van Brunt v. JELD-WEN, Inc. (In re Grossman's Inc.)*, 607 F.3d 114 (3d Cir. 2010) (en banc).

6.1.ee. Bankruptcy court may certify a class action for a class of debtors within a judicial district. A mortgage loan servicer charged and collected postpetition fees without court approval. A debtor filed a class action for declaratory relief against the mortgage servicer on behalf of all debtors in the judicial district for a specified time period who had been charged fees without court approval. The Bankruptcy Rules incorporate Civil Rule 23, authorizing class actions. Section 1334 of title 28 grants the district court limited jurisdiction and authorizes it to refer cases and proceedings within the bankruptcy jurisdiction to the bankruptcy judges of the district. The allocation of cases among the judges is an administrative matter, not a jurisdictional one. Therefore, there is no impediment to a bankruptcy judge's certification of a class of debtors whose cases were pending before other judges of the same district. In this case, however, the facts did not meet the

requirements for class certification. *Wilborn v. Wells Fargo Bank, N.A. (In re Wilborn)*, 609 F.3d 748 (5th Cir. 2010).

6.1.ff. Bank that did not preserve attorney's fees claim after payment in full of its principal may not later assert fees claim as a secured claim. The bank had a secured claim against the debtor, secured by substantially all the debtor's assets and guaranteed by the debtor's principal. The note included an attorney's fees provision. The bank filed a proof of secured claim. The debtor in possession sold some of the assets, paying off about half the bank's claim. The principal paid the bank the remaining amount due, and the bank filed a motion to be dismissed from the case, because it had been paid in full. The creditors committee objected, asserting that the estate had claims against the bank that it intended to pursue. The bank did not pursue the motion to be dismissed from the case. The debtor in possession objected to the bank's claim, and the court disallowed the claim as paid. The debtor confirmed a plan, which discharged all claims and liens not provided for in the plan. The plan also established a creditors trust, which brought an action against the bank to avoid its lien and for equitable subordination, recharacterization, deepening insolvency and other claims. The bank asserted a claim under its loan documents for attorney's fees incurred in the action and moved to set aside the order disallowing its claim. Section 506(b) gives a secured creditor a claim for costs and expenses to the extent the creditor's claim is allowed and the claim is oversecured. Section 506(d) voids a lien to the extent the claim secured by the lien is disallowed. In this case, the bank's claim was disallowed, which extinguished the lien under section 506(d). So section 506(b) does not apply. Section 502(j) permits the court to reconsider an order allowing or disallowing a claim "for cause". The statute does not specify what constitutes cause, but case law incorporates Fed. R. Civ. Proc. 60(b) (made applicable in a bankruptcy case by Fed. R. Bankr. Proc. 9024) into section 502(j), without Rule 60(b)'s one-year time limit. Rule 60(b) does not provide grounds for reconsideration, because the bank had clear notice of claims against it and did not reserve its rights under its claim. *In re Gluth Bros. Constr., Inc.*, 426 B.R. 771 (Bankr. N.D. Ill. 2010).

6.1.gg. SIPA customer net equity claims are based on the "net investment" method. The debtor stockbroker operated a Ponzi scheme. It issued account statements to its customers showing purchases of and earnings on real securities. However, it never purchased any securities for the customers or their accounts. All account statements were fictitious. The last account statements before the commencement of the SIPA liquidation proceeding showed substantial securities positions, for which customers asserted claims against the estate as well as against SIPC for customer advances. SIPA provides for distribution of customer property among customers in priority to other creditors, pro rata, based of customers' "net equity" claims. SIPC may make advances to the trustee of up to $500,000 per customer to pay "claims for the amount by which the net equity of each customer exceeds his ratable share of customer property". SIPC subrogates to each customer's net equity claim that it pays. Therefore, SIPA payments are not "insurance" and may be made only to the extent of a customer's net equity claim. SIPA section 16(11) defines "net equity" as the dollar amount of a customer's account based on "all securities positions" of the customer as of the filing date. The trustee must discharge net equity claims to the extent "ascertainable from the books and records of the debtor". Here, the debtor's books and records revealed no securities positions. Therefore, a customer's net equity claims is based solely on the amount the customer deposited with the debtor over the life of the account, less the amount the customer withdrew. *Secs. Inv. Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC (In re Bernard L. Madoff Inv. Secs. LLC)*, 424 B.R. 122 (Bankr. S.D.N.Y. 2010).

6.1.hh. Unsecured creditor is entitled to attorney's fees incurred postpetition if provided in the contract. The surety company paid the debtor's obligations after bankruptcy and filed a proof of claim for reimbursement of amounts paid and attorney's fees that it incurred in trying to collect from the estate. Section 502(b) requires that a claim be determined as of the petition date and allowed except to the extent provided otherwise in sections 502(b)(1) through (9). "Claim" is broadly defined to include a contingent and unliquidated right to payment. The fact that the postpetition attorney's fees were contingent until incurred after bankruptcy and unliquidated as of the petition date until the amount was determined as they were incurred is not a ground for disallowance in paragraphs (1) through (9). Section 506(b), which allows postpetition attorney's fees to the holder of an oversecured claim as part of the secured claim, does not disallow them as a general unsecured claim to the holder of an unsecured claim. Therefore, the court allows the claim. *Ogle v. Fidelity & Deposit Co.*, 586 F.3d 143 (2d Cir. 2009).

6.1.ii. Section 502(d) disallowance of a claim does not apply to administrative expenses. A creditor asserted an administrative expense claim. The debtor in possession brought an action against the creditor to recover a preference and objected on that ground to the allowance of the administrative expense claim. Section 502(d) requires the court to "disallow any claim of an entity from which property is recoverable" under the avoiding powers, unless the entity has paid the amount for which it is liable. Although the Bankruptcy Code defines "claim" in a way that includes administrative expenses, it does not use "claim" uniformly when addressing administrative expenses, alternately using "expenses" and "claims". Sections 502(a) and (b) provide for automatic allowance of claims filed under section 501, which covers only prepetition claims. Section 502(d) operates an exception to sections 502(a) and (b). Finally, the statutory structure of section 502 suggests that it applies only to prepetition claims, not to administrative expenses. Therefore, section 502(d) does not apply to administrative expenses. *ASM Cap., LP v. Ames Dep't Stores, Inc. (In re Ames Dep't Stores, Inc.)*, 582 F.3d 422 (2d Cir. 2009).

6.1.jj. Section 502(d) disallowance of a claim does not apply to a supplier's 20-day administrative expense claim under section 503(b)(9). The debtor received goods from the supplier within 20 days before the petition date. The debtor made two payments to the supplier on prior invoices within the same 20-day period. The supplier asserted administrative expense priority for its $302,512 claim. Section 503(b)(9) provides "there shall be allowed administrative expenses, … including … the value of any goods received by the debtor within 20 days before" the petition date. Section 502(d) provides the "court shall disallow any claim of any entity from which property is recoverable" under the avoiding powers, unless the entity has paid the amount for which it is liable. Although section 502(d) is designed to foster equality of distribution among creditors, it does not contain any language that suggests it applies to administrative expense claims, which already enjoy priority over general unsecured prepetition claims. Rather, its text and placement suggest that it applies only to a claim filed under section 501, not to "a request for payment of an administrative expense" under section 503, even though the 20-day claim is a prepetition claim. In addition, applying section 502(d) to disallow administrative expense claims would defeat the policy of section 503 generally to encourage suppliers to deal with the estate and the policy of section 503(b)(9) in particular to encourage continued supply of trade credit to a failing debtor. Therefore, section 502(d) does not apply to disallow the supplier's section 503(b)(9) claim. *Southern Polymer, Inc. v. TI Acq., LLC (In re TI Acq., LLC)*, 410 B.R. 742 (Bankr. N.D. Ga. 2009).

6.1.kk. Liquidating chapter 7 trustee is not subject to WARN Act liability. The debtor hospital filed a chapter 7 petition. Within two hours after the petition, the trustee laid off most of the hospital's employees. The trustee obtained court authority under section 721 to operate the hospital for a few days to transfer patients and care for them pending transfer and to dispose of medical waste. Four days later, he laid off the remaining employees. The WARN Act requires an "employer" to provide 60 days' notice of a mass layoff or to pay 60 days' back pay. The Act defines "employer" as a business enterprise that employs 100 or more employees. Department of Labor commentary provides that a "fiduciary whose sole function in the bankruptcy process is to liquidate a failed business for the benefit of creditors [and] is not operating a 'business enterprise' in the normal commercial sense" is not subject to WARN liability, while a fiduciary who "may continue to operate the business for the benefit of creditors" is subject to liability. The Department of Labor's comments are entitled to deference. Here, the trustee's continued operation for four days as part of the winding down process did not continue operations in the normal commercial sense. *Walsh v. Century City Doctors Hosp, LLC (In re Century City Doctors Hosp., LLC)*, 417 B.R. 801 (Bankr. C.D. Cal. 2009).

6.1.ll. Court may use discounted cash flow analysis in the absence of a functional market to determine a repurchase agreement counterparty's deficiency claim. The debtor's counterparty terminated mortgage repurchase agreements shortly before bankruptcy when the mortgage markets were dysfunctional, price quotes for the underlying mortgages could not be obtained and the underlying mortgages could not be sold for a possibly extended period after the termination date. The counterparty asserted a deficiency claim for the amount by which the repurchase price under the repurchase agreement exceeded the value of the mortgages. Section 559 requires that "any excess of which the market price received on liquidation of [the repurchase] assets (or if any such assets are not disposed of on the date of liquidation of such repurchase agreements, at the prices available at the time of liquidation of repurchase agreements from a generally recognized source or the most recent closing bid quotation from such a source) over the sum of the stated repurchase prices … shall be deemed property of the estate". Section 562(a) provides that termination "damages shall be measured as of … the date or dates of such … termination", and section

562(b) provides, "If there are not any commercially reasonable determinants of value as of [that date], damages shall be measured as of the earliest subsequent date or dates on which there are commercially reasonable determinants of value". Although market determinants are preferred, section 562 refers to "commercially reasonable determinants" and so permits multiple alternative means of value determination, not only market pricing. Section 559 does not limit the determination of repurchase agreement termination value to market prices or quotes, because it applies only where the market price exceeds the repurchase price, not where there is a deficiency, as the counterparty asserted here. The discounted cash flow method is nearly always a commercially reasonable value determinant for a bond or mortgage and therefore may be used here, despite the absence of a functional market and of the availability of price quotes or any opportunity to sell the mortgages. Based on the discounted cash flow analysis, the mortgages' value exceeded the repurchase price just slightly, so the court disallows the counterparty's deficiency claim. *In re Am. Home Mortgage Holdings, Inc.*, 411 B.R. 181 (Bankr. D. Del. 2009).

6.1.mm. Section 506(b)'s attorney's fee provision applies only until the plan's effective date. The chapter 13 debtor sought to sell her house under her plan. The secured creditor objected, based on a partially completed prepetition foreclosure. The litigation continued after confirmation. The creditor sought attorney's fees. Section 506(b) provides, "there shall be allowed to the holder of [an oversecured] claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose". Section 506(b) entitles an oversecured creditor to interest and attorney's fees and thereby determines the allowable amount of an oversecured claim. Plan confirmation establishes the scope of allowed claims under the plan. A plan's effective date occurs when it becomes binding on the parties, which is the confirmation date in a chapter 13 case. In addition, section 1325(a) (and section 1129(b) in chapter 11) entitles a secured creditor to post-effective date interest. Therefore, section 506(b)'s interest provision should be read to apply only until the plan's effective date. Section 506(b) does not distinguish between interest and attorney's fees for this purpose, so it should apply only to pre-effective date attorney's fees. Therefore, section 506(b) and the federal rule apply until the effective date. Because section 506(b) does not reference state law, it states a federal rule entitling the creditor to attorney's fees provided under the agreement, which much be interpreted and applied under federal standards. Applicable nonbankruptcy law applies after the effective date. *Countrywide Home Loans, Inc. v. Hoopai (In re Hoopai)*, 581 F.3d 1090 (9th Cir. 2009).

6.1.nn. Bankruptcy Code does not affect managers' liability to employees under the Fair Labor Standards Act. The corporate debtor operated under chapter 11, shut down, laid off employees and then converted its case to chapter 7. Some employees remained unpaid after shut down and conversion. Under the Fair Labor Standards Act, 29 U.S.C. § 206(a), individual managers of a employer may be personally liable for unpaid wages. The Bankruptcy Code does not affect any such liability unless there is some effect on the estate from the potential liability, such as an obligation to defend or indemnify the managers, which is not present here. Therefore, the managers are liable to the employees, despite the bankruptcy and the conversion. *Boucher v. Shaw,* 572 F.3d 1087 (9th Cir. 2009).

6.1.oo. PBGC's Deficit Reduction Act claim arises only upon discharge and is not dischargeable. The debtor obtained a distress termination of its defined benefit pension plan during its chapter 11 case. Congress passed the Deficit Reduction Act of 2005 (DRA) before the debtor's chapter 11 case. Among other things, it provides for an additional premium payable to the Pension Benefit Guaranty Corporation by an employer whose defined benefit pension plan is subject to a distress termination in a chapter 11 case. The section providing for the premium "shall not apply … until the date of discharge". Although the definition of "claim" is broad, it is not unlimited. A claim's existence depends on whether the claimant had a right to payment, and the claim is a prepetition claim only if that right arose prepetition. Nonbankruptcy law determines whether and when a claimant has a right to payment. The DRA establishes the PBGC's right to the termination premiums as of "the date of discharge", specifically to prevent employers from evading the premium by a bankruptcy filing. Therefore, the claim for termination premiums is not affected by the discharge. *Pension Benefit Guar. Corp. v. Oneida Ltd.*, 562 F.3d 154 (2d Cir. 2009).

6.1.pp. Court may disallow late filed cure claim as a general unsecured claim. The debtor in possession assumed and assigned executory contracts in connection with the sale of the debtor's business. The notice to contract counterparties stated cure amounts. The court fixed a bar date for filing cure claims, which provided that any contract counterparty that did not file a proof of claim by the bar date would be bound by the cure amount stated in the notice and "shall be forever barred from asserting any

other cure claim(s) against the Debtor, its estate and/or any successful purchaser of the Debtor's assets arising under such executory contract". The counterparty did not file a cure claim by the cure claim bar date but filed a general unsecured claim before the general bar date. The contract cure amount notice was sufficiently clear, so the counterparty's claim was barred, even from sharing in the distribution on general unsecured claims, by its failure to file by the cure claim bar date. *ReGen Cap. I, Inc. v. Halperin (In re U.S. Wireless Data, Inc.)*, 547 F.3d 484 (2d Cir. 2008).

6.1.qq. Union employees may assign WARN Act and wage claims. Shortly after the debtor's bankruptcy, a claims purchaser solicited union employees to purchase their claims for WARN Act violations and for wages. Several employees sold their claims. Their union later brought claims against the estate on the employees' behalf for the WARN Act violations and wages and reached a settlement with the debtor in possession. The claims purchaser sought payment of the selling employees' claims, while the union sought to pay the employees directly. Under the Labor Management Relations Act, a union is its members' exclusive representative to bring claims against an employer. Still, the WARN Act makes the employer liable to "each aggrieved employee", and the union's representative rights do not deprive the employees of ownership of either WARN or wage claims. Federal law determines whether such claims, which federal law creates, are assignable. Nothing in the statutes or in the federal common law suggests that the claims should not be assignable. Therefore, the settlement amounts should be paid to the purchaser, not to the union or the employees. *Preston Trucking Co., Inc. v. Liquidity Solutions, Inc. (In re Preston Trucking Co., Inc.)*, 392 B.R. 623 (D. Md. 2008).

6.1.rr. Contract interest rate applies to interest allowed as secured under section 506(b), unless inequitable to junior creditors. The secured creditor's collateral value substantially exceeded the amount of its claim under two separate notes plus postpetition interest. It sought allowance of default interest plus compounding, which would have amounted to 38% simple interest. Allowance in full would have left the otherwise solvent liquidating debtor insolvent and unsecured creditors partially unpaid. However, the secured creditor agreed to reduce its interest rate to allow payment of unsecured creditors in full. Although *United States v. Ron Pair Enterps., Inc.*, 489 US. 235 (1989), does not address how interest on an oversecured claim should be calculated section 506(b), most courts have applied the contract rate and have allowed a different rate only if there is creditor misconduct, the contract rate would cause direct hardship to unsecured creditors or prevent the debtor's fresh start or if the interest rate is a penalty. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946), held that it could be inequitable to junior creditors to allow interest on interest accruing during a case to senior secured creditors. However, it did not require considerations of the equities as to the debtor or equity holders. Therefore, the secured creditor's claim should be allowed in the agreed amount, so that there were adequate funds to pay unsecured creditors in full, without any surplus for the debtor. *Urban Communicators PCS Ltd. v. Gabriel Cap., L.P.*, 394 B.R. 325 (S.D.N.Y. 2008).

6.1.ss. Section 502(d) disallowance does not apply to 20-day priority claims allowed under section 503(b)(9). The debtor in possession objected under section 502(d) to the allowance of claims entitled to administrative expense priority under the 20-day provision of section 503(b)(9) on the ground that the claimants had failed to surrender voidable transfers. The court reviews the split in authorities over whether section 502(d) applies to administrative expenses in general and sides with those courts that hold that it does not apply. It reasons that section 502(d)'s introductory phrase, "Notwithstanding subsections (a) and (b)", suggests it supersedes only the allowance provisions of sections 502(a) and (b), not of section 503(b), that section 503 is self-contained as to filing and allowance of administrative expenses, while sections 501 and 502 are self-contained as to filing and allowance of prepetition claims and that the mandatory disallowance and allowance provisions of sections 502(d) and section 503(b) would otherwise conflict. That conclusion does not require section 502(d)'s non-application to 503(b)(9) claims, as those claims arise prepetition. However, the allowance provision's placement in section 503(b), rather than in the priority section 507(a), requires the claim to be handled as an administrative expense under the self-contained section 503 regime, without regard to sections 501 and 502. Therefore, section 502(d) does not apply to section 503(b)(9) claims. *In re Plastech Engineered Prods., Inc.*, 394 B.R. 147 (Bankr. E.D. Mich. 2008).

6.1.tt. Allowance of debt participant's Stipulated Loss Value claim does not foreclose owner participant's Tax Indemnity Agreement Claim. An aircraft leveraged lease's Stipulated Loss Value (SLV) includes amounts necessary to pay the debt, the owner participant's expected equity return under the lease and its expected equity tax benefits. In addition, a related Tax Indemnity Agreement (TIA) gives the

owner participant a claim for lost tax benefits unless the lessee "has paid" SLV. The airline debtor in possession rejected an aircraft leveraged lease. It stipulated with the debt participant to allow a claim in the amount of the lease's SLV minus the aircraft's value. The stipulation provided, "Allowance of the Allowed Claims … constitutes full payment and discharge of" SLV for the lease. "Paid" as used in the TIA is ambiguous. It could mean payment of SLV in cash in full or simply payment in a manner that satisfies the SLV claim. Based on extrinsic evidence, including testimony of counsel who drafted the TIA and a copy of the term sheet on which it was based, and an evaluation of the documents as a whole, the court concludes that "paid" means paid in cash in full, because the apparent purpose of transaction was to permit the owner participant to assert a TIA claim whenever it (rather than the debt participant) was not fully paid through distribution of SLV payments. *In re Northwest Airlines Corp.*, 393 B.R. 337 (Bankr. S.D.N.Y. 2008).

6.1.uu. Oversecured creditor may be entitled to default interest rate upon a sale of its collateral. The creditor's loan agreement provided for interest at a higher rate after a default. The debtor in possession sold the oversecured creditor's collateral during the case and distributed the proceeds to the creditor. Section 506(b) entitles an oversecured creditor to postpetition interest but does not specify at what rate. If the plan provides for leaving the claim's class unimpaired under section 1124 by curing defaults and reinstating maturity, the plan may provide for only the non-default interest rate, because the cure undoes all the default's effects. The same is true for default cures upon executory contract assumption under section 365. When the Bankruptcy Code does not require a contrary result, applicable non-bankruptcy law governs creditors' entitlement in bankruptcy. Section 363, authorizing assets sales, does not provide a cure mechanism similar to the one in sections 365 and 1124. Therefore, the case law permitting reinstatement at the non-default rate does not apply to payment in cash in full of a defaulted secured claim from collateral sale proceeds. The court remands to determine whether the creditor's default rate is enforceable under applicable non-bankruptcy law and is reasonable. *Gen. Elec. Cap. Corp. v. Future Media Prods. Inc.*, 536 F.3d 969 (9th Cir. 2008).

6.1.vv. Bankruptcy court may recharacterize a claim as equity, within the Bankruptcy Code's confines. In the debtor's first chapter 11 case, the plan proponent agreed to make a nonrecourse loan to the debtor after confirmation, against the possibility that the debtor would succeed in its dispute over ownership of its principal asset. If it did not succeed, then the proponent would be entitled to the debtor's other assets and nothing more. After the proponent advanced substantial sums and the debtor prevailed in its dispute over its principal asset, the debtor filed a second chapter 11 case. An objecting creditor sought recharacterization of the proponent's claim as equity on the ground that the parties never intended the loan to be repaid. Claim recharacterization can occur only within the Bankruptcy Code's confines. A transaction's substance rather than its form or name controls its legal effect. Recharacterization is nothing more than an effort to discern a transaction's substance and so is permitted by the Bankruptcy Code. In this case, however, all parties intended a loan, so the claim should be allowed. *FCC v. Telephone and Data Sys., Inc. (In re Airadigm Comm'ns, Inc.)*, 392 B.R. 392 (W.D. Wis. 2008).

6.1.ww. Discovery of a proof of claim in a former subsidiary's bankruptcy case may suffice for MEPPA withdrawal liability notice. When an employer withdraws from a multi-employer pension fund, the Multi-Employer Pension Plan Amendments (MEPPA) to ERISA imposes withdrawal liability on the employer and all members of the controlled group. The controlled group members must commence arbitration within 90 days of withdrawal liability notice to the employer or be bound by the fund's liability notice. If a controlled group member engages in a corporate transaction whose principal purpose to evade or avoid MEPPA liability, liability is determined without regard to the transaction. In this case, over three years before its bankruptcy, the debtor's parent corporation entered into a merger/spin-off transaction after which the debtor was no longer part of the parent's controlled group. The multi-employer pension fund, to which the debtor and its former subsidiary contributed, filed a proof of withdrawal liability claim in the debtor's bankruptcy case but never sent notice to the former parent. Over two years later, the parent's lawyer learned of the proof of claim by happenstance. Three years after that, the fund sent formal notice and demand for withdrawal liability payment. The parent commenced arbitration within 90 days after the formal notice. The fund's proof of claim filing did not suffice as MEPPA notice to the parent, because the debtor was no longer a controlled group member. Disregarding the merger/spin-off transaction for liability purposes does not permit disregard for notice purposes, where the debtor and parent no longer have any corporate relationship. However, the parent's lawyer's discovery of the proof of claim put the parent on notice of the withdrawal liability claim, triggering the 90-day arbitration deadline. The parent's failure to commence

arbitration within 90 days after learning of the proof of claim prevented the parent from seeking a later liability determination. *Chicago Truck Drivers v. El Paso CGP Co.*, 525 F.3d 591 (7th Cir. 2008).

6.1.xx. Administrative claims bar date is subject to claims process of 28 U.S.C. § 959(a). During its lengthy chapter 11 case, the debtor in possession dismissed an employee. Before plan confirmation, the employee filed a state court discrimination action. The debtor then confirmed a plan that provided for payment in full of all allowed administrative claims but also an administrative claims bar date and discharge of all administrative claims not timely filed. The employee received notice of the hearing on approval of the disclosure statement but not of the hearing on confirmation or of the administrative claims bar date. 28 U.S.C. § 959(a) permits a claimant to sue a trustee, without leave of the bankruptcy court, in a nonbankruptcy forum for a claim arising in the operation of the business. The automatic stay does not apply to such an action. However, any judgment obtained in the nonbankruptcy forum may be enforced only in the bankruptcy court, typically by the filing of an administrative claim. A plan that does not preserve litigation rights under section 959(a) and provide for payment of the amount determined in the nonbankruptcy forum is subject to objection. The employee here did not object to that plan provision and so would be bound by it if he had received notice. However, because the employee did not receive notice of the plan, the bar date, or the discharge, he was not bound and did not violate the discharge injunction by continuing to pursue the state court action. *In re UAL Corp.*, 386 B.R. 701 (Bankr. N.D. Ill. 2008).

6.1.yy. Claim transfer may also transfer professional fee reimbursement rights. Secured lenders consented to a cash collateral order, which required the estate to reimburse all professional fees arising from or related to “the interpretation, amendment, modification, enforcement, enforceability, validity or implementation of the” prepetition credit and security agreements or to the bankruptcy cases. The lenders sold their claims under transfer agreements that transferred all claims (as defined in section 101(5)) and any right “that is based upon, arises, out of or is related to” the prepetition loans, including any right against an entity “arising under or in connection with the Credit Documents or the transactions related thereto or contemplated thereby. The debtor and the committee agreed with the claims buyers on plan terms. Later, the committee sued the original lenders to avoid their security interest. The original lenders sought reimbursement from the estate for their professional fees in defending the suit, based on the attorney’s fee provision in the cash collateral order. The transfer agreement covered any such reimbursement rights. The “claim” definition is broad and includes the contingent rights, as of the cash collateral order date, to professional fee reimbursement that might later arise in the case. Such rights are assignable. The transfer agreement language is broad enough to cover them. Therefore, the court disallows the original lenders’ reimbursement claims against the estate. *In re M. Fabrikant & Sons, Inc.*, 385 B.R. 87 (Bankr. S.D.N.Y. 2008).

6.1.zz. Absence of supporting documents is not grounds for claims disallowance. Rule 3001(c) requires a claimant to attach the original or a copy of any writing supporting a proof of claim, and the Official Form contains similar language. A credit card creditor filed a proof of claim, without any supporting documents, in an amount approximately equal to the amount the debtor schedules. The trustee objected. The court overrules the objection. Section 502(b) contains the exclusive grounds for claims disallowance. The Rules may not expand the grounds. A writing is required to prove the claim only if the claim may be disallowed on statute of fraud grounds, because without the writing, the claim is not enforceable under applicable non-bankruptcy law. This interpretation supports the Rules' overall purpose of just, speedy, and inexpensive determination of cases and proceedings, because it eliminates the need for a trustee to object to undocumented claims, the need for creditors to supplement claims at risk of disallowance when there is no substantive dispute over the claim, and possible litigation over whether the claim form "substantially complies " with the Rules. *B-Line, LLC v. Kirkland (In re Kirkland)*, 379 B.R. 341 (10th Cir. B.A.P. 2007).

6.1.aaa. Landlord claim damage cap does not apply to non-rent tort claims. The debtor rejected a lease, after leaving substantial debris on the property. The landlord sued for waste, nuisance, trespass, and breach of contract, seeking $23 million for the debris removal cost. Section 502(b)(6) limits a landlord’s claim for damages “resulting from the termination of the lease”. The damages sought here do not result from the rejection. They would have been the same even if the debtor had assumed the lease or allowed it to run its term. Moreover, applying the cap to a landlord’s tort claim such as these, where its rent-related damages already exceed the cap, would allow a debtor in possession to damage leased property with impunity and would not further Congress’s policy to limit potentially large rent and rent-

related claims. The court excludes from its ruling the issue of whether the damages cap applies to a claim for failure to perform future routine repairs or pay utility bills. *Saddleback Valley Comm. Church v. El Toro Materials Co. (In re El Toro Materials Co.)*, 505 F.3d 978 (9th Cir. 2007).

6.1.bbb. Actual collateral sale price determines collateral value for purposes of section 506(b). The debtor owned C-block spectrum FCC licenses, which it acquired in the original C-block FCC auction in 1997, and which it pledged to secure a loan. The licenses' value plummeted after the filing of its chapter 11 case, but ultimately, after legal issues were resolved favorably to the debtor, the debtor in possession sold the licenses for substantially more than the liens against them. Section 506(b) allows a claim as secured to the extent of the value of the collateral. Section 506(a) requires that the court value collateral "in light of the purpose of the valuation and the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use …". The disposition here is the sale and the purpose is the allowance of the creditor's claim. The best measure of value for such purposes is the actual sale proceeds. *In re Urban Communicators PCS Ltd. P'shp*, 379 B.R. 232 (Bankr. S.D.N.Y. 2007).

6.1.ccc. Contract interest rate does not necessarily apply to interest allowed as secured under section 506(b). The secured creditor's collateral value substantially exceeded the amount of its claim under two separate notes plus postpetition interest. It sought allowance of default interest plus compounding, which would have exceeded by 13% the 25% criminal usury statute rate applicable to one of its notes. *United States v. Ron Pair Enterps., Inc.*, 489 US. 235 (1989), ruled that section 506(b)'s reference to "interest on such claim" is not limited by the agreement under which the claim arises. Therefore, the court has discretion on the allowable rate, although the contract rate is the common measure. Here, the allowance of the excess interest would have rendered an otherwise solvent debtor insolvent. The interest rate sought is very high. And the debtor's equity holders' investment needed to maintain litigation, and the chapter 11 case led to the high collateral value. Therefore, the court limits the rate to 25%. *In re Urban Communicators PCS Ltd. P'shp*, 379 B.R. 232 (Bankr. S.D.N.Y. 2007).

6.1.ddd. PBGC's Deficit Reduction Act claim arises prepetition and is dischargeable. The debtor obtained a distressed termination of its defined benefit pension plan during its chapter 11 case. Congress passed the Deficit Reduction Act of 2005 before the debtor's chapter 11 case. Among other things, it provides for an additional premium payable to the Pension Benefit Guaranty Corporation by an employer whose defined benefit pension plan is subject to a distress termination in a chapter 11 case. The section providing for the premium "shall not apply … until the date of discharge". The premium is a claim that is contingent on plan termination. The claim arose prepetition, because the debtor and the PBGC had a relationship with respect to this pension plan before bankruptcy, and the parties could contemplate before bankruptcy that this additional premium could arise. The claim's unenforceability until discharge does not make it arise postpetition. It is not an administrative claim, because it provides no benefit to the estate. Therefore, it is allowed as a general unsecured prepetition claim, and plan confirmation discharges it. *Oneida Ltd v. Pension Benefit Guar. Corp. (In re Oneida Ltd.)*, 383 B.R. 29 (Bankr. S.D.N.Y. 2008).

6.1.eee. Court disallows note de-acceleration, change of control put, unmatured original issue discount, and yield maintenance. The debtor issued secured notes with original issue discount, due 2009, and warrants under a 2002 indenture. The notes gave the holders the right to put the notes to the debtor at 101% of their full face amount upon a change of control. The notes provided for automatic acceleration, without notice, upon a bankruptcy filing and permitted a majority of holders to waive defaults and acceleration under certain circumstances. After the debtor proposed a plan that would pay the holders in cash the full amount of their oversecured claims and would result in a change of control, the holders attempted to waive defaults and acceleration, return the notes to their pre-default state, and assert the change of control put. Section 502(b)(1) allows claims as of the petition date. The automatic acceleration upon bankruptcy moved the notes' maturity date to the petition date. The amount owing became fixed as of that date, and the attempted waiver could not de-accelerate the claim nor change the claim's allowable amount to 101% of par. Because the notes were oversecured, the debtor in possession paid current contract interest during the case. Upon confirmation, the remaining allowable claim included only original issue discount accrued through the plan effective date. The holders are entitled to accruing postpetition original issue discount only through the plan effective date, not through the notes' original maturity, because the notes accelerated automatically upon bankruptcy, section 502(b)(2) disallows unmatured postpetition

interest, and section 506(b) allows postpetition interest to the extent the claim is oversecured. The holders' claim for contract interest through original maturity is also not allowable. Although it is possible to contract for "yield maintenance", the automatic acceleration here re-set maturity to the petition date and thereby disallows any yield maintenance claim. *In re Solutia Inc.*, 379 B.R. 473 (Bankr. S.D.N.Y. 2007).

6.1.fff. A prepetition unsecured creditor's attorney's fees incurred postpetition are allowable. The unsecured creditor had released the debtor before bankruptcy under a contract that provided for the creditor's attorney's fees. The release was revoked after bankruptcy, and the creditor filed a claim under the prepetition agreement for the attorney's fees it incurred postpetition. The attorney's fees claim was contingent as of the petition date but became fixed after the petition date by the release revocation. The Code's definition of "claim" includes a right to payment, whether contingent or fixed, liquidated or unliquidated. Section 502(b)(1) requires claim disallowance only if the claim is unenforceable under applicable nonbankruptcy law for a reason "other than because such claim is continent or unmatured". A court may not disallow a claim unless section 502(b) provides a specific ground for disallowance. Thus, neither the claim's contingency nor its unliquidated amount as of the petition date provided a ground to disallow it. Section 506(b) does not require disallowance. Section 506(b) addresses only the portion of a claim that is treated as secured, whereas section 502 addresses allowance. Section 502(b) requires the court to determine the amount of a claim "as of the date of the filing of the petition", but the right to payment, though contingent and unliquidated, existed as of the date of the filing of the petition, so the postpetition incurrence of the attorney's fees does not create a bar to their allowance. Otherwise, contingent claims would all be disallowed, contrary to section 502(b)(1). The court rejects public policy analysis as irrelevant to the statutory construction. *Centre Ins. Co. v. SNTL Corp. (In re SNTL Corp.)*, 380 B.R. 204 (9th Cir. B.A.P. 2007); *aff'd*, 571 F.3d 826 (9th Cir. 2009).

6.1.ggg. Section 506(b) does not apply to prepetition fees and costs. A secured creditor incurred attorney's fees both before and after the petition date. Section 506(b)'s reasonableness requirement applies only to the postpetition fees, because section 506(b) operates only on an allowed secured claim, which is the allowable claim amount determined under section 502(b). Section 502(b) governs allowance of the prepetition fees, based on the contract and applicable nonbankruptcy law. *In re Woods Auto Gallery, Inc.*, 379 B.R. 875 (Bankr. W.D. Mo. 2007).

6.1.hhh. Principal co-obligor is not entitled to subrogation upon foreclosure on its property to pay claim against the debtor. One of the partners in the debtor co-signed a promissory note with the debtor as a co-maker and granted a security interest in its own real property to secure a lender's advance to the debtor to acquire real property. The partner was principally liable on the note, not an accommodation endorser, because none of the documents evidenced any intent that the partner be only secondarily liable, and because, as a partner in the debtor, the partner benefited from the debtor's acquisition of the real property. After bankruptcy, the lender foreclosed on the partner's property to satisfy its claim against the debtor. The partner may not subrogate to the lender's secured claim against the debtor. Under section 509(a), a purported subrogee "that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, and that pays such claim, is subrogated to the rights of such creditor to the extent of such payment." Here, the partner was not liable with the debtor on a claim against the debtor but was directly liable to the creditor. The partner did not pay the claim, because suffering the foreclosure is not a payment. In addition, section 509(b)(2) denies subrogation if "as between the debtor and [the subrogee], [the subrogee] received the consideration for the claim". Because the partner was primarily liable for the debt, it received consideration for paying the debt. (The court does not distinguish between receiving consideration for paying the debt (release of liability on the debt) from receiving the consideration for the underlying claim.) *In re Flamingo 55, Inc.*, 378 B.R. 893 (Bankr. D. Nev. 2007).

6.1.iii. Court recharacterizes as equity shareholder advances in excess of board-approved loan amount. A minority shareholder and director, who did not control the board but who served part of the time as the debtor's CEO, made advances to the debtor in excess of the amount the board approved as loans. The amount the board approved was documented as loans, and the debtor signed a security agreement to secure the loans. The debtor treated all the advances as loans for accounting and tax purposes, but, with the lender's acquiescence, it stopped paying interest on all of the advances when it got into financial trouble. The debtor had also borrowed from a bank. When the debtor began to fail, the creditor resigned from the

board, bought the bank's loan, and issued a notice of default on both loans on the same day. The debtor soon filed a bankruptcy petition. The creditor's loan is properly allowed as a claim up to the amount the board authorized as a loan. The board approval, the documentation, and the tax and accounting treatment all show that the advances were loans, not equity investments. However, the advances in excess of the authorized amount were not authorized as loans, were not documented as such, and were made to keep the company afloat. As such, they are properly characterized as equity investments, not allowable claims. *Nelson v. Repository Techs., Inc. (In re Repository Techs., Inc.)*, 381 B.R. 852 (N.D. Ill. 2008).

6.1.jjj. Oversecured creditor may enforce prepayment penalty in a solvent case. 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." In a solvent case, the debtor objected to allowance of an oversecured creditor's prepayment penalty as unreasonable. The penalty was enforceable under applicable nonbankruptcy law. Section 506(b) does not disallow claims, even unreasonable ones, that are enforceable under applicable nonbankruptcy law, but only disallows them the benefit of the creditor's collateral. Section 502(b)(2) disallows a claim that is not enforceable under applicable nonbankruptcy law, but unless there is another, independent ground for disallowance, does not prevent the secured creditor from recovering on an otherwise enforceable but unreasonable fee or cost as an unsecured claim. Therefore, the secured creditor may recover the penalty in this case. The court stresses that its holding is limited to a solvent case, suggesting equitable considerations might require otherwise "if unsecured creditors are at risk of collateral damage", but its statutory interpretation and reasoning would otherwise seem to equally apply to an insolvent case. *Gencarelli v. UPS Capital Bus. Credit (In re Gencarelli)*, 501 F.3d 1 (1st Cir. 2007).

6.1.kkk. Creditor may not allocate payment from guarantor to postpetition interest. The creditor obtained a guarantee limited to $140 million from the debtor's non-debtor affiliate. After the debtor's bankruptcy, the creditor obtained an arbitration award against the debtor and the guarantor, which included $17 million in interest accrued after bankruptcy. The guarantor collected $140 million from the guarantor, which it allocated first to $17 million in interest and the balance to principal, and filed a claim for $140 million (without interest) in the debtor's bankruptcy case. Based on a 1935 Supreme Court case, the guarantor's payment does not reduce the allowable amount of the creditor's claim against the debtor, as a matter of bankruptcy law. New York law, which governs the guarantee, also does not require reduction of the claim against the debtor, as surety. Therefore, the creditor's claim is allowed in the debtor's case for $140 million, despite the guarantor's payment, except the creditor may not collect more than $17 million on its claim. However, for purposes of application in the bankruptcy case, the creditor may not allocate the guarantor's payment to postpetition interest and then collect the balance as principal in the bankruptcy case. The disallowance of postpetition interest is an equitable rule, which requires the courts to sift the facts to ensure that claims treatments are equitable, and the facts here show that the payment would permit the creditor to collect postpetition interest. A concurring opinion suggests the ability of the creditor to call the guarantor's payment interest does not preclude the bankruptcy court from calling it interest. It appears the result might have differed if the guarantee were not limited to the principal amount. A dissent argues that section 524(e) requires allowance of the claim and that because section 502(b)(2) does not protect a non-debtor, the creditor may allocate as it chooses. *Nat'l Energy & Gas Trans., Inc. v. Liberty Elec. Power, LLC (In re Nat'l Energy & Gas Trans., Inc.)*, 492 F.3d 297 (4th Cir. 2007).

6.1.lll. Court allows postpetition interest in solvent case at federal judgment rate. Section 726(a) permits interest in a solvent chapter 7 case at "the legal rate", which the court interprets to mean the rate allowable under 28 U.S.C. § 1961 on federal judgments rather than at the contract rate. The common understanding in 1978 of "the legal rate" was the rate allowable on judgments, as contrasted with "a" legal rate or with the contract rate, which Congress specified in other Bankruptcy Code sections such as section 506(b). Congress adopted this rule to promote fairness among creditors. Even though the legal rate may be lower than the contract rate and thereby create a windfall for the debtor, the court is not free through its equitable powers to change the result that Congress prescribed. *Branch Banking & Trust Co. v. McDow (In re Garriock)*, 373 B.R. 814 (E.D. Va. 2007).

6.1.mmm. Court generally may equitably subordinate or disallow a claim only in the hands of an assignee, not an innocent purchaser. The bank was a member of a lending syndicate. Separately, it engaged in a transaction with the debtor that may have contributed to the misstatement of the debtor's financial statements, securities fraud, and harm to numerous other creditors. The bank also received an avoidable preference. After bankruptcy, it sold its loan syndicate claim to an unrelated third party who had

had no contacts with the debtor before bankruptcy. Section 502(d) provides for disallowance of a "claim of an entity from which property is recoverable ... or that is a transferee of a transfer avoidable [under the avoiding powers], unless such entity or transferee has paid the amount … for which such entity or transferee is liable [under the avoiding powers]". Section 510(c) permits the court, "under principles of equitable subordination, [to] subordinate … all or part of a claim …." These provisions are disabilities that are personal to the holder that engaged in inequitable conduct or that received an avoidable transfer: Section 510(c) permits subordination based on "principles of equitable subordination", which focus on the claimant's conduct, not the nature of the claim; and section 502(d)'s language refers only to "the claim of an *entity … that is a transferee* of a transfer avoided …" (emphasis added), not to the claim itself. A sale/purchase transfers title to a good faith purchaser free of any personal disabilities of the seller. Except for an assignment of a negotiable instrument to a holder in due course, an assignment transfers only what the assignor had, subject to any personal disabilities. Therefore, whether the claim here is subject to equitable subordination or section 502(d) disallowance depends on whether the claim transfer was a sale or an assignment and, if a sale, whether there are any other facts that would prevent the transferee from being a good faith purchaser. The district court remands for a determination of these factual issues, but does not give any guidance on how to distinguish a sale from an assignment. *Enron Corp. v. Springfield Assocs., L.L.C. (In re Enron Corp.)*, 379 B.R. 425 (S.D.N.Y. 2007).

6.1.nnn. Former officer's defense costs advancement claim is not subject to disallowance under section 502(e)(1)(B). The debtor's certificate of incorporation and by-laws permitted it to advance to an officer costs incurred in defense of a civil or criminal investigation or action for which the officer may be entitled to indemnification, subject only to the officer's agreement to repay advances if ultimately found not entitled to indemnification. The SEC settled claims against the debtor related to improper accounting, but the government continued a criminal investigation against one officer. The officer filed a claim for defense costs, which debtor continued to advance during the case. Section 502(e)(1)(B) requires disallowance of a contingent reimbursement claim for which the debtor and the claimant are co-liable. A claim for reimbursement includes an indemnification claim. An advancement means the reimbursement of costs in advance of a final determination of indemnification entitlement and is therefore a form of indemnification claim. The claim, however, is not contingent. It has already accrued, because the officer has already incurred the defense costs for which he seeks advancement. The possibility that the officer may be found not entitled to indemnification may give the estate a contingent claim against the officer for repayment, but does not render the officer's claim against the debtor contingent. (The court does not consider the possibility that the claim may be disputed, rather than contingent, on the theory that the facts giving rise to the officer's claim—incurring defense costs—have occurred, but the dispute over liability has not yet been resolved.) The claim remains unliquidated, however, because the full amount is not yet established. Finally, the debtor and the officer are not co-liable for defense costs. The liability for those costs is the officer's alone. Therefore, section 502(e)(1)(B) does not require disallowance. *In re RNI Wind Down Corp.*, 369 B.R. 174 (Bankr. D. Del. 2007).

6.1.ooo. BAPCPA's section 546(c) does not create a federal reclamation right. The debtor owed prepetition $367 million, secured by its inventory, among other things. The debtor in possession obtained $1.4 billion in financing, also secured in part by inventory, that was used in part to pay off the prepetition claim. Numerous suppliers asserted reclamation claims against the inventory. Section 546(c) provides that "subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the [trustee's avoiding power] rights and powers are subject to the right of a seller of goods … to reclaim such goods" if certain additional conditions are met. This provision is incomplete, in that it does not address many of the issues that the state law right created under U.C.C. § 2-702 addresses, such as the treatment of good faith purchasers, the effect of prior payment for the goods, the requirement of buyer insolvency, or the effect or commingling. Moreover, it contains no creation or granting words such as "may reclaim" or "has the right to reclaim", and the legislative history contains no suggestion that Congress intended to change existing law, which relied on the state law right. Therefore, the provision does not create a federal reclamation right that supplants the state law right and so does not vitiate the limitations inherent in the state law right. Finally, the DIP's use of inventory to secure the postpetition financing acted as a disposition of the goods that were subject to the reclamation claims that rendered the reclamation claims valueless. *In re Dana Corp.*, 367 B.R. 409 (Bankr. S.D.N.Y. 2007).

6.1.ppp. Section 502(b)(7) does not limit an employee's retaliatory discharge claim. The debtor discharged its CFO, who was employed at will, for refusing to violate federal securities laws in the debtor's accounting books. The former CFO sued and obtained a judgment for several years' lost wages, mental anguish, interest, and attorney's fees for the debtor's violation of the state's public policy against retaliatory discharge for refusing to violate law. Section 502(b)(7) limits the claim of an employee for damages resulting from termination of an employment contract to accrued prepetition compensation plus up to one year's postpetition compensation. Here, the CFO's employment, even under an at will agreement, was under an employment contract. However, the state court judgment was not for termination of the contract but, according to applicable state law, in tort. Therefore, the section 502(b)(7) limitation does not apply. *In re Ajay Sports, Inc.*, 370 B.R. 703 (Bankr. E.D. Mich. 2007).

6.1.qqq. Leveraged lease tax indemnity agreement excludes payment of tax indemnity payment included in stipulated loss value. The debtor entered into a typical leveraged lease transaction, under which it agreed to pay stipulated loss value to the lessor/owner trustee if it breached the lease, and agreed to indemnify the owner participant for tax losses, including those resulting from lease breach. The owner trustee granted a security interest in the lease and rents, including the stipulated loss value payment obligation, to the indenture trustee for the debt. The stipulated loss value calculation included amounts necessary to pay off the debt, the return on the equity investment, including the expected return and tax benefits, thereby duplicating payments that might be owing under the tax indemnity agreement. In chapter 11, the debtor in possession rejected the lease. The indenture trustee filed a claim for stipulated loss value, which the debtor's plan did not pay in full, and the owner participant filed a claim for indemnification for lost tax benefits. Although the same lost tax benefits were included in both claims, no contract law (or "cosmic", in the court's word) principle prevents a debtor from contracting with two separate parties to pay the same claim twice. However, the tax indemnity agreement excludes a claim for lost tax benefits if the lessee/debtor were required to make the payment (as opposed to actually making the payment) as part of a stipulated loss value claim. Therefore, the court disallows the owner participant's tax indemnity claim. *In re Delta Airlines, Inc.*, 370 B.R. 552 (Bankr. S.D.N.Y. 2007).

6.1.rrr. Court disallows city's environmental claim as a contingent co-debtor claim. The debtor was a potentially responsible party (PRP) and owed the state for environmental remediation at a large site. The city, which was also a PRP, agreed with the state to undertake the site remediation. Later, the city obtained a judgment against the debtor for contribution under CERCLA section 113(f) for the debtor's portion of remediation costs for the entire site (1.72%), which the debtor paid, and for 100% of future response costs for the debtor's small portion of the site. The city filed a proof of claim for the future response costs, but the state did not. The court disallows the city's claim under section 502(e)(1)(B), which requires disallowance of "any claim for … contribution of an entity that is liable with the debtor on … the claim of a creditor, to the extent that … such claim for … contribution is contingent as of the time of allowance …." The city's claim was for contribution, because it was under CERCLA section 113(f), which only permits a PRP to recover a fair share of remediation costs from other PRP's. The allocation of 100% of future response costs for a portion of the site does not make the claim one for direct cost recovery under CERCLA section 107(a), because the liability was for only a portion of the entire large site and was to another PRP, not to the state. The city was liable with the debtor on the claim, because both were liable to the State for the remediation costs, even though the state had not filed a proof of claim. The principal creditors' failure to file a claim does not erase the underlying liability for section 502(e) purposes, even though the non-filing prevents the "double-dipping" risk that section 502(e)(1) is designed to avert. The city's claim was contingent because it had not yet incurred the future response costs. (The court does not discuss the more traditional "contingency" of a co-debtor's claim, the co-debtor/claimant's nonpayment of the principal creditor's claim.) *In re Apco Liq. Trust*, 370 B.R. 625 (Bankr. D. Del. 2007).

6.1.sss. State-imposed obligation to make deposits against future potential liability is a claim. States who settled tobacco litigation in 2000 adopted legislation to require nonsettling cigarette manufacturers to make quarterly deposits into an escrow fund, which is controlled by the states, is held in the manufacturer's name, earns interest that the manufacturer may receive, and may not be used as collateral for loans. The funds are to be used to pay any of the manufacturer's tobacco liability; if there is no liability in 25 years, the escrow fund is returned to the manufacturer. If a manufacturer fails to make a deposit, it may no longer sell cigarettes in the state. The debtor failed to make fund deposits for several

quarters before bankruptcy. Its chapter 11 plan provided for it to make up the missed deposits over 46 months. The state may enforce the obligation to pay fund deposits. Therefore, even though the state does not have a current right to the funds and might never receive any of the funds, the missed deposits are claims that may be adjusted in a plan, rather than a security deposit or bonding requirement that is unaffected by bankruptcy or the discharge. In addition, section 1123(a)(5), which permits a plan (at least in the Ninth Circuit, *see Pac. Gas & Elec. v. Cal.*, 350 F.3d 932 (9th Cir. 2003)) to override applicable nonbankruptcy law relating only to financial conditions such as insolvency, but not those relating to nonfinancial operating requirements, applies to this state law requirement. Reading "financial condition" broadly to include "profitability," the court concludes that when a business has no potential source of revenues other than from operations, an operational condition and financial condition might be the same. *Settling States v. Carolina Tobacco Co. (In re Carolina Tobacco Co.)*, 360 B.R. 702 (D. Ore. 2007).

6.1.ttt. Landlord damage limitation does not apply to owner participants in a leveraged lease. The debtor entered into a leveraged lease of several of its store locations. As in any leveraged lease, the debtor indemnified the owner participants directly for losses in general and for loss of tax advantages in particular. The debtor's bankruptcy defaulted the lease, and the indenture trustee foreclosed out the owner participants' equity interests in the owner trust. The debtor in possession rejected the leases and settled with indenture trustee on the amount of the lease rejection damage claim, which was subject to the landlord damage cap in section 502(b)(6). The owner participants asserted their own indemnification claims, which may be allowed without application of the cap. First, the owner participants' claims for their lost investment has ties to the lease and the rents but are distinct claims. Second, section 502(b)(6) applies only to a lessor's claim. The owner participants were not the lessors; the owner trust was. To limit the owner participants' claims as lessors would require disregarding the trust, effectively piercing the "trust's veil," and thereby recharacterizing the transaction's economic substance. Third, section 502(b)(6) applies only to claims arising from termination of a lease. Even if the owner participants were the lessors, the losses for which they assert general indemnification claims are not tied to rejection or termination; they could arise had the lease run full term and a loss had occurred within the indemnity's scope. The tax claims similarly could arise from and are in compensation for loss of anticipated tax benefits, not lease termination. *In re Kmart Corp.*, 362 B.R. 361 (Bankr. N.D. Ill. 2007).

6.1.uuu. Court order allowing uncontested proof of claim is *res judicata*. The IRS had filed a proof of claim. No party in interest objected. The claim was allowed by court order. The order is a final adjudication on the merits of the claim by a court of competent jurisdiction. That a bankruptcy court may reconsider a claim under section 502(k) does not detract from the finality of the order. The debtor as well as the trustee may object to a proof of claim, so the debtor is a party for purposes of claim preclusion. Therefore, *res judicata* applies to the order allowing the claim. *EDP Med. Computer Sys., Inc. v. U. S.*, 480 F.3d 621 (2d Cir. 2007).

6.1.vvv. Claim for postpetition attorney's fees is allowable. During the chapter 11 case, the debtor and its workers' compensation surety bond issuer disputed the treatment under the plan of the issuer's unsecured claim. The dispute related solely to bankruptcy law issues, not to the enforceability of the bond or the allowability or amount of the surety's claim. They ultimately settled (except as to the allowability of attorney's fees). The Bankruptcy Code does not by its terms disallow the surety's claim for attorney's fees incurred in the dispute. Section 502(b) specifies the grounds for claims disallowance. Generally, state law determines contract rights. Section 502(b)(1) incorporates state law grounds into the claims allowance process. Neither section 502(b)(1) nor any of the other grounds requires disallowance of attorney's fees for disputes related solely to bankruptcy law issues. Therefore, if the claim is enforceable under the contract and nonbankruptcy law, the Bankruptcy Code does not require that it be disallowed. The Court does not address, however, whether section 506(b), which allows an oversecured creditor's attorney's fees as part of the secured claim, implicitly or explicitly requires disallowance of an unsecured creditor's attorney's fees claim, because the debtor did not timely raise the issue, but allows the court below to consider that issue, as well as nonbankruptcy law enforceability, on remand. *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007).

6.1.www. Tortfeasor who is jointly and severally liable with the debtor is not entitled to subrogation. The debtor and another were found jointly and severally liable to a creditor for a tort. The

other paid the claim in full and asserted a subrogation claim against the debtor under section 509(a). Section 509(b), however, disallows the subrogation claim. It denies subrogation if as between the debtor and the subrogee, the subrogee "received the consideration for the claim held by such creditor." The other party's joint and several liability for the tort made it primarily and directly liable to the creditor. As such, it received a release of its liability upon payment, which was the consideration for payment of the claim, bringing it under the disallowance provision of section 509(b). The court does not distinguish between receiving the consideration for paying the claim and the statutory language of "received the consideration for the claim." *Fibreboard Corp. v. Celotex Corp. (In re Celotex Corp.)*, 472 F.3d 1318 (11th Cir. 2006).

6.1.xxx. Secured creditor's prepayment charge is allowable only under section 502(b). The loan documents provided for a prepayment penalty if the debtor defaulted and the lender accelerated the loan, all of which happened prepetition. The court denies allowance of the prepayment charge under section 506(b), which applies solely to postpetition interest, fees, and charges. The prepayment charge arose prepetition, upon the default. Because the charge is enforceable under applicable nonbankruptcy law, it is allowable under section 502(b) as part of the lender's prepetition claim. The prepetition claim, including the charge, is an allowed secured claim under section 506(a). *In re Tri-State Ethanol Co. LLC*, 354 B.R. 913 (Bankr. D.S.D. 2006).

6.1.yyy. Where postpetition interest is disallowed, principal should not be discounted to present value. The creditor filed a claim under a guarantee that included the principal amount of the guaranteed claim plus interest that would accrue under the guarantee until maturity of the underlying obligation. The bankruptcy court disallowed the portion representing interest that would accrue after bankruptcy under section 502(b)(2), which requires disallowance of a claim for unmatured interest. The court did not, however, discount the remaining principal amount to present value. The language in section 502(b), that a claim is to be determined "as of the date of the filing of the petition," does not require discounting of a claim's principal amount where postpetition interest has already been disallowed. That would amount to improper "double discounting." Case law requiring principal discounting involves only claims without a stated interest rate (as to which discounting is questionable, based on the legislative history's statement that the stated interest rate – even 0% – provides an irrebutable presumption as to the proper discount rate), which is not the kind of claim at issue here. *In re Oakwood Homes Corp.*, 449 F.3d 588 (3d Cir. 2006).

6.1.zzz. A bankruptcy court may recharacterize claims. The parent sold inventory to the subsidiary, accruing an intercompany receivable that it intended to collect only when the subsidiary became profitable. Its auditor recognized the major part of the receivable as an equity investment. After the subsidiary filed bankruptcy, the committee sought to recharacterize the intercompany claim as an equity investment. Recharacterization differs from disallowance, in that it is applied to a legitimate underlying obligation from the debtor to the claimant that is not a right to payment but an equity investment. It differs from equitable subordination in that it is based on the substance of the underlying transaction, not on the creditor's behavior. Consistent with the bankruptcy court's equitable powers, it may look through form to substance to determine whether an obligation is debt or equity. The facts here, including the special relationship between the parent and the subsidiary, the deferral of the repayment obligation until profitability, the long history of unprofitability, and the auditor's recognition of the transfers as equity contributions, support recharacterization. Transfers of inventory qualify for recharacterization equally with transfers of cash. *Fairchild Dornier GMBH v. Official Comm. of Unsecured Creditors (In re Dornier Aviation (N. Am.), Inc.)*, 453 F.3d 225 (4th Cir. 2006).

6.1.aaaa. "Fair contemplation" rule applies to gender discrimination claims. The debtor filed a prepackaged chapter 11 case on February 28. The court set an April 19 prepetition claims filing bar date. The court confirmed the plan on April 30 and set a July 1 bar date for administrative claims arising between February 28 and April 30. The plan became effective on May 13 and purported to discharge all claims arising on or before the effective date. Three female employees of the debtor claimed that they suffered from gender discrimination upon the debtor's payment of certain similarly situated male employees in January, but that they did not learn of the discrimination until "late April or early May." The "fair contemplation" rule of *Cal. Dep't of Health Servs. v. Jensen (In re Jensen)*, 995 F.2d 925 (9th Cir. 1993), applies to gender discrimination claims, so they were deemed to arise when the women learned of

the discrimination in late April or early May. *ZiLOG, Inc. v. Corning (In re ZiLOG, Inc.)*, 450 F.3d 996 (9th Cir. 2006).

6.1.bbbb. Time barred fraudulent transfer claim does not provide section 502(d) disallowance grounds. The creditor filed a proof of claim on the debtor's guarantee of its parent's obligation. The liquidating trustee's claim to avoid the guarantee as a constructively fraudulent obligation under section 544(b) was barred by the statute of limitations of section 546(a). In a prior decision, the court had ruled that the trustee could not use section 502(d) to object to the claim, because that provision applies only to a creditor "that is a transferee of a transfer avoidable under" the avoiding powers, not to an avoidable obligation. *In re Asia Global Crossing, Ltd.*, 333 B.R. 199 (Bankr. S.D.N.Y. 2005). In this decision, the court rules that the trustee may not obtain disallowance under section 502(d) on a "common law" fraudulent obligation defense. First, unlike the fraudulent transfer law, the common law recognizes and enforces contracts for which the consideration may be wholly inadequate, as long as there is consideration. Second, section 502(d) provides a defense to a time-barred avoiding power for avoiding power claims only under section 544(a), because, in addition to an avoiding power, section 544(a) gives the trustee a status (judicial lien creditor or real property bona fide purchaser), which the trustee may use defensively against the creditor. *In re Asia Global Crossing, Ltd.*, 344 B.R. 247 (Bankr. S.D.N.Y. 2006).

6.1.cccc. Landlord claim cap does not limit kind of allowable claim. The landlord obtained a state court judgment against the debtor for attorney's fees for lease-related litigation and filed a proof of claim for that amount. Section 502(b)(6) limits a landlord's claim for damages for breach of a lease to an amount calculated based on the "rent reserved under the lease." The cap does not limit the kind of claim the landlord may assert for breach of the lease, only the amount. Therefore, so long as the attorney's fees claim did not exceed the formula amount, it is allowable. *Wall St. Plaza, LLC v. JSJF Corp. (In re JSJF Corp.)*, 344 B.R. 94 (9th Cir. B.A.P. 2006).

6.1.dddd. Dispute over the amount of a claim does not make it unliquidated. The chapter 13 debtor challenged the IRS's claim for past years' taxes and argued that the claims were contingent and unliquidated, so that the debtor's debts would not push the debtor's debts over the eligibility limit for chapter 13. The debts were for tax years that had already been completed. Thus, all facts necessary to establish liability had occurred, so the debts are not contingent. The tax debts were disputed in amount, but the determination of the allowable amount is not based on the court's discretion or a future event (other than a judicial determination of the amount owing). The judicial determination is limited by the specific provisions of the Internal Revenue Code. A debt that has been made certain by agreement of the parties or operation of law, rather than one based upon a future exercise of discretion, is liquidated. Therefore, though disputed, the debts are liquidated. *In re Tucker*, 345 B.R. 373 (Bankr. M.D. Ala. 2006).

6.1.eeee. A plan may not categorically disallow punitive damage claims. Bankruptcy law generally enforces state law entitlements. State law in this case permits punitive damages but requires that 60% of punitive damage claims be paid to the state, which does not affect their allowability in bankruptcy. State law does not permit punitive damages where the agent who committed the tort acted outside his authority or where defendant has corrected the offending conduct. The court may not make those determinations on confirmation but only upon proceedings on an objection to the tort claim. In a liquidation case, punitive damages are given fourth priority, ahead of any return to equity. In a chapter 11 case, therefore, they cannot be disallowed without a showing at a minimum that they would not receive any recovery in a chapter 7 case. The claims may be subordinated only on an independent analysis on a case-by-case basis. *In re Roman Catholic Archbishop of Portland in Oregon*, 339 B.R. 215 (Bankr. D. Ore. 2006).

6.1.ffff. Only the district court may estimate tort claims for a plan distribution cap. The debtor's proposed plan distributed a fixed amount to a settlement trust as the sole source of payment of all tort claims. Confirmation with the cap would have the effect of limiting the distribution on the tort claims, so confirmation requires a determination that the aggregate amount of the tort claims does not exceed the proposed distribution. The debtor sought an estimate of the aggregate amount of the claims for purposes of limiting distribution under the plan. Only the district court may determine the amount of personal injury tort claims for purposes of distribution. Because the plan had the effect of limiting distribution to the aggregate estimated amount of the claims, the estimation would be for purposes of distribution, not just

for allowance. The bankruptcy court may recommend a methodology to the district court. The methodology would not require mini-trials for each of the 129 claims but might entail the employment of an expert to develop a matrix or the use of advisory jury trials to develop a range of possible recoveries. However, estimation for confirmation and voting purposes involves less drastic effects on the claimants and will be permitted in the bankruptcy court with less exacting procedures. *In re Roman Catholic Archbishop of Portland in Oregon*, 339 B.R. 215 (Bankr. D. Ore. 2006).

6.1.gggg. Claim transfer does not vitiate section 502(d) objection. Section 502(d) provides for disallowance of a "claim of an entity from which property is recoverable … or that is a transferee of a transfer avoidable …." Section 502(d) continues to apply to the claim in the hands of a transferee who acquired the claim after bankruptcy. The statute focuses on the claim, not its holder, and a transferee takes a claim subject generally to all of the defenses that the debtor would have, so the transfer does not affect section 502(d)'s applicability. What's more, claims traders can protect themselves by agreements allocating the risk of disallowance, whether on the claim's merits or for Bankruptcy Code reasons. Finally, section 550(b) does not protect the transferees. Section 550(b) applies only to transfers of property of the debtor, not of claims against the debtor. Moreover, section 550(b) requires that a transferee take "without knowledge of the voidability of the transfer." Knowledge of bankruptcy or insolvency imputes knowledge of voidability. *Enron Corp. v. Avenue Special Situations Fund II, LP (In re Enron Corp.)*, 340 B.R. 180 (Bankr. S.D.N.Y. 2006).

6.1.hhhh. Court may temporarily disallow claim under section 502(d) pending determination of the related preference action. The debtor in possession brought a preference avoidance action against a creditor who had previously transferred the claim to an unrelated entity. The debtor in possession also objected to the claim under section 502(d). The objection to claim may proceed, despite a motion to dismiss, even though the preference action has not been resolved. The claim may be temporarily disallowed pending resolution of the preference action, subject to reconsideration if the preference action defense is successful. *Enron Corp. v. Avenue Special Situations Fund II, LP (In re Enron Corp.)*, 340 B.R. 180 (Bankr. S.D.N.Y. 2006).

6.1.iiii. Section 510(b) subordinates employees stock option claims. The debtor was guilty of securities fraud. When the fraud was uncovered, the value of the debtor's stock collapsed, and the debtor was forced into bankruptcy. Employees filed claims for losses they suffered when their stock options became worthless. Stock options are "securities" within the meaning of section 101. A claim against the employer for its fraudulent inducement to the employee to purchase the stock option, that is, to take the option as compensation, is therefore a claim arising in connection with the purchase of a security. So also are claims for fraudulent inducement to retain the stock option and not exercise it. Although the cases are not so clear as to the latter kind of claim, section 510(b) subordinates both kinds of claims. *In re Enron Corp.*, 341 B.R. 141 (Bankr. S.D.N.Y. 2006).

6.1.jjjj. Limitation on landlord damage claim does not apply to letter of credit draw. The landlord drew on a letter of credit when the debtor in possession rejected the lease. The amount of the draw exceeded the limitation on a landlord's damage claim imposed by section 502(b)(6). The landlord did not file a proof of claim for damages. The bankruptcy court may not disallow the draw. Section 502(b)(6) applies only to disallow a filed proof of claim. It is not an avoiding power. Therefore, it does not affect the landlord's draw. The court does not address whether section 502(b)(6) would affect the bank's resulting letter of credit reimbursement claim. *EOP-Colonnade of Dallas Ltd. P'ship v. Faulkner (In re Stonebridge Techs., Inc.)* 439 F.3d 260 (5th Cir. 2005).

6.1.kkkk. Trustee may recover letter of credit proceeds in excess of damage claim. The landlord took a security deposit and a letter of credit to secure the debtor's performance under a lease. When the trustee rejected the lease, the landlord applied the security deposit and drew the full amount under the letter of credit. The trustee sued to recover the amount that the landlord had recovered that was in excess of the landlord's actual damages. First, the lease rejection did not vitiate the trustee's rights. Rejection is a breach, not a rescission, and it does not eliminate any of the trustee's rights under the lease. Second, the doctrine of independence applicable to letters of credit does not prevent the trustee from recovering excess amounts. A letter of credit establishes two relationships (bank-customer and bank-beneficiary)

based on a third relationship, customer-beneficiary. The independence principle prevents the customer-beneficiary relationship from interfering with the first two relationships, but the letter of credit relationship does not provide any additional protection to the customer-beneficiary relationship. Therefore, if the landlord over-recovered its damage claim, the fact that it did so through a letter of credit did not prevent the trustee from recovering the overage. *First Ave. W. Bldg., LLC v. James (In re OneCast Media, Inc.)*, 439 F.3d 558 (9th Cir. 2006).

6.1.llll. Third Circuit rejects recharacterization and equitable subordination claims and narrows grounds for both. As the debtor drifted further into financial distress, the debtor's secured term lenders kept extending more credit and taking more collateral and guarantees, including from the debtor's subsidiaries. In the process, the lenders acquired seats on the debtor's board, and other board members resigned, leaving only the three lender representatives and the debtor's CEO on the board. As the end neared, the lenders worked with a venture fund to acquire the debtor. The deal they negotiated required them to assign their secured claims to a new entity, formed and funded by the venture fund. The new entity agreed to acquire the debtor in a section 363 sale by credit bidding the secured claims and paying an additional amount in cash, which was used to pay the debtor's senior working capital lender, to pay administrative expenses, and to assume certain ordinary operating expense obligations. After the sale closed, the creditors' committee sued the secured lenders on several theories, all of which the court rejects. The court rejects the claim for recharacterization of the loans, including the latest ones. It first notes that recharacterization should be called "characterization," because it seeks to determine what the substance rather than the form of the transaction was, and differs from equitable subordination, because equitable subordination operates only when it is clear there is a claim (rather than equity) to subordinate. The court addresses recharacterization as a question of the intent of the parties, not of a "mechanistic scorecard" of factors. Because the resolution is based on intent, it is a question of fact, not law. The court concludes that the trial court's decision determining that the loans were not equity investments was not clearly erroneous: the lenders' transactions were documented as loans and were not improper, and the lenders' membership on the debtor's board was not unusual and did not require recharacterization. The court rejects the equitable subordination claim, because the lenders' conduct did not result in any harm to other creditors. In fact, it kept the debtor alive and allowed most operating expenses to be paid. Finally, in a footnote, the court rejects the "inaccurate generalizations of *Credit Lyonnais* that have gained traction from uncritical repetition," that directors' fiduciary duties extend to creditors when a corporation is in the vicinity of insolvency, and instead adopts the clarification of directors' duties set forth in *Prod. Res. Group L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004). *Cohen v. KB Mezz. Fund II, LP (In re Submicron Sys. Corp.)*, 432 F.3d 448 (3d Cir. 2006).

6.1.mmmm. Postpetition attorney's fees incurred under prepetition contract are allowable as a prepetition claim. The debtor's prepetition surety litigated after bankruptcy with the beneficiary and recovered substantial sums, but not full compensation, for the surety and for the estate. Its remaining reimbursement claim was unsecured. The surety bond obligated the debtor to reimburse the surety for attorney's fees, for which the surety sought allowance as part of its claim. Section 506(b), which allows attorney's fees to an oversecured creditor as part of its secured claim, does not impliedly prohibit allowance of postpetition attorney's fees to an unsecured creditor. Section 502(b), which requires determination and allowance of a claim as of the date of the filing of the petition, also does not prohibit allowance of fees incurred postpetition. The surety's prepetition contract gave it a contingent, unliquidated claim as of the petition date. The later incurrence of attorney's fees fixed and liquidated the claim, which could be allowed as part of the surety's unsecured prepetition claim. *Ins. Co. of N. Am. v. Sullivan*, 333 B.R. 55 (D. Md. 2005).

6.1.nnnn. Breach of PACA floating trust creates personal liability. The Perishable Agricultural Commodities Act imposes a floating trust in favor of a produce supplier on a buyer's commodity-related liquid assets. If a buyer does not pay a seller, the seller has a claim for breach of trust against such of the buyer's principals who are in a position to control the trust assets. The claim arises out of the common law, not PACA, for breach of the trustee's duty to preserve the assets for the trust's beneficiaries. Such a liability is personal to the trustee. The court does not distinguish between the corporation as trustee and its officers, who are agents of the corporation. *Weis-Buy Servs., Inc. v. Paglia*, 411 F.3d 415 (3d Cir. 2005).

6.1.oooo. Secured letter of credit proceeds are deducted from landlord's capped claim. The debtor's landlord secured its claim for breach of lease with a fully collateralized letter of credit. In determining the allowable amount of the landlord's remaining unsecured claim under section 502(b)(6), the court must deduct the collateral from the capped claim, not from the gross, uncapped claim, at least where (as here) the letter of credit is fully collateralized by the debtor's property, so that the net effect on the estate is the same as if the landlord held the collateral directly. *AMB Prop., L.P. v. Official Creditors Committee (In re AB Liquidating Co.)*, 416 F.3d 961 (9th Cir 2005).

6.1.pppp. Lien perfected by court filing is a statutory lien. A Pennsylvania driver who violates the motor vehicle law may be liable to the state for various surcharges. The law permits the state to obtain a lien on the driver's property by filing a certificate with the superior court; the certificate has the same effect as the docketing of a judgment in the court, including the creation of a lien on the driver's real property. Such a lien is a statutory lien, not a judicial lien, even though a court filing is required to make it effective. The lien arises based on specified facts and circumstances and is not based on a judicial determination of liability. Nor is it significant that the motor vehicle law does not directly grant the lien, which is then perfected by the filing. As a result, the debtor may not avoid the lien under section 522(f) as a judicial lien. *In re Schick*, 418 F.3d 321 (3d Cir. 2005).

6.1.qqqq. Administrative claims are not entitled to interest in a surplus chapter 7 case. The trustee sought interest on his fees in a surplus chapter 7 case. Section 726(a)(5) requires "payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1)." Section 726(a)(1) provides for payment of claims described in section 507. The majority view permits interest only from the date the fees are allowed, despite the literal language of the statute. The minority view follows the literal language and permits interest from the petition date on administrative claims. However, section 726(a)(1) applies only to a claim, "proof of which is timely filed under section 501." Because section 501 does not apply to administrative claims, which are filed under section 503, section 726(a)(5) does not apply, and interest is not payable at all. *Tarbox v. United States Trustee (In re Reed)*, 405 F.3d 338 (5th Cir. 2005).

6.1.rrrr. Creditor gets postpetition interest at contract rate in surplus liquidation case. After the debtor's case was closed as a no-asset chapter 7, the bank investigated and discovered substantial assets that the debtor had concealed. The trustee reopened the case, which resulted in a surplus. The bank sought postpetition interest on its claim and attorney's fees from the surplus. Section 502(b)(2) disallows postpetition interest, but section 726(a)(5) provides for distribution of interest at the legal rate before any surplus is returned to the debtor. Based at least in part on the debtor's asset concealment and the absence of an objection by the debtor to the claim's allowance, the court awards the interest and, noting the split in the cases, at the contract rate, so that the debtor does not receive a windfall. The court also allows the bank's postpetition attorney's fees as part of its prepetition claim, because the note provided for attorney's fees, which were contingent claims as of the petition date. *In re Fast*, 318 B.R. 183 (Bankr. D. Colo. 2004).

6.1.ssss. Note holder does not have standing as a creditor without proper proof of note ownership. Premier brought a nondischargeability complaint against the debtor based on a negotiable note the debtor had issued to Fleet. Fleet had assigned the note to Sovereign, who had assigned it to Premier. Although Premier had endorsement and transfer documents from Sovereign, it had no similar proof of transfer from Fleet to Sovereign. UCC article 3 requires proper endorsement and transfer of possession of the note for the transferee to enforce the note, unless the transferee properly shows loss of documents and the right to enforce the note and protects the debtor against the risk of double payment. Here, Premier did not have proof of right to enforce because it did not have any documents showing transfer from Fleet to Sovereign. Therefore, Premier lacked standing as a creditor. *Gavin v. Premier Capital, LLC (In re Gavin)*, 319 B.R. 27 (B.A.P. 1st Cir. 2004).

6.1.tttt. Claim filed one day late is disallowed. The claimant's attorney's clerk mailed the proof of claim by "second day delivery" to the claims agent one day before the bar date, and the claim predictably arrived one day late. The attorney did not verify whether the claim had arrived on time and did not move for an extension of the bar date until 81 days after the bar date. The claim was disallowed because the

claimant did not show excusable neglect: (1) although one claim arriving one day late might not prejudice the debtor, the precedent could; (2) the one day delay was short, but the delay in requesting relief from the bar date was long; (3) the reason for the delay—the attorney's delay until the eleventh hour and the clerk's mailing error—was not compelling and was the claimant's own fault; and (4) the claimant acted in good faith, but the finding of good faith was mitigated by the claimant's own delay. *In re Kmart Corp.*, 381 F.3d 709 (7th Cir. 2004).

6.1.uuuu. Faxed claim is untimely. The bar date notice provided that to be timely filed, claims had to be received by the bar date and that faxed claims would not be accepted. On the claims bar date, the creditor's attorney mailed the claim to the claims agent and faxed a copy to the trustee, who forwarded the faxed claim to the claims agent. The claim was disallowed as untimely. The fax did not comply with the bar date notice. The trustee's receipt of the fax was not timely under Bankruptcy Rule 5005(c), which requires a claim erroneously delivered to the wrong official to be transmitted to the clerk and permits the court to backdate the filing, and should not be treated as an informal proof of claim. Both those grounds are based on equitable considerations, which are not demonstrated by the creditor's attorney's "self-inflicted wound." *In re Outboard Marine Corp.*, 386 F.3d 824 (7th Cir. 2004).

6.1.vvvv. Responsible officer who pays trust fund taxes subrogates to the IRS's withholding tax claim. The debtor failed to pay employee withholding taxes. After bankruptcy, the IRS offset its 100% penalty claim against tax refunds owing to the responsible officers in partial satisfaction of the withholding tax claims. After the chapter 7 trustee paid the balance of the IRS's claims, the responsible officers asserted subrogation claims. After an extensive review of the conflicting case law on both the standard for allowing subrogation in a bankruptcy case and whether a 100% penalty payment gives rise to a right of subrogation, the court concludes that the requirements for subrogation set forth in section 509 are exclusive and preempt any state law rights of subrogation and that a responsible officer "is liable with the debtor on" the tax claim, does not receive the consideration for the claim and is therefore entitled to subrogation under section 509. *In re Fiesole Trading Corp.*, 315 B.R. 198 (Bankr. D. Mass. 2004).

6.1.wwww. Disputed claim can nevertheless be a liquidated claim. An insurance company sought recovery from the debtor for fraudulent claims, listing the specific checks and amounts that the debtor had received. The debtor claimed that the debtor were not the payees on all of the checks and so were not liable. The court determines, in the context of chapter 13 debt eligibility limits, that the claims are disputed but liquidated, because the amounts in dispute are either known or readily ascertainable. *In re Huelbig*, 313 B.R. 540 (D.R.I. 2004).

6.1.xxxx. Court denies recharacterization of loan to Ponzi scheme debtor. A creditor of a Ponzi scheme debtor's affiliate rolled its loan into a loan to the debtor, with an interest rate and other terms similar to those promised to the equity investors in the Ponzi scheme, but the loan was secured. The trustee seeks to recharacterize the loan as an equity contribution. The Tenth Circuit carefully distinguishes between recharacterization (the substance of the transaction was really an equity investment at the outset) from equitable subordination (a loan is subordinated because of the lender's subsequent inequitable conduct) and denies recharacterization. It adopts the 13-factor test from *In re Auto-Style Plastics, Inc.*, 269 F.3d 726 (6th Cir. 2001), but stresses that "[n]one of these factors is dispositive and their significance may vary depending upon circumstances." In this case, despite the absence of a fixed maturity date and the debtor's thin capitalization, the court refuses to recharacterize the loan. *Sender v. Bronze Group, Ltd.*, 380 F.3d 1292 (10th Cir. 2004).

6.1.yyyy. Landlord's section 502(b)(6) claim is reduced by the amount of a secured letter of credit. The debtor posted $350,000 in cash and $650,000 in a letter of credit "as security for the faithful performance" of the debtor's obligations under the lease. The debtor deposited $650,000 in cash with the issuing bank to secure its reimbursement obligation under the letter of credit. The debtor in possession rejected the lease. The landlord applied the cash deposit and drew on the letter of credit. The sum of those amounts was less than the landlord's allowed claim under section 502(b)(6). The court reduced the landlord's unsecured claim not only by the amount of the cash security deposit, but also by the amount of the letter of credit draw. Although the issuing bank's obligation to the landlord under the letter of credit is independent of the debtor's obligation to the landlord for breach of the lease, the debtor's pledge of cash to

the issuing bank resulted in property of the estate being used to satisfy the landlord's claim. A long and thoughtful concurrence argues that the court improperly focused on the landlord's remedy and that the proper analysis is to apply section 502(b)(6) only to limit the estate's exposure. It also traces the effect of an amendment to UCC Article 5 that may treat the issuing bank's reimbursement claim the same as the claim of a guarantor or other secondarily liable entity, which would support the court's ruling. *Redback Networks, Inc. v. Mayan Networks Corp. (In re Mayan Networks Corp.)*, 306 B.R. 295 (9th Cir. B.A.P. 2004).

6.1.zzzz. Secured tax claim allowed, based on value of debtor's use of property. The debtor owed substantial personal property taxes on equipment it used in the operation of its business. The taxes were secured by the equipment, which was also encumbered by other liens in excess of its value. The debtor in possession operated its business for a short while postpetition and sold its business, including the equipment, but for less than enough to pay off all secured claims, including the secured tax claims. Section 502(b)(3) disallows a secured property tax claim to the extent that the claim "exceeds the value of the interest of the estate in such property." The section is designed to prevent a windfall to a secured creditor, whose lien would otherwise be subject to the secured tax claim, and to prevent a concomitant disadvantage to general unsecured creditors. In this case, however, the court construes "the interest of the estate in such property" broadly to include the benefit the estate received from postpetition operation and from sale of the equipment as part of an operating business and allows the tax claim as a general unsecured claim, even though the debtor did not have equity in the property. *In re Precision Concepts, Inc.*, 305 B.R. 438 (M.D.N.C. 2004).

6.1.aaaaa. Consideration paid for transferred claim need not be disclosed. The creditor had acquired two claims before proofs of claim had been filed. The creditor filed the proofs of claim. The debtor in possession objected to the claims on the ground that the creditor did not disclose the consideration paid for the claims. Such disclosure is irrelevant to the allowance of a claim that has been transferred before the proof of claim has been filed. Bankruptcy Rule 3001(e)(1), which governs transfer of claims before a proof is filed, does not require disclosure of the consideration paid, as do Rules 3001(e)(3) and 3001(3)(4) (governing transfers of claims for security). Thus, the claims should be allowed without the disclosure. *Resurgent Capital Servs. v. Burnett (In re Burnett)*, 306 B.R. 313 (9th Cir. B.A.P. 2004).

6.1.bbbbb. Letter of credit beneficiary does not hold a secured claim. To protect its claim against the debtor in prepetition state court litigation, the creditor obtained an order from the state court requiring the debtor to post a letter of credit. When the letter of credit was about to expire post-bankruptcy before the condition to its draw (a state court decision on the merits) had been met, the creditor sought an order requiring the debtor in possession to obtain a renewal or extension of the letter of credit. The creditor argued that it was entitled to adequate protection of its interest under the letter of credit, which it would not receive if the letter of credit expired before resolution of the state court litigation. The Second Circuit concludes that the creditor is not entitled to adequate protection. Adequate protection is available only to a holder of a secured claim, that is, a creditor whose claim is secured by an interest in property of the debtor. A letter of credit is not such an interest. *In re Dairy Mart Convenience Stores, Inc.*, 351 F.3d 86 (2d Cir. 2003).

6.1.ccccc. Debtor may not strip off a valueless junior lien. Following the Supreme Court's reasoning in *Dewsnup v. Timm*, 502 U.S. 410 (1992), the Sixth Circuit joins the Fourth Circuit in holding that a chapter 7 debtor may not strip off a valueless junior lien. The Sixth Circuit notes the extensive split among the lower courts on this issue, but follows the only other court of appeals to have decided it. *Talbert v. Citi Mortgages Services (In re Talbert)*, 344 F.3d 555 (6th Cir. 2003).

6.1.ddddd. True lease or security interest? The debtor had entered into an agreement for the counterparty to install energy saver light fixtures. The debtor would pay the counterparty over a period of up to eight years based on the expected energy cost savings. At the end of the term of the agreement, the counterparty had the option of removing the equipment and replacing it with equipment comparable to the prior equipment originally, abandoning the equipment or negotiating with the debtor for an additional lease term or for a buyout. The cost of removal would have exceeded the value of the equipment removed. After bankruptcy, the debtor sought to recharacterize the agreement as a disguised security interest, while the

counterparty sought treatment as a lessor. The court determines the transaction is a disguised security interest. It relies on the 1995 version of section 1-201(37) of the UCC. The agreement does not meet the bright line test for recharacterization of a security interest, because the lease term does not exceed the useful life of the equipment, the debtor does not have a nominal purchase or re-lease option, and the debtor is not contractually bound to renew the lease or to become the owner of the goods. Nevertheless, because the economics and the lease negotiation dynamics dictate that counterparty must abandon the equipment at the end of the lease term, the court determines that the transaction is a disguised security interest. The court notes the departure in the 1995 version of the UCC from the "intent of the parties" test to the "economic realities of the transaction" test. The court discounts the importance of the accounting and tax treatment of the transaction. *Duke Energy Royal, LLC v. Pillowtex Corp. (In re Pillowtex, Inc.)*, 349 F.3d 711 (3d Cir. 2003).

6.1.eeeee. Treatment under section 365 requires "true lease." To finance improvements in various municipal airports, the debtor entered into lease-leaseback transactions, under which it leased its airport facility to a municipal agency. The municipal agency issued tax-exempt bonds, the proceeds of which were used to construct improvements on the airport property. The agency then leased the property back to the debtor for rental payments equal to the debt service payments on the municipal bonds. The leaseback terminated upon payment of the bonds. The leasebacks were not true leases, because the municipal agency did not have any of the benefits or risks of ownership at the end of the leaseback term. Accordingly, section 365 did not apply. *United Airlines, Inc. v. HCS Bank USA (In re UAL Corp.)*, 307 B.R. 618 (Bankr. N.D. Ill. 2004), *rev'd*, 317 B.R. 335 (N.D. Ill. 2004).

6.1.fffff. Court allows undersecured property tax claim under section 502(b)(3). The debtor owed substantial personal property taxes on equipment it used in the operation of its business. The taxes were secured by the equipment, which was also encumbered by liens in excess of its value. The debtor in possession operated for a short while postpetition and then sold its business, including the equipment, but for less than enough to pay all secured claims, including the secured tax claims. Section 502(b)(3) disallows a secured property tax claim to the extent that the claim "exceeds the value of the interest of the estate in such property." The section is designed to prevent a windfall to a secured creditor, whose lien would otherwise be subject to the secured tax claim, and to prevent a concomitant disadvantage to general unsecured creditors. In this case, however, the court construes "the interests of the estate in such property" broadly to include the benefit the estate received from postpetition operation and from sale of the equipment as part of an operating business and allows the tax claim as a general unsecured claim, even though the debtor did not have equity in the property. *In re Precision Concepts, Inc.*, 305 B.R. 438 (M.D.N.C. 2004).

6.1.ggggg. Pay in lieu of notice is subject to one year salary cap. After bankruptcy, the trustee terminated two executives, whose employment contracts provided for two years' severance pay plus a requirement for 90 days' notice of termination without cause or 90 days' salary in lieu of notice. The claim for 90 days' pay in lieu of notice was equally subject to the one-year cap on damages for termination of an employment agreement under section 502(b)(7). The claim is for amounts that are accelerated or become due by reason of termination, rather than "unpaid compensation due under such contract, without acceleration." *Harrington v. Dornier Aviation (North America), Inc. (In re Dornier Aviation (North America), Inc.)*, 305 B.R. 650 (E.D. Va. 2004).

6.1.hhhhh. Bank is not liable for aiding and abetting breach of fiduciary duty. A closely held corporation's owners fraudulently inflated the corporation's revenues and its accounts receivable after the bank opened its revolving credit line. The bank became suspicious and demanded that the corporation refinance the line. The corporation borrowed additional funds from its existing noteholders, which were used to repay the bank. The trustee in bankruptcy sought recovery from the bank for the insiders' breach of fiduciary duty to the corporation, alleging that the bank aided and abetted the fraud by participating in or encouraging the fraud on the corporation and the noteholders. The bank claimed that its sole participation in the refinancing was to demand that the corporation obtain new financing, to avoid telephone inquiries from the noteholders, and to consent to the refinancing, as required under the loan agreement, and that it did not immediately call its loan when it suspected fraud. Such conduct did not rise to the level of aiding and abetting. Because a lender is not a fiduciary to its borrower, the bank had no

obligation to put the corporation's interests ahead of its own in attempting to stop the fraud, which thereby might have prevented the repayment of the bank. In addition, the bank's consent to the new borrowing did not impose an affirmative duty to protect either the corporation or the new lenders from the owners' fraud. Accordingly, the complaint was dismissed. *Sharp Int'l Corp. v. State Street Bank and Trust Co. (In re Sharp Int'l Corp.)*, 302 B.R. 760 (E.D.N.Y. 2003).

6.1.iiiii. Mandatorily redeemable preferred stock and warrants are equity interests. The debtor had issued mandatorily redeemable preferred stock and warrants to purchase preferred stock, which became redeemable shortly after the debtor filed its chapter 11 petition. The holders had given notice of redemption shortly before bankruptcy and asserted that their right to payment was a claim, not an equity interest. The court disallows the claim. Reading the definition of "equity security" closely, the court concludes that a right to sell an equity security is an equity interest and that the equity characteristics of the interest prevail over the claim status of the same interest. *Carrieri v. Jobs.com Inc.*, 301 B.R. 187 (N.D. Tex. 2003).

6.1.jjjjj. A bar date order does not trump section 1111(a). The court issued a bar date order requiring all creditors to file proofs of claim. Neither the order nor the notice to creditors specifically stated that creditors whose claims were deemed filed under section 1111(a) (listed on the schedules as liquidated, undisputed, and not contingent) also needed to file proofs of claim by the bar date. Because the notice was not clear, the creditors' claims were deemed filed, despite the bar date order. However, the court questions whether such a bar date order, which might be inconsistent with section 1111(a) and with Bankruptcy Rule 3003, would ever be permitted. *ATD Corp. Advantage Packaging, Inc. (In re ATD Corp.)*, 352 F.3d 1062 (6th Cir. 2003).

6.1.kkkkk. Post confirmation claim objection is permitted. The plan provided for a deadline for objections to claims 60 days after the effective date. The debtor in possession objected to the creditor's claim 30 days after confirmation. The bankruptcy court overruled the objection on the grounds that confirmation had resolved the claim. The court of appeals reverses, holding that the plan bar date provision is binding. Unless the evidence in support of confirmation relied on the validity of the claim, confirmation does not determine the allowability of the claim, and the debtor in possession may object within the time provided in the plan. *In re Hovis*, 356 F.3d 820 (7th Cir. 2004).

6.1.lllll. Rabbi Trust assets are not subject to creditor's security interest. A "rabbi trust" protects an executive by a deposit in a trust for her benefit of cash or cash equivalents sufficient to pay specified executive compensation benefits such as severance. The executive does not receive a security interest or other specific right to the trust assets, so as to prevent taxable constructive receipt of the funds. Still, she can be assured that the money is available in the event that the corporation, for whatever reason (such as parting on bad terms or a change of control) chooses not to pay the benefit. The funds in the trust remain subject to the claims of the corporation's creditors. The IRS' "Model Rabbi Trust" form states that the assets are subject to the claims of "general creditors," which probably means unsecured creditors. In a case of apparent first impression involving a corporation that had used the IRS Model Rabbi Trust form, the Seventh Circuit ruled that the trust assets are not subject to a security interest of a creditor secured by "general intangibles." *Bank of America, N.A. v. Moglia*, 330 F.3d 942 (7th Cir. 2003).

6.1.mmmmm. Secured creditor need not file fee application to recover attorneys fees. A secured creditor seeking attorneys fees under section 506(b) may include the amount in its proof of claim, even if the fees are incurred postpetition, and need not file a fee application under Bankruptcy Rule 2016. *Atwood v. Chase Manhattan Mortgage Co. (In re Atwood)*, 293 B.R. 227 (9th Cir. B.A.P. 2003).

6.1.nnnnn. Employment termination damage claim not limited by prepetition payments. Section 502(b)(7) limits the claim of an employee for breach of an employment contract to the extent the claim exceeds "the compensation provided by such contract … for one year following the earlier of the date of the filing of the petition or the [termination] date" plus any unpaid compensation due on the earlier of those dates. In this case, the executive had been terminated several years before bankruptcy and had been receiving payments under the termination provision of his employment contract. When the debtor filed bankruptcy, approximately one year's salary was still owing. The court separates the

measurement of the cap from the calculation of the damage claim. It rules that the court must first determine the allowable claim and then must calculate the cap in a mechanical fashion and apply the cap to the damage claim. As a result, it doesn't matter how much of the employee's damage claim has been paid before bankruptcy. The Code applies the cap only to the amount allowable as of the date of bankruptcy. In addition, a letter of credit available to the employee is irrelevant in determining the amount of the cap, even though the draw on the letter of credit occurred after bankruptcy. Finally, "compensation" includes salary as well as other benefits. *Young v. Condor Systems, Inc. (In re Condor Systems, Inc.)*, 296 B.R. 5 (9th Cir. B.A.P. 2003).

6.1.ooooo. Non-repayment of avoidable transfer does not require disallowance of administrative claim. Section 502(d) requires disallowance of a claim, "notwithstanding subsection (a) or (b) of this section" if the claimant received an avoidable transfer and has not returned it to the estate. Taking sides in the split among the courts that have ruled on this issue and listing the cases on both sides, the court rules that section 502(d) does not require disallowance of an administrative claim. The court analyzes the structure of the statute, concluding that section 502(d) applies only to allowance of claims under section 502, not allowance of administrative expenses under section 503. *Beasley Forest Products, Inc. v. Durango Georgia Paper Co. (In re Durango Georgia Paper Co.)*, 297 B.R. 326 (Bankr. S.D. Ga. 2003).

6.1.ppppp. Bankruptcy court may deny claims transfer on equitable grounds. The bankruptcy court does not need to approve a request for issuance of a notice of transfer of claim under Bankruptcy Rule 3001(e). In this case, the transferee's inequitable conduct in obtaining the claim could have given the bankruptcy court grounds to deny the transfer. *Bevin v. SoCal Communications Sites, LLC (In re Bevin)*, 327 F.3d 994 (9th Cir. 2003).

6.1.qqqqq. Creditor did not demonstrate that yield maintenance premium was reasonable. The creditor's 20 year loan provided a fixed yield maintenance premium of approximately 18% of the principal balance, regardless of any change in interest rates between the date of the loan and the date of pre-payment. The district court construes such a yield maintenance premium as a penalty, rather than a liquidated damages clause, because the creditor did not make any showing of any actual loss suffered or anticipated as a result of the pre-payment. As a result, the yield maintenance premium was not a reasonable fee allowable under section 506(b). *In re Schwegmann Giant Supermarkets*, 287 B.R. 649 (E.D. La. 2002).

6.1.rrrrr. Court disallows prepayment penalty. The debtor issued an eight-year note to the secured creditor. The note provided for an increase in the interest rate of five percent upon default and a prepayment penalty based on the difference between the note interest rate and the interest rate on comparable maturity treasuries. The court disallows the prepayment penalty on the ground that the return on short-term treasuries is not an accurate measure of the current market interest rate for the type of commercial loan that a commercial lender is likely to make. In addition, the high default interest rate that the creditor received and the presence of junior lienors who would be damaged led the court to conclude that it would be inequitable to allow the lender the prepayment penalty. *Sachs Electric Co. v. Bridge Information Systems, Inc. (In re Bridge Information Systems, Inc.)*, 288 B.R. 556 (Bankr. E.D. Mo. 2002).

6.1.sssss. Letter of credit proceeds reduce section 502(b)(6) cap. The landlord had received, in lieu of a security deposit, a letter of credit. The landlord drew on the letter of credit before bankruptcy but after the landlord accepted surrender of the premises. Because the letter of credit operated in the place of a security deposit, and because security deposits are deducted from a landlord's allowed claim *after* applying the section 502(b)(6) cap, the proceeds of the letter of credit would be applied against the landlord's capped claim, leaving the landlord an unsecured claim for only the balance. The court of appeals notes that any other rule could permit an end run around section 502(b)(6). *Solow v. PPI Enterprizes (U.S.), Inc. (In re PPI Enterprizes (U.S.), Inc.)*, 324 F.3d 197 (3d Cir. 2003).

6.1.ttttt. One-year limitation in section 502(b)(6) relates to the year immediately following the petition. Section 502(b)(6) limits the claim of a landlord for damages resulting from a termination of a lease to "the rent reserved by such lease . . . for . . . one year . . . following the earlier of" the petition and the date of repossession or surrender. In this case, the landlord argues that the measure should be the

average one year's rent over the remaining term of the lease. The court does not agree, holding that the measure is the rent reserved for the one year immediately following the trigger date, even though that period may overlap with the period of administration of the case for which the trustee paid rent. *In re USInternetworking, Inc.*, 291 B.R. 378 (Bankr. D. Md. 2003).

6.1.uuuuu. Joint tort feaser may not subrogate to victims' claim. Celotex and Fibreboard were held jointly liable in asbestos litigation. While the judgments were on appeal, Fibreboard purchased the victims' claims at a discount, obtaining a full release of Fibreboard. Fibreboard filed the claims in the Celotex chapter 11 case, seeking subrogation under section 509 rather than contribution under section 502(e). The court rules that Fibreboard is not entitled to subrogation under section 509 because it cannot be subrogated for paying its own debts. *Celotex Corp. v. Allstate Ins. Co. (In re Celotex Corp.)*, 289 B.R. 460 (Bankr. M.D. Fla. 2003).

6.1.vvvvv. Section 502(e) disallowance does not apply when the principal creditor has waived its claim. The debtor and a co-debtor were obligated to the state under CERCLA. The co-debtor settled with the state and agreed to clean up a polluted site. As part of the settlement, the state agreed not to pursue any claims against the debtor. When the co-debtor filed its claim against the debtor, the debtor objected to allowance under section 502(e) on the ground that the co-debtor had not yet satisfied its claim to the state in full. In a case of apparent first impression, the bankruptcy court overrules the debtor's objection and allows the co-debtor's claim, concluding that there is no difference between the co-debtors satisfaction of the state's claim and the state's waiver of the claim against the debtor. *In re Laidlaw USA, Inc.*, 287 B.R. 603 (Bankr. W.D.N.Y. 2002).

6.1.wwwww. Disallowance of late filed claim does not avoid lien. Section 506(d)(2) voids a lien to the extent that it secures a claim that is not an allowed secured claim, "unless such claim is not an allowed secured claim due only to the failure of any entity to file proof of such claim." In this case, the creditor filed a proof of claim late. The bankruptcy court disallowed the claim but refused to void the lien. The Fourth Circuit, joining the Eighth and Eleventh Circuits, affirms, reasoning that a creditor should not be penalized more for filing a late claim than for not filing a claim at all. *Hamlett v. AmSouth Bank (In re Hamlett)*, 322 F.3d 342 (4th Cir. 2003).

6.1.xxxxx. Interest rate swap termination damages are not unmatured interest. Affirming the district court's decision, the Ninth Circuit rules that termination damages under an interest rate swap between the debtor and the lead lender on the debtor's credit line did not amount to unmatured interest that should be disallowed under section 502(b)(2). The court adopted the opinion of the district court, which found that the loan agreement and the swap agreement were not tied together and so should not be integrated. The court also ruled that the CFTC's exemption of swaps from bucket shop laws applied retroactively to this transaction, which was entered into before the regulations were promulgated. *Thrifty Oil Co. v. Bank of America N.T. & S.A. (In re Thrifty Oil Co.)*, 310 F.3d 1188 (9th Cir. 2002).

6.1.yyyyy. Yield maintenance premium allowed. The creditor's loan was accelerated pre-petition, which triggered the debtors obligation for a yield maintenance premium. The court finds the yield maintenance premium enforceable as a liquidated damages provision under New York law and rules that it is an allowable claim, because if it was owing as of the petition date, even though the plan did not propose pre-payment and instead proposed reinstatement of the note for the original term at the interest rate contained in the note. In addition, because the debtor was solvent, the court rules that the plan does not meet the best interest test of section 1129(a)(7) unless it pays the yield maintenance premium, because upon a liquidation, the loan would have been repaid in full, with the yield maintenance premium, because a liquidation would have resulted in a prepayment. *In re Vanderveer Estates Holdings, Inc.*, 283 B.R. 122 (Bankr. E.D.N.Y. 2002).

6.1.zzzzz. Receipt of unreturned preference precludes allowance of administrative claim. Section 502(d) requires disallowance of any claim of an entity that received a voidable transfer who has not returned the transfer. The Ninth Circuit B.A.P. rules that this disallowance provision applies as well to administrative claims. Even though the provision is in section 502, which deals only with pre-petition claims, the provision uses the word "claim" which is not limited to pre-petition claim. The B.A.P. dismisses any

argument that the ruling will discourage pre-petition creditors from providing post-petition goods or services to a debtor-in-possession, on the theory that the pre-petition creditor would be liable for the preference in any event, but does not discuss whether the preference liability and the administrative claim may be offset. *MicroAge, Inc. v. Viewsonic Corp. (In re MicroAge, Inc.)*, 284 B.R. 914 (9th Cir. B.A.P. 2002).

6.1.aaaaaa. Unclaimed funds under section 347(a) do not bear interest. The liquidating trustee's check to the creditor was not cashed within 90 days, so the trustee deposited it into the bankruptcy court as required under section 347(a). When the creditor sought recovery, he claimed interest on the funds. The Court of Appeals for the Federal Circuit rules that the creditor is not entitled to interest, because the bankruptcy court did not invest the funds at interest and was under no obligation to do so. Therefore, the general rule that "interest follows the principle" does not apply. *Leider v. United States*, 301 F.3d 1290 (Fed. Cir. 2002).

6.1.bbbbbb. "Legal rate" means federal judgment rate. The creditor obtained a pre-petition judgment against the debtor in state court, forcing the debtor into bankruptcy. The debtor's chapter 11 plan provided for payment of post-petition interest on the claim at the federal judgment rate under 28 U.S.C. § 1961(a), rather than the judgment rate provided for under state law. Focusing only on section 726(a)(5), which requires "payment of interest at the legal rate" in a solvent chapter 7 case, the Ninth Circuit rules that the "legal rate" is the federal judgment rate, rather than the state law judgment rate, even in a chapter 11 case. *Onink v. Cardelucci (In re Cardelucci)*, 285 F.3d 1231 (9th Cir. 2002).

6.1.cccccc. Property tax claim limited by section 502(b)(3). The state assessed personal property taxes of $81,000 against the debtor's assets for 1998 and 1999. After the taxes were assessed, the debtor filed bankruptcy. At the time of the bankruptcy, the debtor's personal property was worth only $58,000. The tax claim was limited to $58,000, equal to the gross value of the property, rather than being prorated across all of the property on which the tax was assessed. *Universal Seismic Associates, Inc. v. Harris County (In re Universal Seismic Associates, Inc.)*, 288 F.3d 205 (5th Cir. 2002).

6.1.dddddd. Letter of credit bank is not subrogated to creditor's non-dischargeable claim. The creditor obtained a fraud judgment against the debtor in state court before bankruptcy. To obtain a stay pending appeal, the debtor posted a bond and obtained a letter of credit payable to the bonding company to secure the debtor's reimbursement obligation to the surety. The underlying creditor obtained a judgment from the bankruptcy court that the state court judgment was non-dischargeable, and the state court of appeal ultimately affirmed the liability. After the bonding company paid the defrauded creditor and drew under the letter of credit, the letter of credit bank asked the bankruptcy court to hold that the letter of credit reimbursement obligation was also non-dischargeable, on the ground that the bank subrogated to the creditor's claim. The Ninth Circuit rules that section 509(a) of the Bankruptcy Code does not provide statutory subrogation: the bank was not liable with the debtor on the claim, because the letter of credit obligation was independent of the debtor's obligation. The court also denies equitable subrogation for the same reason. The court reasons that the bank was not a victim of the debtor's fraud but was rather a contractual creditor, whose claim should be discharged. *Hamada v. Far East National Bank (In re Hamada)*, 291 F.3d 645 (9th Cir. 2002).

6.1.eeeeee. Case dismissal vacates claim disallowance order. Although the creditor had obtained a state court judgment against the debtor, the bankruptcy court disallowed the creditor's proof of claim on the grounds that the creditor corporation had been suspended by the Secretary of State. The bankruptcy court thereafter dismissed the chapter 11 case. After the creditor attempted to execute on the state court judgment, the debtor filed another chapter 11 case and sought disallowance, on the grounds that the prior order of disallowance in the prior chapter 11 case was binding. Relying on section 349, the district court holds that the dismissal of the prior case vacated the order disallowing the claim, so that it was not binding in the subsequent case. *Mirzai v. Kolbe Foods, Inc. (In re Mirzai)*, 271 B.R. 647 (C.D. Cal. 2001).

6.1.ffffff. Yield maintenance premium is disallowed. The debtor filed its chapter 11 petition when it was not in default to its secured creditor. The creditor moved to compel sale of the assets securing its $8.4 million loan and then claimed a pre-payment penalty of $1.3 million upon the sale of the asset and pre-payment of the loan. The court rules first that the allowance of a pre-payment penalty is an issue of federal

law under section 502(b) ("reasonable fees, costs, or charges provided for under the agreement . . ."). Second, the court disallows the pre-payment penalty as unreasonable and inequitable on the grounds that the debtor did not seek pre-payment but was rather forced into it by the creditor's motion to compel sale of the property. *In re Schwegmann Giant Supermarkets Partnership*, 264 B.R. 823 (Bankr. E.D. La. 2001).

6.1.gggggg. Bankruptcy court may recharacterize debt as equity. Although some courts have ruled that the bankruptcy court does not have authority to disallow a claim other than through express provisions of the Bankruptcy Code authorizing disallowance, the Sixth Circuit rules that the bankruptcy court has the authority to recharacterize debt as equity under the court's equitable powers to test the validity of a debt. Moreover, the bankruptcy court may use the factors developed under the tax law to determine whether a claim should be recharacterized. *Bayer Corp. v. Mascotech, Inc. (In re Autostyle Plastics, Inc.)*, 269 F.3d 726 (6th Cir. 2001).

6.1.hhhhhh. Bank participation agreements defined. The shareholders advanced funds to the debtors' principal secured lender in exchange for subordinated participation agreements in the creditors revolving credit facility. A junior secured creditor challenged the validity of the shareholders' claims against the corporation's assets. The Sixth Circuit rules that the shareholders were parties to true participation agreements and that their claims, through the lead lender, were allowable and took priority over the secured claim of the junior secured creditor. In so doing, the Sixth Circuit adopts a four-part definition of a true participation agreement: (1) money is advanced by a participant to a lead lender; (2) the participant's right to repayment arises only when the lead lender is paid; (3) only the lead lender can seek legal recourse against the debtor; and (4) the document evidences the parties' true intentions. *Bayer Corp. v. Mascotech, Inc. (In re Autostyle Plastics, Inc.)*, 269 F.3d 726 (6th Cir. 2001).

6.1.iiiiii. Interest for a pre-petition period that is awarded post-petition is not unmatured interest. The creditor sued the debtor on a breach of contract claim two years before the petition date and was awarded judgment, including interest from the date of breach, after the petition date. The trustee objected to the allowance of the interest attributable to the pre-petition period under section 502(b)(2), which disallows a claim for "unmatured interest" as of the petition date. The bankruptcy court allows the claim on the ground that the interest was contingent but matured as of the petition date and became fixed upon the awarding of judgment. *In re Lamarre*, 269 B.R. 266 (Bankr. D. Mass. 2001).

6.1.jjjjjj. Bankruptcy court may not estimate administrative claims under section 502(c). By its terms, section 502(c) applies only to prepetition claims, although some courts have permitted estimation to be used in the context of administrative claims. The First Circuit B.A.P. rules that estimation of an administrative claim under section 502(c) defeats the rights of an administrative claimant, whose claim must be determined under section 503. What is more, because the claim was an administrative tax claim, section 505 provides the exclusive procedure for determining the allowability of the claim. *United States v. Sterling Consulting Corp. (In re Indian Motorcycle Co., Inc.)*, 261 B.R. 800 (1st Cir. B.A.P. 2001).

6.1.kkkkkk. Non-return of avoided preference does not require disallowance of administrative expense claim. The debtor in possession avoided preferences to a prepetition creditor who had also provided postpetition services. The debtor sought to disallow the creditor's administrative expense claim under section 502(d), which requires disallowance of a claim by an entity that has received and not returned a voidable transfer. The bankruptcy court rules that section 506(d) does not apply to the allowance or disallowance of administrative expense claims, which are creatures of the bankruptcy law that are unique and differ from prepetition claims dealt with by section 502. *Camelot Music, Inc. v. MHW Advertising and Public Relations, Inc. (In re CM Holdings, Inc.)*, 264 B.R. 141 (Bankr. D. Del. 2001).

6.1.llllll. Disallowance under section 502(d) does not require finding of liability to return a voided transfer. Section 502(d) requires the court to disallow the claim of a recipient of an avoidable transfer unless the creditor returns the property for which it is liable. In this case, the tax lien of the city of El Paso was avoidable under section 545, but the debtor did not seek avoidance or recovery of the lien. When the debtor objected to the claim under section 502(d), the city argued that it had not been found liable to release the tax lien, so section 502(d) did not apply. The Ninth Circuit reads the "unless" clause as a savings clause only and does not require a finding of liability for return and refusal to return before the

claim must be disallowed. *El Paso v. America West Airlines, Inc. (In re America West Airlines, Inc.)*, 217 F.3d 1161 (9th Cir. 2000).

6.1.mmmmmm. A tort claim does not arise until there is harm. A manufacturer sold pipe which burst long after the manufacturer's bankruptcy. The pipe purchaser did not have a claim that would be subject to the bar date at the time of bankruptcy. *Fogel v. Zell*, 221 F.3d 955 (7th Cir. 2000).

6.1.nnnnnn. "Mello-Roos" bondholders are not creditors. Under California law, a city may issue bonds to finance development of real property. The city pays the bond's solely from a special tax assessment on the real property. Because the bondholders have a claim only against the city, which has a claim only for the tax revenues (secured by a tax lien) on the real property, the bondholders are not "creditors" whose rights can be modified under a chapter 11 plan. *Ritter Ranch Development, L.L.C. v. City of Palmdale (In re Ritter Ranch Development, L.L.C.)*, 255 B.R. 760 (B.A.P. 9th Cir. 2000).

6.1.oooooo. Burden of proof on tax claims does not shift in bankruptcy. State law imposed the burden of proof on the taxpayers for a sales and use tax. The taxing agency filed a proof of claim. The trustee filed an objection but came forward with little evidence to refute the claim. Because the burden of proof is a part of the substantive tax law, it does not shift upon the filing of the bankruptcy. The trustee did not meet his burden, so the claim was allowed. *Raleigh v. Illinois Dept. of Revenue*, 120 S. Ct. 1951 (2000).

6.1.pppppp. Loan participant does not have a claim against the debtor. A bank purchased a 22.5% participation interest in a letter of credit facility originated by another bank and asserted a direct claim against the borrower/debtor when it filed its chapter 11 case. Distinguishing among a participation agreement, an interbank loan, and a syndication agreement, the court ruled that a participation agreement gives the participant a claim only against the originating bank, not against the debtor, despite language in the participation agreement under which the originating bank "sells" and the participating bank "purchases" an interest in the loan. *In re Okura and Co. (America), Inc.*, 249 B.R. 596 (Bankr. S.D.N.Y. 2000).

6.1.qqqqqq. A "keep-well" is not a guarantee. The shareholders agreed to provide adequate capital to support payments on the note to the creditor. The shareholders failed to do so, and the creditors sued. The Second Circuit holds that the keep-well is not a guarantee, but the creditor has a contract damage claim against the shareholders for the amounts that he may have lost as a result of their failure to provide adequate capital to the corporation to pay the note. *Terwilliger v. Terwilliger*, 206 F. 3d 240 (2d Cir. 2000).

6.1.rrrrrr. Interest rate swap termination damages are not unmatured interest. Affirming the bankruptcy court's decision, the district court rules that termination damages under an interest rate swap between the debtor and the lead lender on the debtor's credit line did not amount to unmatured interest that should be disallowed under section 502(b)(2). The court found that the loan agreement and the swap agreement were not tied together and so should not be integrated. The court also ruled that the CFTC's exemption of swaps from bucket shop laws applied retroactively to this transaction, which was entered into before the regulations were promulgated. *Thrifty Oil Co. v. Bank of America N.T. & S.A. (In re Thrifty Oil Co.)*, 249 B.R. 537 (S.D. Cal. 2000).

6.1.ssssss. Objection of proof of claim must be served on corporate officer. The debtor filed an objection to a proof of claim and served the objection on the address shown in the proof of claim under the block entitled "name and address where notices should be sent." The bankruptcy court rules that service of the objection was inadequate. Bankruptcy Rule 9014 makes an objection to a proof of claim a contested matter. Rule 7004 governs service in a contested matter and requires service on a corporate officer, managing or general agent, or agent for service of process. *Boykin v. Marriott International, Inc. (In re Boykin)*, 246 B.R. 825 (Bankr. E.D. Va. 2000).

6.1.tttttt. Subordination agreement applies to section 1111(b) deficiency claim. Rejecting an argument that the Rule of Explicitness requires a subordination agreement to provide expressly for the

subordination of the junior creditor's artificial deficiency claim created under section 1111(b) of the Bankruptcy Code, the court holds that the deficiency claim is subordinated to the same extent as the principal recourse secured claim. *Bank of America, N.A. v. North LaSalle St. Ltd. Partnership (In re 203 N. LaSalle St. Ltd. Partnership)*, 246 B.R. 325 (Bankr. N.D. Ill. 2000).

6.1.uuuuuu. Claim for partnership interest is not discharged. A former general partner sought reinstatement of its partnership interest in the discharged debtor. Because monetary damages would not be an alternative remedy for the former partner, the Third Circuit holds that the partner's state court proceeding for reinstatement did not assert a "claim" that was discharged in the partnership's chapter 11 case. *In re Ben Franklin Hotel Associates*, 186 F.3d 301 (3d Cir. 1999).

6.1.vvvvvv. A subsequent transferee of a preference does not have a claim against the debtor. After the debtor-in-possession recovered a preference from a subsequent transferee, the subsequent transferee asserted a claim under section 502(h). The claim was disallowed, on the grounds that the debtor never owed the subsequent transferee any money. *Southmark Corp. v. Schulte, Roth & Zabel, L.L.P.*, 242 B.R. 330 (N.D. Tex. 1999).

6.1.wwwwww. Administrative claimant does not have standing to surcharge secured creditor's collateral. The secured creditor took all assets of this failed chapter 11 debtor, leaving an administrative claimant unpaid. The claimant sought to surcharge the secured creditor's collateral for the benefit the claimant had rendered to the collateral. Departing from the ruling of four other circuits and its own prior panel ruling, the Eighth Circuit *en banc* holds that only the trustee has standing to surcharge a secured creditor collateral under section 506(c). *Hartford Underwriters Ins. Co. v. Magna Bank N.A. (In re Hen House Interstate, Inc.)*, 176 F.3d 719 (8th Cir. 1999).

6.1.xxxxxx. Landlord damages cap applies to claim against a guarantor. In a case of first impression, the Ninth Circuit rules that the landlord damages cap of section 502(b)(6) applies to the claim of the landlord against a debtor guarantor of the lease, even if the guarantor is solvent. *Arden v. Motel Partners (In re Arden)*, 176 F.3d 1226 (9th Cir. 1999).

6.1.yyyyyy. Employee damages cap does not apply to a claim against a guarantor. The individual debtor was held jointly liable in state court for breach of an employment agreement between the creditor and the debtor's wholly-owned corporation. The Fifth Circuit rules that the employee damages cap of section 502(b)(7) does not apply to limit the employee's claim in the bankruptcy case of the debtor, whom the court analogizes to a guarantor on these facts. *Hall v. Goforth (In re Goforth)*, 179 F.3d 390 (5th Cir. 1999).

6.1.zzzzzz. Senior lienor is entitled to interest from a junior lienor on wrongful payment of cash collateral. Despite the IRS's senior lien on the debtor's assets, cash collateral was paid to the junior bank lender, largely because the IRS was not given notice of the intention to pay the cash collateral to the bank. On the IRS's action against the bank and the debtor for payover of the wrongfully diverted cash collateral, the district court awarded the IRS principal and interest to the date of payment against the bank. The district court also holds that notice of the case was not adequate notice of the subsequent proceedings in which the court authorized the payment of the cash collateral to the bank. *United States v. National Westminster Bank USA (In re Q-C Circuits Corp.)*, 231 B.R. 506 (E.D.N.Y. 1999).

6.1.aaaaaaa. Property tax claim allowed to the full value of the debtor's property. A creditor secured by property subject to an ad valorem tax objected to the allowance of the tax under section 502(b)(3), which disallows a property tax "to the extent that . . . such claim exceeds the value of the interest of the estate in such property." The court holds that the phrase refers to the value of the entire property, not just the debtor's equity, and allows the tax claim. *In re Milit, Inc.*, 231 B.R. 604 (Bankr. W.D. Tx. 1999).

6.1.bbbbbbb. Proof of claim required in chapter 12. Even though the chapter 12 plan listed the creditor and the undisputed amount and provided for payment, the claim was disallowed because the creditor did not timely file a proof of claim. Reliance on the plan provision did not constitute excusable

neglect or meet any of the exceptions to timely filing a proof of claim under Bankruptcy Rule 3002(c). Thus, the confirmation of the plan was not *res judicata* on the allowance of the claim. *In re Greenig*, 152 F.3d 631 (7th Cir. 1998).

6.1.ccccccc. First claim purchaser's rights defeat second claim purchaser. Several trade creditors sold their claims to two different purchasers. The second purchaser purchased the claims and filed a notice of claims transfer with the bankruptcy court under Bankruptcy Rule 3001(e) before the first purchaser filed the notice. Nevertheless, the first purchaser's rights defeated the second purchaser. The claims register is not a notice system for recording interest in claims, and once the original creditors sold the claims to the first purchaser, they had nothing to transfer to the second purchaser. *In re The Celotex Corp.*, 224 B.R. 853 (Bankr. M.D. Fla. 1998).

6.1.ddddddd. Default rate interest allowed on reinstated claim. The plan proposed reinstatement of the oversecured creditor's claim but did not specifically refer to section 1124(2) or the cure and de-acceleration provided in that section. As a result, interest was allowed at the higher default rate. *Southland Corporation v. Toronto-Dominion (In re Southland Corporation)*, 160 F.3d 1054 (5th Cir. 1998).

6.1.eeeeeee. Deferred compensation claim is not subject to one-year cap on employment contract damages. The employee voluntary resigned three years before bankruptcy. Because the debtor refused to pay deferred compensation owing under the employee's contract, the employee sued and obtained a state court judgment for deferred compensation and attorney's fees. The claim was allowable in full. It did not come within the restrictions of section 502(b)(7), which restricts damages for termination of an employment contract, because the employee was not an "employee" at the time of the breach of contract. *Irvine-Pacific Commercial Ins. Brokers, Inc. v. Adams (In re Irvine-Pacific Commercial Ins. Brokers, Inc.)*, 228 B.R. 245 (9th Cir. B.A.P. 1998).

6.1.fffffff. Rents in excess of valuation amount remain subject to a mortgage. The debtor owed $13.4 million, secured by a mortgage. The bankruptcy court valued the property at $10.1 million for purposes of plan confirmation, but denied confirmation and granted relief from the stay. The creditor foreclosed, credit bidding $10.0 million. The Ninth Circuit rules that postpetition rents of $330,000 remain subject to the mortgage, despite the prior valuation, which would have suggested that the credit bid plus $100,000 would have satisfied the secured claim in full. A valuation becomes irrelevant when the purpose of the valuation no longer exists, and *Dewsnup v. Timm*, 502 U.S. 410 (1992) applies in Chapter 11, so that the mortgage could not be stripped down based on the valuation. *Gold Coast Asset Acquisition, L.P. v. 1441 Veterans Street Co. (In re 1441 Veterans Street Co.)*, 144 F.3d 1288 (9th Cir. 1998).

6.1.ggggggg. An administrative creditor may surcharge a lender's collateral under section 506(c). The prepetition lender agreed to postpetition financing, based on a budget that included payment of workers' compensation premiums. When the chapter 11 case failed, the insurance carrier sought to surcharge the collateral to pay unpaid premiums. Following its prior decision in *IRS v. Boatmen's First National Bank*, 5 F.3d 1157 (8th Cir. 1993), the Eighth Circuit recognizes the standing of an administrative claimant under section 506(c) to seek surcharge of collateral. However, two judges on the panel, though compelled to follow *Boatmen's*, dissented from the principle. As a result, the Eighth Circuit has granted rehearing *en banc*. *Hartford Underwriters Insurance Company v. Magna Bank N.A. (In re Henhouse Interstate, Inc.)*, 150 F.3d 868 (8th Cir. 1998).

6.1.hhhhhhh. A confirmed plan is not *res judicata* on the allowable amount of a claim. The amount owing on certain priority tax claims was listed as zero in the plan and the disclosure statement. The IRS did not object, but after confirmation sought to hold the debtor liable for the non-dischargeable taxes. The plan was not *res judicata* on the allowed amount of the claim. The debtor should have used section 505 to determine the amount of the tax claim. *IRS v. Taylor (In re Taylor)*, 132 F.3d 256 (5th Cir. 1998).

6.1.iiiiiii. Deemed allowed claim is *res judicata*. The secured creditor filed a proof of claim in the debtor's no asset chapter 7 case. The trustee did not object, so the claim was deemed allowed under section 502(a). In the debtor's post-bankruptcy action against the creditor, the deemed allowance of the claim was held *res judicata*, on the grounds that the debtor (not just the trustee) could have objected to the allowance of the claim in the bankruptcy case. *Siegel v. Federal Home Loan Mortgage Corp.*, 143 F.3d 525 (9th Cir. 1998).

6.1.jjjjjjj. Equipment should be valued "in location." The creditor had a valid lien on dry-cleaning equipment and the real property lease. In their chapter 13 plan, the debtors proposed a valuation based on separate sales of the equipment and the lease, not as a package. The Ninth Circuit reversed, holding that the value of the equipment and lease in place was the proper measure, relying on its decision in *Taffy v. United States (In re Taffy)*, 96 F.3d 1190 (9th Cir. 1996) (*en banc*) but without citation of *Associates Commercial Corp. v. Rash*, 117 S. Ct 1879 (1997). *Ardmore Vending Co. v. Kim (In re Kim)*, 130 F.3d 863 (9th Cir. 1997).

6.1.kkkkkkk. Oversecured creditor is not entitled to contract rate of interest after confirmation. In a chapter 13 case, interest on the oversecured creditor's claim runs at the contract rate until the date of confirmation of the plan. If the contract rate is higher than the current market rate, then the creditor is entitled to only the current market rate after confirmation, because to give the contract rate would allow the creditor to recover more than the present value of its claim. *Key Bank N.A. v. Milham (In re Milham)*, 141 F.3d 420 (2d Cir. 1998).

6.1.lllllll. A non-secured creditor may not be surcharged under section 506(c). A subcontractor of the debtor claimed entitlement to a portion of payments the debtor received under his contract with the project owner, under a state trust fund act that provides for such payments to be held in trust for the benefit of subcontractors and suppliers. The bankruptcy court upheld the trust fund claim, but surcharged the subcontractor under section 506(c) for the trustee's expenses in recovering the property. The Sixth Circuit reversed, holding section 506(c) "applies only to secured creditors (which [the subcontractor] was not) and their claims against property of the estate (which [the subcontractor's] money was not). *Architectural Building Components v. McClarty (In re Foremost Manufacturing Co.)*, 137 F.3d 919 (6th Cir. 1998).

6.1.mmmmmmm. A "make-whole" prepayment penalty is allowed. A prepayment penalty, characterized as a "make-whole" amount, was allowed, even though the debtor had a prepetition right to reduce the amount if the prepetition restructuring agreement had been carried out in full. The court concluded that the restructuring agreement was not an executory contract, that the filing of a bankruptcy was an enforceable event of default under the "make-whole" amount reduction provision, and that the resulting increase in the amount of the allowable claim that occurred primarily because of the filing of the petition should not be equitably subordinated. *Anchor Resolution Corp. v. State Street Bank and Trust Co. (In re Anchor Resolution Corp.)*, 221 B.R. 330 (Bankr. D. Del. 1998). But see *In re Public Serv. Co.*, 114 B.R. 813 (Bankr. D. N.H. 1990) (prepayment penalty disallowed where bondholders demanded that plan pay them in full).

6.1.nnnnnnn. The S.E.C. may be a creditor to enforce a disgorgement judgment. The individual debtor was ordered to pay disgorgement to a receiver for his corporation, which had defrauded investors. The S.E.C. holds a claim for the disgorgement amount and may bring dischargeability litigation against the debtor. *Securities Exchange Commission v. Cross (In re Cross)*, 218 B.R. 76 (9th Cir. B.A.P. 1998).

6.1.ooooooo. Seniority rights under a collective bargaining agreement are a "claim." By giving a broad reading to the word "claim" in the Bankruptcy Code, the Third Circuit holds that the right of pilots under a collective bargaining agreement to seniority integration upon the merger of Continental Airlines with Eastern Airlines can be satisfied by a monetary award and is therefore an allowable claim that is dischargeable in bankruptcy. *Air Line Pilots Association v. Continental Airlines (In re Continental Airlines)*, 125 F.3d 120 (3d Cir. 1997).

6.1.ppppppp. Bankruptcy Court may not interfere with claims transfer. General partners of the debtor unsuccessfully sought to purchase the debtor's partnership interest from the trustee. The creditors then purchased all of the unsecured claims at a deep discount and moved for dismissal of the case. The Eighth Circuit ruled that in the absence of an objection from the claim transferors, the bankruptcy court must recognize the claims transfer and has no authority to disallow or subordinate the purchased claims. *Viking Associates, L.L.C. v. Drewes (In re Olson)*, 120 F.3d 98 (8th Cir. 1997).

6.1.qqqqqqq. Interest rate swap upheld. The Bankruptcy Court allows termination damages under an interest-rate swap agreement between the bank and the debtor entered into at the same time as the loan from the bank to the debtor, finding that the termination damages, which are fixed at the date of filing of the petition, are not disallowable as unmatured interest under section 502(b)(2). The court also determines that the interest rate swap does not violate the California Bucket Shop laws. *In re Thrifty Oil Company*, 212 B.R. 147 (Bankr. S.D. Cal. 1997).

6.1.rrrrrrr. Replacement value standard adopted for plan purposes. The Supreme Court has ruled that the second sentence of section 506(a), which requires that value "be determined in light of the purpose of the valuation and of the proposed disposition or use of such property," requires that a replacement value standard be used in valuing property for purposes of determining the treatment of a secured claim under a chapter 13 plan (and presumably under any chapter 11 or chapter 12 plan). *Associates Commercial Corporation v. Rash*, 117 S. Ct. 1879 (1997).

6.1.sssssss. Chapter 12 plan may strip down a lien. In a case of first impression in the courts of appeals, the Eighth Circuit holds that a chapter 12 plan may provide for stripping down an undersecured creditor's lien to the value of the collateral. The court distinguishes *Dewsnup v. Timm*, 502 U.S. 410 (1992) as dealing only with section 506(d) in a chapter 7 case and *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993) as dealing only with the limitation on restructuring a home mortgage in a chapter 13 case. Because the language of chapter 12 is so similar to the comparable language of chapters 11 and 13, this ruling should allow strip down of liens under both of those chapters as well (other than home mortgages in chapter 13). *Harmon v. United States*, 101 F.3d 574 (8th Cir. 1996).

6.1.ttttttt. Creditor allowed fees for substantial contribution. The Fifth Circuit orders the award of fees and expenses for a substantial contribution, even though the creditor was acting only in its own self-interest, ruling "that a creditor's motive in taking actions that benefit the estate has little relevance whether the determination whether the creditor has [made] a substantial contribution to a case." Moreover, the creditor is not required to give advance notice before confirmation of the debtor's plan of its intent to seek substantial contribution fees and expenses. *Hall Financial Group, Inc. v. DP Partners Ltd. Partnership (In re DP Partners Ltd. Partnership)*, 106 F.3d 667 (5th Cir. 1997).

6.2 Priorities

6.2.a. Court subordinates LLC interest buy-back claim. The LLC member withdrew from the LLC under the LLC's operating agreement, which entitled her to payment of the appraised amount of her interest. After the LLC refused to pay, she obtained a judgment against the LLC for the amount owed. The LLC then filed bankruptcy. Section 510(b) subordinates a claim "for damages arising from the purchase or sale of" a security of the debtor. The non-limiting definition of "security" includes equity interests similar to LLC interests, so an LLC interest is a security. Section 510(b) does not contain any limitation on the nature of "damages" to which it applies; the term includes loss from breach of contract as well as from fraud or another tort. Similarly, courts construe "purchase or sale" in section 510(b) broadly to encompass the underlying principle that an equity investor takes the risks and rewards of an enterprise and should not be able to elevate an equity interest to a priority that competes with creditors who have only fixed claims. Here, the investor's claim was for purchase of her interests and so comes within section 510(b)'s mandatory subordination rule. *O'Donnell v. Tristar Esperanza Props., LLC (In re Tristar Esperanza Props., LLC)*, 488 B.R. 394 (9th Cir. B.A.P. 2013).

6.2.b. Stockholder claim to enforce settlement agreement arising from failure to hold a stockholder meeting is not subordinated. Stockholders sued the debtor for failure to hold a

stockholder meeting. The debtor settled by agreeing to pay all the stockholders' expenses and to direct 50% of certain receivables to the stockholders. Though the debtor made an initial payment, it did not make later payments. The stockholders sued to enforce the settlement agreement. While that action was pending, the debtor filed a chapter 11 case. During the bankruptcy, a trustee was appointed. The chapter 11 trustee negotiated a settlement with the stockholders to allow a claim as a general unsecured claim. Section 510(b) subordinates the claim of a stockholder "arising from the rescission of a purchase or sale of a security of the debtor …, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution … on account of such a claim". Courts have applied section 510(b) broadly to ensure that equity holders may not assert claims that are disguised attempts to recover equity interests, but there still must be some connection between the claim and a purchase or sale of stock. The section does not subordinate any stockholder claim that is merely connected with stock ownership. To apply section 510(b), courts look behind a judgment or a settlement agreement to determine the underlying nature of the claim. Here, the underlying claim relates to litigation over holding a stockholder meeting. The claim does not seek recovery on account of the stockholders' equity interests. Therefore, it is not subordinated. *Stucki v. Orwig*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 53139 (N.D. Tex. Apr. 12, 2013).

6.2.c. 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.d. 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.e. 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).

6.2.f. Wage priority applies only to wages earned before termination of employment. Four years before bankruptcy, the debtor fired an employee, who then sued. The employee obtained a jury verdict for back pay, front pay and emotional distress damages in an amount substantially in excess of the employee's annual salary. The debtor filed bankruptcy soon thereafter. The employee filed a proof of claim for the jury verdict amount, asserting the wage priority for a portion of the claim. Section 507(a)(4) gives

priority to "allowed unsecured claims … earned within 180 days before" bankruptcy. Salary can be earned only while the individual is employed, so any claim for salary is earned no later than the termination of the individual's employment. In this case, the debtor terminated the former employee several years before bankruptcy, so none of his claim was entitled to priority. *Belson v. Olson Rug Co.*, ___ B.R. ___, 2012 U.S. Dist. LEXIS 143885 (N.D. Ill. Oct. 1, 2012).

6.2.g. Unpaid sales taxes collected from customers are entitled to priority without time limit under section 507(a)(8)(C). The individual debtor operated a business in corporate form. The corporation failed to pay the state sales taxes that it had collected from customers. State law makes the principal liable for any such unpaid taxes, characterizing the taxes as being held in trust pending payment to the state. Section 507(a)(8)(C) grants priority to "a tax required to be collected or withheld and for which the debtor is liable in whatever capacity," without a time limitation. Section 507(a)(8)(E) grants priority to "an excise tax" on a transaction within three years before bankruptcy. Taxes entitled to priority under either subparagraph are nondischargeable in an individual debtor's case. The sales taxes here might qualify under either of the subparagraphs. Because it is unclear which subparagraph encompasses the taxes, resort to the legislative history is appropriate. But the legislative history is equally unclear. Therefore, the court may turn to policy considerations. Providing a debtor a fresh start and creditors a maximum distribution are two fundamental bankruptcy policies. However, the Code should not be interpreted to give a debtor an incentive to refuse to turn over state sales taxes once he knows he is in financial trouble. This latter policy weighs more heavily. In addition, the taxes are similar to trust fund taxes withheld from employees' paychecks. The taxes are funds in which the debtor never held an equitable interest. Therefore, the sales taxes should be treated under section 507(a)(8)(C) as "taxes collected or withheld" and are entitled to priority and are nondischargeable without time limit. The court does not consider the possibility that the two subparagraphs are not necessarily mutually exclusive and that the tax might qualify under both. *In re Calabrese*, 689 F.3d 312 (3d Cir. 2012).

6.2.h. Employees earn severance upon termination. The debtor implemented a severance pay plan for its employees which entitled them to a payment, based on length of service, upon termination of employment without cause. The debtor reserved the right to amend or terminate the plan at any time. Employees who were terminated within 180 days before the petition date filed a priority claim for their severance pay. Section 507(a)(4) grants priority to an individual's claim for "wages, salaries, or commissions, including vacation, severance, and sick leave pay" "earned within 180 days before the date of the filing of the petition". An individual earns pay when he becomes entitled to receive it. The severance pay here was earned upon termination, not over the course of the employees' employment, even though the measure was based on length of service. Otherwise, if the employee had earned the severance pay each week he worked for the debtor, the debtor could not have terminated the plan and divested the employee of the earnings. Therefore, the claims are entitled to priority under section 507(a)(4). The result may differ from a claim for severance pay after a postpetition termination, because section 503(a)(1), which governs payment of administrative expenses, uses different language to define which claims are entitled to priority. *Matson v. Alarcon*, 651 F.3d 404 (4th Cir. 2011).

6.2.i. *Reading v. Brown* does not apply in a non-operating chapter 7 case. The debtor installed and operated a system to collect and sell methane and other gases generated in a landfill. It filed a chapter 11 case and continued to operate the system for four years as a debtor in possession, after which a chapter 11 trustee was appointed. Two years later, the case converted to chapter 7, and a different chapter 7 trustee was appointed. The system did not function properly during the entire bankruptcy case, but it did not fail until four days after the chapter 7 trustee's appointment. When it failed, it released noxious odors into a hotel adjacent to the landfill. The hotel owner filed an administrative expense claim in the chapter 7 case for the loss of the hotel's value resulting from the incident. *Reading v. Brown*, 391 U.S. 471 (1968), gives administrative expense priority to the claim of a party who is injured by the operation of a business in chapter 11. *Reading*'s touchstone is the operation of the business, not the chapter in which the trustee operates, because tort expenses are part of the ordinary and necessary expenses of operation. Here, however, the chapter 7 trustee was not operating a business in any meaningful sense. He was not attempting to achieve improved recoveries for creditors by keeping the system functioning. He operated only for a short time and only under compulsion of *Midlantic Nat'l Bank v. N.J. Dep't of Enviro. Protection*, 474 U.S. 494 (1986), which prohibits a trustee from abandoning environmentally hazardous materials.

Therefore, the estate is not liable for the tort as an administrative expense. *In re Resource Tech. Corp.*, 662 F.3d 472 (7th Cir. 2011).

6.2.j. A claim for the amount owing under a note is not subject to subordination under section 510(b). The debtor issued notes that were exchangeable for an amount of cash based on the value of a reference security. The notes were contractually subordinated in right of payment to "senior indebtedness". Before bankruptcy, some holders exercised their exchange right, which would have entitled them to a cash payment substantially in advance of the notes' maturity. The debtor did not pay them in cash. Section 510(b) subordinates a claim "for damages arising from the purchase or sale of a security". The notes are "securities" under section 101(49), but the exchanging noteholders' claims are not claims for "damages". The claims are for payments on the notes. More generally, section 510(b) is designed to prevent disappointed creditors or equity holders from attempting to elevate their position in the capital structure by asserting a claim for damages rather than under the instrument under which they assert their claim or interest. The exchanging noteholders are not doing so here. They seek only payment of the amount owed on the notes at the priority level specified in the notes. Therefore, section 510(b) does not apply to their claims. *In re Tribune Co.*, ___ B.R. ___, 2011 WL 5142420 (Bankr. D. Del. Oct. 31, 2011).

6.2.k. A fraudulent transfer claim is not an asset of the debtor for purposes of applying a contractual subordination provision. The debtor issued notes that were contractually subordinated in right of payment to senior indebtedness "upon distribution of assets of the Company in the event of any … bankruptcy case". The chapter 11 plan established a litigation trust to pursue fraudulent transfer claims that the debtor in possession could assert. The Bankruptcy Code and applicable state law provide fraudulent transfer claims to the trustee and creditors, respectively, but not to the debtor, who may not pursue such claims. Therefore, any distribution from the litigation trust is not from "assets of the Company" and is not subject to the notes' subordination provision. *In re Tribune Co.*, ___ B.R. ___2011 WL 5142420 (Bankr. D. Del. Oct. 31, 2011).

6.2.l. Mortgage on after-acquired rents trumps a federal tax lien. The bank had a mortgage on the borrower's property and on all rents "derived or owned by the Mortgagor directly or indirectly from the Real Estate or Improvements". The borrower defaulted, and the bank obtained the appointment of a receiver for the property. The borrower also defaulted on his taxes, and the IRS filed a federal tax lien against the borrower. The receiver rented the property after the IRS filed the tax lien. Under Internal Revenue Code section 6323(h)(1), a federal tax lien is junior only to a lien or other interest if, when the interest is acquired, "the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation". Property is "in existence" if it is a source of value for repaying an obligation, such as proceeds. Thus, a federal tax lien does not take priority over a lender's security interest in proceeds that are generated after the tax lien is perfected. The rents generated by the real property are proceeds of the property, every bit as much as sale proceeds. The rents represent value derived from the property, not newly created property. Therefore, the tax lien is junior to the bank's lien on rents. Parenthetically, the court rejects using the concept of "choateness" as a measure of whether the property is in existence, both on linguistic and legal grounds. *Bloomfield State Bank v. U.S.*, 644 F. 3d 521 (7th Cir. 2011).

6.2.m. Electricity is a good for purposes of section 503(b)(9). Section 503(b)(9) gives administrative expense priority to a seller of goods that the debtor received within 20 days before bankruptcy. Electricity suppliers sought administrative expense priority. As used in section 503(b)(9), "goods" has the meaning assigned in the U.C.C., which is "things that are moveable at the time of identification to a contract for sale". Electricity is identified for sale when it is metered. It moves through the electric lines from the power source to the meter to the loan, however rapidly, and therefore meets the definition of "goods". Section 366, providing special protection to suppliers of "utility services" does not indicate a Congressional intent to treat electricity as goods. Therefore, the supplier's claim is entitled to priority. *GFI Wisc., Inc. v. Reedsburg Util. Comm'n*, 440 B.R. 791 (W.D. Wis. 2010).

6.2.n. Securities purchase rescission claims against the parent arising from the sale of a subsidiaries' securities are subordinated to the parent's general unsecured claims. Creditors asserted claims against the debtor parent for misrepresentation in the selling of a subsidiary's securities.

The parent had issued senior debt securities of its own and also had general unsecured claims. Section 510(b) requires subordination of claims arising from the purchase or sale of a security of the debtor or an affiliate of the debtor to all claims that are senior or equal to the claim represented by the security. At the parent level, the misrepresentation claim is a general unsecured claim, not a security claim and so is subordinated to all claims that are senior or equal to general unsecured claims. *In re Wash. Mut., Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011).

6.2.o. Reclaiming creditor must do more to preserve claim than give written reclamation notice. On the petition date, the court approved debtor in possession financing, which was secured by the debtor in possession's inventory and was used to repay prepetition financing that was secured by the debtor's inventory. A creditor gave the debtor in possession a written reclamation notice one day after the bankruptcy petition. Three days after the petition date, on the debtor in possession's motion seeking an orderly reclamation procedure and warning of the likely spate of litigation that might occur in its absence, the court ordered reclamation claimants to file demands no later than 20 days after the petition date. The order provided that it did not limit or expand other remedies or a claimant's rights. The debtor in possession's reorganization efforts failed, so two months later, with the court's approval on notice to creditors, it conducted going out of business sales. Section 546(c) makes the trustee's avoiding powers "subject to the right of a seller of goods … to reclaim such goods" if the seller makes timely written demand for reclamation. Section 546(c) is not self-executing. A reclaiming creditor must diligently assert its rights. Filing a written demand without more, such as seeking stay relief to reclaim goods, objecting to debtor in possession financing that liens the goods or to a going out of business sale that results in sale of the goods, is insufficient to preserve the reclaiming creditor's legal rights in the bankruptcy case. Therefore, the creditor lost its right to reclaim the goods or to an administrative expense for their use during the chapter 11 case. *Paramount Home Entertainments Inc. v. Circuit City Stores, Inc.*, 445 B.R. 521 (E.D. Va. 2010).

6.2.p. Severance pay is earned upon termination. The debtor maintained a severance plan that promised payment upon severance without cause equal to a specified number of weeks of salary based on number of completed years of service. The debtor terminated employees within 180 days before the petition date. The terminated employees asserted priority claims for their severance benefits. Section 507(a)(4) grants priority to "wages, salaries, or commissions, including vacation, severance, or sick leave pay, earned by an individual" within 180 days before bankruptcy. This provision differs in its application to severance pay from section 503(b)(1)'s application to severance pay owing for postpetition termination, because section 503(b)(1) grants administrative expense priority to wages for "services rendered" to the estate, regardless of when the wages were earned. Severance pay is neither earned nor accrued on a daily basis: if an employee quits, the employer owes no severance pay, and an employee who works for most but not all of an additional year does not become entitled to additional severance, but an employee who may have worked only a few additional days becomes entitled to the additional amount. In addition, severance is to compensate for the dislocation resulting from termination of employment, not for work performed. Therefore, severance pay is earned for purposes of section 507(a)(4) upon termination, and the employee's claims are entitled to priority if termination occurred within 180 days before bankruptcy. *In re LandAmerica Fin. Group*, 435 B.R. 343 (Bankr. E.D. Va. 2010).

6.2.q. 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.r. 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.s. 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.t. 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).

6.2.u. Electricity is "goods". The supplier supplied electricity to the debtor within 20 days before bankruptcy. Section 503(b)(9) grants administrative priority to claims for "the value of any goods received by the debtor within 20 days before" bankruptcy. The priority applies only to "goods received". Services are not covered. Therefore, the U.C.C.'s "predominant factor" test in determining whether something is "goods" has no place in the Code, which grants priority only to the value of goods. The Code does not define "goods". However, courts must apply the common meaning of a term that Congress uses that has acquired a common meaning. The widespread adoption of Article 2 of U.C.C., which deals with "goods", provides a source for defining the term. As section 503(b)(9) is a federal statute, the definition must be uniform. Therefore, the court should look to the model U.C.C., independent of any state variations. The U.C.C. defines "goods" as "all things … which are movable at the time of identification to the contract for sale …". Electricity is movable; it is transmitted over wires. It is identified to the contract and sold when it passes through the meter, which precedes, if only by an imperceptible amount of time, its use and consumption. Therefore, it is movable (and moving) when it is identified to the contract and qualifies as goods. *In re Erving Inds., Inc.*, 432 B.R. 354 (Bankr. D. Mass. 2010).

6.2.v. Subordinated creditor's examiner motion is an act to collect that is barred by its subordination agreement. A subordinated creditor of two of sixteen chapter 11 debtors objected to the debtors' proposed allocation of proceeds from the sale of all debtors' consolidated assets and moved for the appointment of an examiner to investigate an appropriate allocation. Under its subordination agreement, the creditor agreed not to "exercise any rights or remedies or take any action or proceeding to collect or enforce any of" its claims before the senior creditor was paid in full, without the senior creditor's consent, and waived any legal or equitable principles or provisions that might be in conflict with the subordination agreement. Section 510(a) requires the court to enforce a subordination agreement. The examiner motion is tantamount to an effort by the creditor to collect its subordinated claim. Therefore, the creditor does not have standing to move for an examiner. An examiner is mandatory only when requested by a party in interest and so is not required in this case. *In re Erickson Retirement Communities, LLC*, 425 B.R. 308 (Bankr. N.D. Tex. 2010).

6.2.w. Court defines "goods" for purposes of section 503(b)(9). Various suppliers asserted claims for administrative expense priority under section 503(b)(9), which gives priority to a claim for "the value of any goods received by the debtor within 20 days before" bankruptcy, if the goods were sold to the debtor in the ordinary course of business. The Code does not define "goods". First, the definition is a federal question, because the priority implements a federal policy without reference to state law. The U.C.C. may provide guidance on the definition of "goods", but only the "model" version, not individual state variations. The U.C.C. definition requires that goods be movable at the time of identification, and it includes minerals, including oil and gas, within its definition of goods. Second, priorities are narrowly construed. Therefore, the scope of "goods" should be narrowly construed. Third, the Code does not grant priority for services, nor for a claim under a contract that provides for delivery of goods and services. Therefore, the U.C.C.'s "predominant factor" test is not relevant; a supplier is entitled to priority only for the goods the debtor receives. Finally, "value", also not defined, should be determined as the amount the debtor would have to pay to acquire similar goods, consistent with the concept in both section 506(a) and in allowing an administrative claim for postpetition goods or services under a rejected contract or lease. Based on this interpretation, "electricity" is not a good. It cannot be identified until it is used, and it cannot be packaged or handled. By contrast, natural gas is a good. The U.C.C. specifies it as such. Trucking services and the city's sewer and waste removal services do not qualify, but the water the city supplied is a "good". The suppliers have the burden of proving value. *In re Pilgrim's Pride Corp.*, 421 B.R. 331 (Bankr. N.D. Tex. 2009).

6.2.x. Section 510(a) applies only to fixed subordination agreements. The U.S. debtor entered into a credit default swap with a synthetic collateralized debt obligation SPV (CDO), which issued notes. The notes' proceeds were held as collateral for the CDO's obligations under both the notes and the swap. The security agreement, which was governed by English law, provided that the security interest of the debtor, as swap counterparty, had priority over the security interest of the noteholders, unless the debtor defaulted under the swap and amounts become payable after sale of the collateral. After the debtor filed bankruptcy, the collateral trustee issued a notice of default and terminated the swap. Section 510(a) requires the bankruptcy court to enforce a contractual subordination agreement. However, it applies only to such agreements that establish "priorities that are permanently fixed without regard to the unenforceable future contingency of a bankruptcy filing". Therefore, it does not apply to protect the noteholders here. *Lehman Bros. Special Financing Inc. v. BNY Corp. Trustee Servs. Ltd. (In re Lehman Bros. Holdings Inc.)*, 422 B.R. 407 (Bankr. S.D.N.Y. 2010).

6.2.y. Debtor's payment to supplier within 20 days before petition date does not affect supplier's 20-day administrative expense claim 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 and filed its chapter 11 petition on July 27. 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 supplier asserted administrative expense priority for its $302,512 claim. Section 503(b)(9) provides "there shall be allowed administrative expenses, … including … the value of any goods received by the debtor within 20 days before" the petition date. In enacting section 503(b)(9), Congress intended to insure that certain ordinary course sellers receive priority over most other creditors. The provision does not restrict its application in any way, such as based on whether the supplier's claim is secured, nor does it give the court authority to apply equitable considerations in allowing the claim as an administrative expense. Therefore, the court may not net the payments the supplier received in the 20-day prepetition period against the supplier's administrative expense claim for the value of the goods the debtor received in that period. *Southern Polymer, Inc. v. TI Acq., LLC (In re TI Acq., LLC)*, 410 B.R. 742 (Bankr. N.D. Ga. 2009).

6.2.z. Uniform Commercial Code definition of "goods" and predominant purpose test govern 20-day administrative expense claims. Section 503(b)(9) grants administrative expense priority for a claim for "the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business." The Bankruptcy Code does not define "goods". In such circumstances, the courts ordinarily should look to a word's well-known meaning in the law generally and, in bankruptcy cases, should look to state law to define undefined terms. However, suppliers sold the debtor goods in 48 states in this case, and resorting to the law of 48 states would cause disparate results. Therefore, a federal rule should apply. A federal interpretation may rely on general state law to fill definitional gaps. The Uniform Commercial Code provides the rule of decision in at least 49 states and has come to provide the generally accepted definition of "goods". In addition, Congress adopted section 503(b)(9) as part of its revision of reclamation law in bankruptcy. Before the amendment, the reclamation provision relied on the U.C.C. definition of "goods", so Congress may be presumed to have intended that definition. Therefore, the court adopts the U.C.C. definition as the federal rule of decision for the scope of section 503(b)(9). The U.C.C. determines whether a contract is for the sale of goods or of services by the "predominant purpose" test. Although the statute grants priority for a claim arising from the sale of "any goods", it also requires that the sale be "to the debtor in the ordinary course of such debtor's business". That formulation requires that goods have been sold to the debtor. The U.C.C. determines whether goods have been sold by the predominant purpose test. Therefore, that test should apply in determining whether a qualifying sale of goods to the debtor has occurred. *In re Circuit City Stores, Inc.*, 416 B.R. 531 (Bankr. E.D. Va. 2009).

6.2.aa. "Value" of goods received within 20 days prepetition is generally the invoice or purchase price. Section 503(b)(9) grants administrative expense priority for a claim for "the value of any goods received by the debtor within 20 days before" the petition date. The goods' invoice or purchase price is presumptively the best value determinant, though the presumption may be rebutted by evidence to the contrary. The Bankruptcy Code does not define "goods". All but one state has adopted Article 2 of the Uniform Commercial Code. Adoption of its definition of goods is consistent with commercial expectation. "Goods" in section 503(b)(9) is therefore defined by reference to the U.C.C. *In re SemCrude, L.P.*, 416 B.R. 299 (Bankr. D. Del. 2009).

6.2.bb. Court subordinates limited partnership rescission judgment that was based on post-issuance conduct. Two groups formed the debtor limited partnership. One contributed expertise and contacts; the other contributed assets and cash. Dispute quickly arose, and the groups agreed to rescind the agreement. The debtor defaulted on the rescission agreement, resulting in a judgment in favor of the capital-contributing partner for return of the assets, which was accomplished, and for payment of an amount based on the contributed cash. The debtor soon filed bankruptcy and sought subordination of the limited partner's judgment claim. Section 510(b) requires subordination of "a claim arising from rescission of a purchase or sale of a security of the debtor [or] damages arising from the purchase or sale of such a security". Under section 101(49)(A)(xiii), a limited partnership interest is a "security". "Rescission" in section 510(b) includes not only rescission under a judgment but also an agreement to rescind. Section 510(b) includes damage claims resulting from post-issuance conduct, such as a breach of contract, as long as the claim is "arising from", that is, has some nexus or causal relationship with, the securities purchase or sale. Subordination is based on the investor's having bargained for equity return and risk and creditors' presumable reliance on the equity investment. Such factors do not apply differently if the debtor's misconduct occurs after issuance rather than before. Finally, whether the creditor has obtained a judgment does not affect subordination, and the court may look through a judgment to determine if it was based on rescission of the purchase or sale of a security. Therefore, the court subordinates the creditor's claim here. *SaaQuest Diving, LP v. S&J Diving, Inc.*, 579 F.3d 411 (5th Cir. 2009).

6.2.cc. Workers' compensation fund claim is not entitled to excise tax priority. After bankruptcy, the debtor in possession failed to maintain its self-insured workers' compensation insurance. The state workers' compensation insurance fund drew on the letter of credit the debtor had posted to secure its obligations to the fund and asserted a priority excise tax claim against the estate for the balance owed. A claim qualifies as an excise tax only if it is an involuntary pecuniary burden, imposed or authorized by legislation for a public purpose, such as defraying governmental expenses, under the state's police or taxing power and only if a private creditor similarly situated to the state cannot be hypothesized under the relevant statute. The last requirement carries out the Bankruptcy Code's equal distribution policy by preventing the state from having an advantage over similarly situated creditors. The parties did not dispute

the applicability of any except the last test. Here, the letter of credit issuer as well as the injured worker could have a claim against the debtor of the same kind as the workers' compensation fund, unlike under other state workers' compensation schemes, under which only the fund may assert such claims. Therefore, the claim is not an excise tax entitled to priority. *Calif. Self-Insurers' Sec. Fund v. Lorber Indus. of Calif. (In re Lorber Indus. of Calif.)*, 564 F.3d 1098 (9th Cir. 2009).

6.2.dd. Retiree health care claims are not entitled to priority under section 507(a)(5). A third party plan administrator administered the debtor's health care coverage for the debtor's employees and retirees. The administrator paid the employees' and retirees' claims, and the debtor was required to reimburse the administrator. The debtor filed bankruptcy owing substantial sums to the administrator. Section 507(a)(5) grants priority to "claims for contributions to an employee benefit plan … arising from services rendered within 180 days before the date of the petition". The priority amount cap is based on the number of employees covered by the plan times the employee wage priority under section 507(a)(4) minus the aggregate amount paid to employees under the wage priority. Health care coverage is an employee benefit plan. Because the benefits priority and the wage priority are tied to each other, they should be construed together to determine the scope of the benefit priority's coverage. The wage priority applies only to payments to employees for services rendered within the 180 days before bankruptcy. The benefit priority should be construed in parallel, so the "services rendered within 180 days before" bankruptcy are only services of active employees during that period, not the services of retirees or of the health care plan administrator. However, the plan administrator's claim is entitled to priority to the extent it is for payment of health care expenses of covered employees. For the same reason, the cap amount is determined by the number of employees who rendered services during the 180-day period, whether or not they were employed at the petition date. The benefits priority cap amount is an aggregate amount, not a per employee cap, because the benefits priority provision does not include the phrase "for each individual" in referring to the cap amount. *Consol. Freightways Corp. v. Aetna, Inc. (In re Consol. Freightways Corp.)*, 564 F.3d 1161 (9th Cir. 2009).

6.2.ee. WARN Act claims for prepetition termination are not entitled to administrative expense priority. The debtor terminated employees five days before bankruptcy without providing WARN Act's 60-day notice. The employees asserted WARN Act damages for 60 days' pay, which would have run 55 days into the postpetition period. Section 503(b)(1)(A) grants administrative expense priority to "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 and benefits awarded pursuant to a judicial proceeding … as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered". The introductory phrase, "actual, necessary costs and expenses of preserving the estate", limits the language of clause (ii). WARN claims based on prepetition termination are not necessary to maintain the debtor as a going concern or to preserve the estate. In addition, allowing such claims would magnify the amount of wages entitled to priority and possibly cripple any attempt at reorganization. Therefore, the claims are not entitled to administrative expense priority. *Binford v. First Magnus Fin. Corp. (In re First Magnus Fin. Corp.)*, 403 B.R. 659 (D. Ariz. 2008).

6.2.ff. WARN Act claims for prepetition termination are not entitled to administrative expense priority. The debtor terminated most of its employees before bankruptcy. After bankruptcy, a terminated employee brought a class action adversary proceeding against the debtor for allowance as administrative claims of the WARN Act claims arising from the termination, or at least the portion that would have been attributable to the employees' postpetition services had they not been terminated. Administrative expenses include only the costs and expenses of services rendered to the estate to preserve the estate. Because the claims here arose prepetition and did not provide any benefit to the estate, they are not entitled to administrative expense priority. In addition, the claimant's counsel's attorney's fees, which the WARN Act authorizes, are also not entitled to administrative expense priority. *Bridges v. Continentalafa Disp. Co. (In re Continentalafa Disp. Co.)*, 403 B.R. 653 (Bankr. E.D. Mo. 2009).

6.2.gg. Employee fringe benefit priority is based only on employee, not provider, services. The debtor self-funded its health insurance for its employees and retirees. Aetna administered the program, paying claims and seeking reimbursement from the debtor. When the debtor filed bankruptcy, it owed both

employees and retirees for unpaid claims and Aetna for unpaid reimbursement. Section 507(a)(4) grants priority to up to $10,950 per individual of wages and salaries earned within 180 days before bankruptcy. Section 507(a)(5) grants priority to "unsecured claims for contributions to an employee benefit plan—(A) arising from services rendered within 180 days before [bankruptcy]; but only (B) for each such plan, to the extent of—(i) the number of employees covered by each such plan multiplied by [$10,950]; less (ii) the aggregate amount paid to such employees under paragraph (4) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan". The linkage between the two provisions makes clear that paragraph (5) should be read to refer to the same people as paragraph (4)—employees who earned wages within 180 days before bankruptcy—not to individuals who were retirees during the whole period, and that the "services rendered" are those of the employees, not those of the benefit plan provider. Finally, the priority limit is calculated on an aggregate basis, not a per employee basis, because paragraph (5) refers to the "aggregate", unlike paragraph (4)'s reference to "per individual". *Consol Freightways Corp. of Del. v. Aetna, Inc. (In re Consol. Freightways Corp. of Del.)*, 564 F.3d 1161 (9th Cir. 2009).

6.2.hh. A non-statutory insider's claim may be equitably subordinated under a "rigorous scrutiny" standard. The debtor and the supplier entered into a strategic partnership agreement, under which the supplier would become the debtor's exclusive telecommunications equipment and software supplier and would provide the debtor with substantial financing to make purchases from the supplier. The financing agreement permitted the supplier to call its loan if the debtor's capital expenditures or the loan balance exceeded specified amounts and required, among other things, that the debtor use any increase in its bank facility to pay down the supplier's credit line. The supplier used the debtor "as a mere instrumentality to inflate [the supplier's] own revenues …. [w]hat began as a 'strategic partnership' … degenerated into a relationship in which the much larger company bullied and threatened the smaller into taking actions that were designed to benefit the larger at the expense of the smaller … to prop up its own revenue … in the form of purchases … of unneeded equipment". The supplier used its position as lender to ensure the debtor's cooperation by repeated threats to stop the funding. The Bankruptcy Code defines "insider" to include an officer, director and "person in control of the debtor", but the definition is open-ended. A person not listed in the definition of "insider" may be a non-statutory insider. The statutory term "person in control" requires actual control. However, actual control is not necessary to qualify as a non-statutory insider. Otherwise, "person in control" would virtually eliminate the concept of nonstatutory insider. Rather, a nonstatutory insider includes anyone not dealing at arms' length with the debtor, such that its conduct should be subject to closer scrutiny. In this case, the supplier's ability to coerce the debtor into unnecessary and disadvantageous transactions showed that the parties were not dealing at arms' length, making the supplier a nonstatutory insider, even though the supplier had the right under its credit agreement to call its credit line or require payment of the bank loan increase to itself. The court may equitably subordinate a claim if the creditor engaged in inequitable conduct that injured creditors or conferred an unfair advantage on the creditor and if subordination is not inconsistent with the Bankruptcy Code. Subordination of a non-insider's claim requires more egregious conduct, but an insider's conduct is rigorously scrutinized. Here, the supplier was an insider, and its conduct was sufficiently egregious to constitute inequitable conduct. The conduct harmed creditors because it forced the debtor into increased and unnecessary equipment purchases that provided no value to creditors, resulting in increased interest expense that further depleted the estate, and it induced lenders to increase the bank loan. Therefore, the court equitably subordinates the claim, but only to the claims of other creditors, not to equity interests, because subordination to equity would be inconsistent with the Bankruptcy Code. *Schubert v. Lucent Techs. Inc. (In re Winstar Comm'ns, Inc.)*, 554 F.3d 382 (3d Cir. 2009).

6.2.ii. Court equitably subordinates claim of bank that was overly aggressive in selling an unnecessary loan to the debtor. The debtor was a luxury resort development that was initially almost debt free. The bank approached the debtor with a new "financial product" that would allow the debtor to borrow $375 million and loan or dividend $209 million to shareholders. The bank would get a fee for making the loan and would syndicate the loan. The bank conducted legal due diligence but very limited financial due diligence, relying only on projections. Complete financial due diligence would have revealed that the debtor was missing projections substantially in the year of the loan and had negative cash flow for several earlier years. The bank also developed a new appraisal method that would support the loan size when traditional appraisal methods would not. After the loan was made, the debtor made a demand loan

to the controlling shareholder $209 million without documentation other than a journal entry. The shareholder took the distribution as a loan in part because taking a dividend would have resulted in negative equity accounts and would have required sharing the proceeds with other shareholders. The bank knew of these facts when the loan was made. The debtor then fell behind in its accounts payable but did not demand any funds from its shareholder to cover expenses, selling assets at a discount to cover cash flow shortages. The court may equitably subordinate a claim if the creditor engaged in inequitable conduct that injured other creditors or conferred an unfair advantage on the creditor and if subordination is not inconsistent with the Bankruptcy Code. A showing of gross and egregious conduct is required to subordinate a non-insider's claim. Because the bank earned fees for selling the loan and earned higher fees the larger the loan, and because the developers could take profits out in advance, the bank encouraged developers to take unnecessary loans, and the bank and the developer benefited from the loan, though the other creditors bore the risk of loss. The bank could not have believed that the debtor could service the loan. The bank's "naked greed" for fees and "complete disregard" for the debtor and others who were subordinated to the bank's first lien position shocks the court's conscience and meets the first standard for equitable subordination. The debtor's failure satisfies the second standard. But the court subordinates the loan only to unsecured claims, not to membership interests, because doing so would be inconsistent with the Bankruptcy Code. *Credit Suisse v. Official Committee of Unsecured Creditors (In re Yellowstone Mtn. Club, LLC)*, Adv. Proc. 09-00014 (Bankr. D. Mont. May 12, 2009) (matter settled; op. vacated, June 29, 2009).

6.2.jj. Postpetition well plugging expense is entitled to administrative expense priority. The debtor stopped operating several oil wells several years before bankruptcy. State law requires an owner to plug a well that has not been operated for over a year. After bankruptcy, the state commission plugged the wells and sought reimbursement of the cost as an administrative expense. Section 503(b)(1) allows administrative expense priority to actual and necessary costs and expenses of administering the estate. The activity for which the claimant seeks priority must benefit the estate. "Benefit" is an element of "actual and necessary". *Midlantic Nat'l Bank v. N.J. Dept. of Envtl. Prot.*, 474 U.S. 494, 507 (1986), held that an estate must comply with state law "that is reasonably designed to protect the public health or safety from identified hazards". 28 U.S.C. § 959(b) requires the trustee to comply with applicable state law. The estate is therefore subject to the obligation to plug the wells, even though the plugging obligation arose prepetition. Because the state commission undertook to fulfill the estate's postpetition obligation, its right to reimbursement for fulfilling the obligation is entitled to administrative expense priority. *In re Am. Coastal Energy, Inc.*, 399 B.R. 805 (Bankr. S.D. Tex. 2009).

6.2.kk. Court may bifurcate claim for goods and services to grant administrative expense priority under section 503(b)(9). Section 503(b)(9) grants administrative expense priority to a claim for "the value of any goods received by the debtor within 20 days before" bankruptcy. Here, the claimants provided a mix of goods and services to the debtor. One claimant plowed snow from the debtor's plants and salted and sanded the areas from which snow had been plowed. Another took scrap plastic from the debtor and processed it into plastic pellets that it resold to the debtor. Another repaired electric machines for the debtor, providing both parts and labor to the repair. Section 503(b)(9) applies by its terms only to goods received by the debtor, not to services. Because the Bankruptcy Code does not define "goods", the court may use the UCC's definition of "goods" in section 2–105. Although the UCC may require categorization of a transaction for some purposes as one involving goods or services, section 503(b)(9) does not appear to require categorization of a transaction giving rise to a claim as a whole as one for the sale of goods for the resulting claim to qualify for administrative expense priority. Therefore, the court may dissect any transaction that might qualify for administrative expense priority into its constituent parts of goods and services. Finally, the goods need not be subject to reclamation under U.C.C. section 2–702 or Bankruptcy Code section 546(c) to qualify for administrative expense treatment under section 503(b)(9), as the latter section contains no such requirement. Applying these principles, the portion of the snowplower's claim for salt and sand, the entire claim for plastic pellets and the portion of the repair company's claim for parts are entitled to administrative expense priority. *In re Plastech Eng'd Prods., Inc.*, 397 B.R. 828 (Bankr. E.D. Mich. 2008).

6.2.ll. Equitable subordination requires injury to other creditors. A bank held a $900,000 claim secured by several real estate parcels owned by two individual debtors. The debtors' bankruptcy trustee

unsuccessfully attempted to negotiate a deal with the bank to reduce its claim substantially in exchange for allowing the bank to foreclose. The two individual debtors secretly formed a corporation which separately negotiated with the bank and purchased the claim for $16,500. The bankruptcy court found misconduct in the debtors' failure to disclose their interest in the corporation and to file a claim transfer statement under Rule 3001 and equitably subordinated the secured claim to all unsecured claims. Section 510(c) permits equitable subordination where the creditor has been guilty or misconduct resulting in injury to other creditors and subordination is not inconsistent with the Bankruptcy Code. Equitable subordination is remedial, not punitive, and may be applied only to the extent necessary to redress the injury that the misconduct caused. It is unclear whether the debtors engaged in misconduct here, as claims trading is entirely permissible, but their efforts at secrecy suggest they thought they were doing something wrong. Still, their conduct did not injure other creditors. If they had not purchased the claim, the unsecured creditors' recoveries still would have been subject to satisfaction of the secured claim. The only creditor that might have been injured was the bank, which willingly sold its claim and was not complaining. Therefore, subordination is improper. *In re Kreisler*, 546 F.3d 863 (7th Cir. 2008).

6.2.mm. Reclaiming inventory vendor takes priority over secured creditor. An inventory vendor sold goods to the debtor shortly before bankruptcy and demanded reclamation promptly after bankruptcy. The debtor in possession proposed that each vendor be granted an administrative expense priority claim "in the amount (if any) of its allowed reclamation claim". Promptly after the filing of the case, the debtor in possession obtained postpetition DIP financing, secured by all inventory, that was used to pay off an existing secured loan that was also secured by inventory. Later in the case, the debtor in possession liquidated, and all inventory was sold, with the proceeds used to pay the DIP lender. The vendor asserted an administrative expense claim. The debtor in possession objected on the ground that the vendor did not have a valid reclamation right. A vendor's reclamation right is subject to "the rights of a … good faith purchaser or lien creditor". U.C.C. § 2-702's reclamation theory is that the vendor has been defrauded by an insolvent buyer. Under that theory, the defrauded vendor's rights are superior to those of the buyer to use the goods to pay other creditors. Therefore, the secured creditor's inventory lien did not defeat the vendor's reclamation right, and the vendor's priority claim should be allowed. *Phar-Mor, Inv. v. McKesson Corp.*, 534 F.3d 502 (6th Cir. 2008).

6.2.nn. WARN Act claims for prepetition termination are not entitled to administrative expense priority. The debtor terminated employees immediately before bankruptcy, on the date of the filing of the petition, without providing WARN Act's 60-day notice. The employees asserted WARN Act damages for 60 days' pay. Section 503(b)(1)(A) grants administrative expense priority to "the actual, necessary costs and expenses of preserving the estate, including … wages and benefits awarded pursuant to a judicial proceeding … as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered". The WARN Act claims' priority is based on the period to which the wages are "attributable", that is, when they accrue and vest. WARN's purpose is "to provide a form of statutory severance pay". Severance pay that is pay in lieu of notice (rather than pay at termination based on length of service) vests at the time of termination. WARN Act claims vest at time of termination and are unrelated to length of service. As such, they vest at termination. Because termination here was before the commencement of the case, the claims are prepetition claims and not entitled to administrative expense priority. *Henderson v. Powermate Holding Corp. (In re Powermate Holding Corp.)*, 394 B.R. 765 (Bankr. D. Del. 2008).

6.2.oo. Multi-employer pension plan's withdrawal liability claim for postpetition plan withdrawal is not entitled to administrative expense priority. The debtor was a participant in a multi-employer plan that was underfunded as of the petition date. The debtor in possession ceased operations and thereby withdrew from the plan two years after the petition date, which resulted in the imposition of withdrawal liability calculated as the withdrawing employer's portion of the plan underfunding as of the withdrawal date. The Sixth Circuit has previously held that a withdrawal liability claim arises upon withdrawal. *CPT Holdings, Inc. v. Local 73*, 162 F.3d 405 (6th Cir. 1998). However, a claim is not entitled to administrative expense priority simply because it arises postpetition. Priority entitlement requires that the claim arise from a transaction with the estate and that directly and substantially benefits the estate. The withdrawal liability amount depends heavily on external factors, including the plan portfolio's investment returns and the applicable discount rate, none of which bear any relation to the services employees render to benefit the estate. Moreover, withdrawal liability accrues only upon withdrawal, not as employees perform services.

Therefore, the withdrawal liability claim does not meet the test for administrative expense priority. *Reading Co. v. Brown*, 391 U.S. 471 (1968), grants administrative priority to an expense that does not directly benefit the estate if the claim arises from the estate's postpetition operation. However, *Reading* applies only to claims arising from torts or intentional misconduct. Therefore, it does not require administrative priority for the withdrawal liability claim. *United Mine Workers of Am. 1974 Plan and Trust v. Lexington Coal Co. (In re HNRC Dissolution Co.), 396 B.R. 461 (6th Cir. B.A.P. 2008).*

6.2.pp. Section 510(b) subordinates note purchase agreement termination fee. The debtor entered into a letter of intent with a lender, which contemplated an agreement under which the lender would purchase senior subordinated secured notes from the debtor. The letter of intent entitled the lender to a fee as liquidated damages if the debtor terminated the letter of intent. Before the debtor and the lender entered into the note purchase agreement, creditors filed an involuntary petition against the debtor. The creditor filed a claim for the fee. Section 510(b) requires that "a claim … for damages arising from the purchase or sale" of a security of the debtor "be subordinated to all claims or interests that are senior to or equal to the claim or interest represented by such security …". Courts have construed section 510(b) and the phrase "arising from" broadly to encompass transactions that have a causal link to a purchase of securities. The Bankruptcy Code includes "note" in the definition of security. Therefore, the fee claim under the letter of intent is a claim for damages arising from the purchase of a security of the debtor, even though the purchase never occurred. Although only secured claims are senior or equal to the claim that would have been represented by the note, the court subordinates the claim to the level of general unsecured claims, rather than to a level between secured and general unsecured claims. *In re Patriot Aviation Servs., Inc.*, 396 B.R. 780 (Bankr. S.D. Fla. 2008).

6.2.qq. Equitable subordination requires actual harm to creditors. The debtor experienced severe cash flow problems. After other financing options fell through, the largest shareholders, who were also officers, directors and guarantors of a portion of the existing debt, made a new loan, secured by the franchisee royalty streams, intellectual property rights and other intangible property. When severe cash flow problems persisted, the debtor sought a loan from a bank, who declined, but agreed to lend to the shareholders so they could lend to the debtor. The shareholders agreed, if the loan were secured by the same collateral that secured the first loan and if their prior guarantee reimbursement claims were similarly secured. The board discussed the new financing need, the bank formally approved the loan 10 days later, and two days later the board was given one day's notice of a special telephonic meeting. Management informed the board at the meeting that without additional funds, the debtor could not meet payroll and would default on a secured loan. The independent audit committee and all non-interested directors approved the transaction, which was disclosed in SEC filings. The debtor used the loan proceeds to pay unsecured creditors and keep the company in operation. The debtor filed chapter 11 nine months later. The creditors' committee sought equitable subordination of the shareholders' secured claims and quantified damages based in part on a theory of deepening insolvency. The bankruptcy court found that the shareholders, as fiduciaries, engaged in inequitable conduct in the second transaction, based largely on the hurried, eleventh hour manner in which they sought board approval, and their conduct conferred an unfair advantage on them, and that by securing the loan with the debtor's "crown jewel" asset, the shareholders "grabbed for as much as they could get[,] and they got it all." Finally, the bankruptcy court found that taking collateral for the pre-existing guarantees in connection with the second loan also resulted in "unfair advantage". The court, however, did not find that any of the actions resulted in actual harm to creditors nor that the debtor's insolvency had deepened. Equitable subordination requires the claimant to have engaged in inequitable conduct that resulted in injury to the creditors or conferred an unfair advantage on the claimant. Because equitable subordination is remedial, not penal, a "claim should be subordinated only to the extent necessary to offset the harm which the debtor or its creditors have suffered as a result of the inequitable conduct." The court found that creditors were not harmed, because the proceeds of the second loan were used to pay unsecured creditors and to fund the debtor's continued operations. Although some unsecured creditors were unpaid while others were paid, unsecured creditors as a whole did not suffer harm. In addition, creditors did not suffer harm from the shareholders' taking collateral to secure their prior personal guarantee reimbursement claims because no reimbursement claims ever arose. Although the court did not reach the viability of "deepening insolvency" as a theory of damages, it agreed with the increasing number of courts that have criticized and rejected the theory. *Wooley v. Faulkner (In re SI Restructuring, Inc.)*, 532 F.3d 355 (5th Cir. 2008).

6.2.rr. WARN Act claims for prepetition termination are not entitled to administrative expense priority. The debtor terminated employees five days before bankruptcy without providing WARN Act's 60-day notice. The employees asserted WARN Act damages for 60 days' pay, which would have run 55 days into the postpetition period. Section 503(b)(1)(A) grants administrative expense priority to "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 and benefits awarded pursuant to a judicial proceeding … as back pay attributable to any period of time occurring after commencement of the case under this title, as a result of a violation of Federal or State law by the debtor, without regard to the time of the occurrence of unlawful conduct on which such award is based or to whether any services were rendered". Priorities must be clearly stated, and Congress is presumed not to write on a clean slate to change settled interpretations of the bankruptcy law. WARN Act claims based on prepetition termination are not "actual, necessary costs and expenses of preserving the estate". In addition, because clauses (i) and (ii) of section 503(b)(1)(A) are joined by "and", even though they are in an "including" list, both requirements must be met. The claims here did not meet clause (i)'s requirement that they be for "services rendered after the commencement of the case". Though the WARN Act claim is calculated based on 60 days' wages, this mathematical formula does not make the wages for postpetition services. *In re First Magnus Fin. Corp.*, 390 B.R. 667 (Bankr. D. Ariz. 2008).

6.2.ss. Section 510(b) subordinates an employment agreement stock-based compensation claim. The creditor's compensation included an annual cash salary and the grant of common stock and warrants. When the debtor wrongfully terminated the creditor, the creditor obtained a judgment that included the value of the loss of unvested stock and warrants. Section 510(b) subordinates a claim "for damages arising from the purchase or sale" of a security of the debtor. "Purchase" is construed broadly. The grant of stock and warrants is a "purchase", because the creditor exchanged his labor for the securities. A claim "arises" from the purchase if there is a nexus between the purchase and the claim, even if the claim arises after the purchase. Thus, the claim arose from the creditor's purchase of the securities even though the debtor breached the creditor's employment agreement after the creditor acquired the securities. Finally, a court may look behind a judgment to determine whether the underlying facts meet a Bankruptcy Code provision's conditions. Here, though the creditor had reduced the claim to judgment, the facts underlying the judgment involve a claim that arose from the purchase of a security of the debtor, which requires the court to subordinate the claim. The court distinguishes these facts from the case where the debtor issues a note before bankruptcy to pay for securities that it agrees to repurchase, because the debtor's obligation there arises from a fixed debt obligation, not from the creditor's decision to take an equity risk. *The Liq. Trust of U.S. Wireless Corp., Inc. v. Wax (In re U.S. Wireless Corp., Inc.)*, 384 B.R. 713 (Bankr. D. Del. 2008).

6.2.tt. Super-priority DIP loan is not an administrative expense. The debtor in possession obtained approval for a DIP loan under section 364(c), which permits the court to approve financing "(1) with priority over any or all administrative expenses of the specified in section 503(b) or 507(b) of this title", (2) a lien on unencumbered property, or (3) a junior lien on encumbered property, if the debtor in possession "is unable to obtain unsecured credit allowable under section 503(b) of this title as an administrative expense". At the end of the case, there remained only unencumbered assets. The DIP lender objected to confirmation under section 1129(a)(9)(A) on the ground that its claim was an administrative expense for which the plan did not provide payment. The DIP may borrow under section 364(c) only if granting the lender an administrative expense claim is inadequate to induce the lender to lend. Section 364(c)(1) expressly permits such a loan priority over "any and all administrative expenses". Therefore, a loan granted super-priority status under section 364(c) cannot be an administrative expense. The plan must still provide for payment, as the claim has priority over administrative expenses, but section 1129(a)(9)(A) does not apply. *In re Mayco Plastics, Inc.*, 379 B.R. 691 (Bankr. E.D. Mich. 2008).

6.2.uu. Section 510(b) does not subordinate "make-whole" payments based on stock price. The debtor purchased a business from a creditor and paid for the purchase with a combination of cash, notes, and stock. Under the purchase agreement, if the stock price did not reach a certain value three years after the purchase, the debtor would pay the creditor/seller a "make whole" payment equal to the aggregate shortfall created by the stock price. The make-whole amount is not a damage claim arising from the purchase or sale of a security or caused by fraud or securities law violation. It is simply a purchase price

adjustment. Therefore, section 510(b) does not subordinate the claims. Although the court posits that the creditor was not an investor and was not speculating on the debtor's success, the court does not acknowledge that the creditor took an express equity value risk. *In re Nationsrent, Inc.*, 381 B.R. 83 (Bankr. D. Del. 2008).

6.2.vv. Section 510(b) subordinates a claim related to continuing to hold stock. The debtor maintained a pension plan for its employees. The employees' contributions were invested in the debtor's stock, and the debtor's contributions were made in stock. The debtor embarked on a risky venture. The plan trustees, who were also officers and directors of the debtor, decided not to diversify the plan's holdings but to leave them all in the debtor's stock. After bankruptcy, the plan beneficiaries sued the trustees for breach of fiduciary duty relating to that decision. The trustees filed indemnification claims against the debtor. If section 510(b) applies to a claim, then it applies equally to an indemnification claim arising out of the underlying claim. The decision to hold the stock arose from the plan's initial acquisition of the stock. The initial acquisition was a "purchase" because the employees exchanged the value of their labor for contributions to the plan, even though they did not choose for the contribution to be used to acquire the stock. Therefore, the claim meets section 510(b)'s subordination requirements that it be for damages arising from the purchase or sale of a security of the debtor. *In re Touch Am. Holdings, Inc.*, 381 B.R. 95 (Bankr. D. Del. 2008).

6.2.ww. A creditor/director's acquisition of a bank loan at par and declaration of default after resigning does not warrant equitable subordination. A minority shareholder and director, who did not control the board but who served part of the time as the debtor's CEO, loaned funds to the debtor. The debtor had also borrowed from a bank. When the debtor began to fail, the creditor resigned from the board, bought the bank's loan at par, and issued a notice of default on both loans on the same day. The debtor soon filed a bankruptcy petition. Equitable subordination requires inequitable conduct resulting in injury to creditors or in an unfair advantage. Acquisition of the bank loan at par, which did not require debtor approval, and declaring a default after resigning did not breach any duty to the debtor, because there was no evidence of self-dealing while acting on behalf of the debtor, and is not inequitable conduct. *Nelson v. Repository Techs., Inc. (In re Repository Techs., Inc.)*, 381 B.R. 852 (N.D. Ill. 2008).

6.2.xx. Section 510(b) does not subordinate a prepetition litigation claim for damages arising from a breached contract for compensation measured by the value of the debtor's stock. Section 510(b) subordinates claims for damages arising from the purchase or sale of a security of the debtor. It should be construed broadly to implement its remedial policy of preventing a disappointed equity holder from sharing with creditors in the distribution of the debtor's assets. Here, nine years before bankruptcy, the debtor retained a financial advisor to assist in an initial public offering. The debtor agreed to pay the advisor "4% of the final valuation in the form of [debtor's] common stock". After the debtor breached the agreement, the advisor obtained a judgment against the debtor for the value of the stock it would have received, rather than for the stock itself. Such a judgment, rendered years before bankruptcy, established a money debt, not an interest as a stockholder, which the advisor specifically rejected long before bankruptcy. The court focuses more on the advisor's pursuit of a money judgment rather than of the debtor's common stock. It interprets the contract as providing for compensation measured by the stock's value when issued, not as providing for compensation in the form of stock. The court therefore denies subordination of the claim under section 510(b). *Racusin v. Am. Wagering, Inc. (In re Am. Wagering, Inc.)*, 493 F.3d 1067 (9th Cir. 2007).

6.2.yy. Section 503(b)(9) administrative priority applies to secured claims as well as unsecured claims. The debtor received goods from the supplier cooperative within 20 days before bankruptcy. The supplier's claim was secured by the supplier's stock that the debtor owned. The collateral did not prevent the supplier from having an administrative priority claim under section 503(b)(9). That section does not by its terms apply only to unsecured claims. In the absence of any such limitation, the supplier's claim is entitled to the priority. *Brown & Cole Stores, Inc. v. Assoc. Grocers., Inc. (In re Brown & Cole Stores, Inc.)*, 375 B.R. 873 (9th Cir. B.A.P. 2007).

6.2.zz. Debtor's workers' compensation reimbursement obligation is not entitled to the tax priority. The debtor employer self-insured its workers' compensation obligations. After bankruptcy, it

defaulted on payments owing to injured workers, thereby obligating the state compensation fund to step in and pay the workers. When it did, the employer became liable to reimburse the fund. The fund's claim is for an excise tax, but it is not on "a transaction occurring during the three years immediately preceding the date of the filing of the petition", as section 507(a)(8)(E) requires for it to be entitled to priority. Rather, the "transaction" is the event that causes the fund to become liable and creates the employer's reimbursement obligation, which occurred postpetition. Therefore, it is not entitled to tax priority treatment under the plan. (The parties had stipulated that the claim would not be an administrative expense, so the court does not analyze section 507(a)(2)'s applicability.) *Calif. Self-Insurers' Sec. Fund v. Lorber Indus. of Calif. (In re Lorber Indus. of Calif.)*, 373 B.R. 663 (9th Cir. B.A.P. 2007).

6.2.aaa. Third party's postpetition attorney's fees for the estate's suit are not entitled to administrative expense priority. Before bankruptcy, the debtor sued a third party on various contract and tort theories. After bankruptcy, the trustee continued to pursue the action. The defendant filed a proof of claim for its postpetition attorney's fees under a state prevailing party attorney's fee rule and asserted its claim was entitled to administrative expense priority. Under *Reading Co. v. Brown*, 391 U.S. 471 (1968), a third party damaged by the estate's activities may assert an administrative expense priority claim against the estate if fundamental fairness requires the claim's recognition. The Ninth Circuit has rejected application of the fundamental fairness doctrine to postpetition attorney's fee claims arising out of a prepetition cause of action, at least where the trustee's pursuit of the claim is not frivolous or meritless. Because the trustee's pursuit here was neither, the attorney's fee claim is not entitled to administrative expense priority. *In re Sec. Aviation, Inc.*, 374 B.R. 720 (Bankr. D. Alaska 2007).

6.2.bbb. Postpetition termination does not elevate an accrued severance payment to administrative expense liability. The debtor in possession terminated one of its senior managers after bankruptcy without cause. The manager was a beneficiary under various unfunded retirement plans, under which benefits had vested prepetition. Benefits were payable monthly after the manager's retirement, but if the manager were terminated without cause then benefits were payable as a lump sum. The debtor in possession sold the division for which the manager worked postpetition, and the manager was terminated without cause, so the manager was entitled to a lump sum payment. Under the Second Circuit's pre-Code decision in *In re Straus-Duparquet, Inc.*, 386 F.2d 649 (2d Cir. 1967), a severance payment that is a new obligation that arises as a result of termination is entitled to administrative expense priority, because the obligation arises out of the DIP's actions, compensates for the hardship associated with termination, and is earned by reason of the termination. A benefit that accrues before bankruptcy is not entitled to administrative expense priority, whether or not it is characterized as a severance payment and whether or not it become payable upon severance. Therefore, the manager's lump sum claim was not entitled to administrative expense priority. *Supplee v. Bethlehem Steel Corp. (In re Bethlehem Steel Corp.)*, 479 F.3d 167 (2d Cir. 2007).

6.2.ccc. A nonprofit debtor's state unemployment fund reimbursement obligation is not a priority tax. The state's unemployment insurance law, in accordance with the Federal Unemployment Tax Act, permits a nonprofit employer to reimburse the state unemployment fund for payments actually made to the employer's discharged employees, rather than to pay unemployment insurance contributions, which are taxes. To participate in the reimbursement program, a nonprofit with annual compensation expense above $100,000 must post a surety bond to secure its reimbursement obligations. An obligation is a tax it is involuntary, imposed universally by the legislature under the state's police or regulatory power on all similarly situated entities, and for public purposes. A nonprofit's reimbursement obligation is not for public purposes and is not imposed universally on all similarly situated entities, because it is imposed solely to reimburse the government for expenses incurred on behalf of the nonprofit. In addition, the Bankruptcy Code grants tax claims priority in part because the government is an involuntary creditor that cannot protect itself in advance. The ability to require a surety bond permits the government to protect its ability to collect the reimbursement obligation. Therefore, the reimbursement obligation is not a tax entitled to priority under section 507(a)(8). *Mich. Unemployment Ins. Agency v. Boyd (In re Albion Heath Servs.)*, 360 B.R. 599 (6th Cir. B.A.P. 2007).

6.2.ddd. Retiree health insurance claims are entitled to priority under section 507(a)(5). The debtor had contracted with Aetna to administer its self-insured employee health plan. Employees and retirees submitted all medical claims to Aetna, who examined and paid them and sought reimbursement

from the debtor. At the petition date, the debtor owed unpaid employee and retiree medical claims and an unreimbursed amount to Aetna. Section 507(a)(5) grants priority to "unsecured claims for contributions to an employee benefit plan (A) arising from services rendered within 180 days before the date of the filing of the petition … but only (B) for each such plan, to the extent of (i) the number of employees covered by each such plan multiplied by [$10,950]; less (ii) the aggregate amount paid to such employees under paragraph (4) …." The limitation to "services rendered within 180 days" refers to the services Aetna rendered, not solely to employee (or retiree) services. Section 507(a)(5), by integrating with section 507(a)(4), recognizes that employees exchange current wages for employee benefit plans, such as health insurance. The retirees exchanged current wages for medical benefits, just as current employees do, and therefore are covered in the same way. The retirees are the most vulnerable people with employee benefit plan claims, so it makes sense that Congress would have intended to cover them. Therefore, the retirees' claims, as well as Aetna's reimbursement claims for retiree medical expense payments, are entitled to priority under section 507(a)(5). In addition, the interpretation of the word "employees" in determining that retirees are entitled to the priority requires that they similarly be included in the "employees" whose number calculates the cap. Moreover, inclusion of the retirees' claims in the priority while excluding their numbers in calculating the cap would dilute the priority recoveries of both retirees and current employees. Therefore, calculation of the aggregate priority cap under section 507(a)(5) must include the number of retirees, even though they are not included in the number of employees covered under section 507(a)(4). *In re Consol. Freightways Corp. of Del.*, 363 B.R. 110 (Bankr. C.D. Cal. 2007).

6.2.eee. Claim for promise to deliver common stock in the debtor is subordinated. In a severance agreement with its CEO, the debtor agreed to exchange its common shares for common shares in another company that the CEO held. The debtor failed to deliver its shares. The CEO sued, but before trial, the debtor filed chapter 11. The CEO's claim against the debtor is subordinated under section 510(b) as a claim "for damages arising from the purchase or sale of" a security of the debtor. The CEO agreed to take the benefits and risks of stock ownership rather than the certainty of a cash payment and, consistent with the language and rationale of section 510(b), should not be able to elevate his relationship to a creditor claim. The stock acquisition claim arises from an attempted, though uncompleted, "purchase," so the claim falls within section 510(b). *Rombro v. Dufrayne (In re Med Diversified, Inc.)*, 461 F.3d 251 (2d Cir. 2006).

6.2.fff. Section 510(b) does not subordinate a prepetition litigation claim for damages arising from a breached contract to issue stock. Section 510(b) subordinates claims for damages arising from the purchase or sale of a security of the debtor. It should be construed broadly to implement its remedial policy of preventing a disappointed equity holder from sharing with creditors in the distribution of the debtor's assets. Here, nine years before bankruptcy, the debtor retained a financial advisor to assist in an initial public offering. The debtor agreed to pay the advisor in the form of common stock. After the debtor breached the agreement, the advisor obtained a judgment against the debtor, for the value of the stock it would have received, rather than for the stock itself. Such a judgment, rendered years before bankruptcy, established a money debt, not an interest as a stockholder, which the advisor specifically rejected long before bankruptcy. The court focuses more on the long period before bankruptcy during which the advisor sought a money judgment rather than on the nature of the underlying contract, under which the advisor had agreed to take equity risk, and denies subordination of the claim under section 510(b). *Racusin v. Am. Wagering, Inc. (In re Am. Wagering, Inc.)*, 465 F.3d 1048 (9th Cir. 2006), reh'g granted, *op. w'drawn and replaced*, 493 F.3d 1067 (9th Cir. 2007).

6.2.ggg. Claim for administrative expense under a collective bargaining agreement must meet section 503(b) standards. The debtor's collective bargaining agreement required its employees to be "on call" and provided for compensation if they were available, whether or not the debtor actually used their services. After filing chapter 11, the debtor in possession kept the employees on call but did not use their services until the debtor in possession obtained an order approving rejection of the collective bargaining agreement. Section 503(b)(1) limits administrative expenses to claims for "the actual and necessary costs and expenses of preserving the estate." Section 1113 prohibits a debtor in possession from unilaterally altering the terms of a collective bargaining agreement. Following the majority view, the court rules that section 1113 does not specifically override the requirements of section 503(b), unlike section 1114, which specifically grants administrative expense priority to retiree benefits. Therefore, for claims under a

collective bargaining agreement to receive priority, the services must be rendered after bankruptcy and must be necessary to preserve the estate. The former requirement were met based on the services performed—the employees' being on call—not on the debtor in possession's actions. Otherwise, the debtor in possession could skirt the anti-modification provision of section 1113 by unilateral action. The employees also met the second test, because their on-call availability to provide the services until the rejection decision was necessary to preserve the debtor's opportunity to reorganize. Finally, because section 1113 prohibits unilateral modification, the contract remained binding until court approval of the rejection, not just until the debtor in possession filed the rejection motion. Therefore, the employees were entitled to administrative expense priority for their pay for the post-petition, pre-rejection period. *Peters v. Pikes Peak Musicians Ass'n (In re Colorado Springs Symphony Orch. Ass'n)*, 462 F.3d 1265 (10th Cir. 2006). *Accord Peters v. Enterasys Networks, Inc. (In re Native Am. Sys., Inc.)*, 351 B.R. 135 (10th Cir. B.A.P. 2006) (creditor remained available postpetition and prerejection to perform services under a prepetition contract).

6.2.hhh. Allegations of corporate looting state a claim for equitable subordination. The creditors' committee's complaint alleged that the debtor's parent corporation looted the debtor's assets by selling the debtor's assets, causing the proceeds to be diverted to the parent, backdating the debtor's note to the parent and related authorizing board resolutions, and causing the debtor to guarantee the parent's bank debt. These allegations state a claim for equitable subordination of the parent's claim. Such a claim is not dependent on a claim for alter ego liability or piercing the corporate veil. *Official Comm. of Unsecured Creditors v. Am. Tower Corp. (In re Verestar, Inc.)*, 343 B.R. 444 (Bankr. S.D.N.Y. 2006).

6.2.iii. Workers' compensation insurance premiums are not entitled to priority under section 507(a)(5). The debtor's workers' compensation insurance company filed a claim for unpaid prepetition premiums and sought priority under section 507(a)(5) for "contributions to an employee benefit plan." The Bankruptcy Code "aims, in the main, to secure equal distribution among creditors, [and] preferential treatment of a class of creditors is in order only when clearly authorized by Congress." "[P]rovisions allowing preferences must be tightly construed," because granting priority to one reduces both priority for other priority creditors and equal treatment for all. Because of the close linkage between the wage priority in section 507(a)(4) and the employee benefit plan priority in section 507(a)(5), "employee benefit plan" should be construed to encompass employer obligations that substitute for wages or other direct compensation to workers. Workers' compensation systems, by contrast, protect employees but also protect employers from tort liability. They substitute for tort recovery and liability, rather than for compensation. ERISA's definition of employee benefit plans is not relevant to the analysis, because section 507(a)(5) contains no indication that the phrase should be construed by reference to other statutes. Therefore, unpaid workers' compensation insurance premiums are not entitled to priority under section 507(a)(5). *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 126 S. Ct. 2105, 165 L. Ed. 2d 110 (2006).

6.2.jjj. Administrative rent claim may be equitably subordinated. The debtor's principal rented real property to the debtor, which the debtor in possession and the trustee occupied after bankruptcy. The principal/lessor and the debtor were convicted of money laundering and other crimes, resulting in a forfeiture of a substantial portion of the property of the estate to the United States. The court equitably subordinates the principal's administrative rent claim. It determines that section 510(c), which authorizes subordination, is not limited to prepetition claims, and that the inequitable conduct need not be related directly to the claim. The court then finds that the facts satisfy the three grounds for imposing equitable subordination: The principal's conduct was inequitable. It harmed creditors; in this case, it harmed only a priority creditor, but that was adequate. Finally, subordination is not inconsistent with any Bankruptcy Code provision, particularly section 365(d)(3) or (4), requiring prompt payment of administrative rent, because neither those provisions nor section 510(c) limits equitable subordination of administrative rent. *Bala v. Kaler (In re Racing Servs., Inc.)*, 340 B.R. 73 (8th Cir. B.A.P. 2006).

6.2.kkk. Consumer deposit priority applies to full, as well as partial, advance payment. The creditor paid in full in advance for the debtor contractor's services in constructing a pool for the creditor's home. The contractor did not complete the project. The creditor's claim was entitled to priority under

section 507(a)(7), even though the creditor had paid in full. The priority for "deposits" is not limited to partial payments. *Salazar v. McDonald (In re Salazar)*, 430 F.3d 992 (9th Cir. 2005).

6.2.lll. Administrative expense claim may arise from prepetition agreement. The debtor and the creditor each owned a working interest in an oil well. After bankruptcy, the debtor in possession used the creditor's portion of well receipts in the administration of the case. The creditor's claim to the proceeds is entitled to administrative expense priority. Even though the contract was a prepetition agreement, the "transaction" giving rise to the claim occurred postpetition, when the debtor in possession denied the creditor access to the profits, which should have been distributed. The retained profits benefited the estate, because the debtor in possession used the profits in the operation of the business. Therefore, the creditor's claim is entitled to administrative expense priority. *Robert M. Hallmark & Assocs., Inc. v. Athens/Alpha Gas Corp. (Athens/Alpha Gas Corp.)*, 332 B.R. 578 (B.A.P. 8th Cir. 2005).

6.2.mmm. ESOP stock redemption note may not be equitably subordinated. Based on cases from 1919 and 1920, the First Circuit has categorically subordinated notes a debtor issued to redeem its stock. Based on the enactment of section 510(c) (authorizing equitable subordination) and the Supreme Court's decisions in *United States v. Noland*, 517 U.S. 535 (1996) and *United States v. CF&I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996), the First Circuit abrogates its precedents and rules that subordination must be determined on a case-by-case basis. Although it continues to suggest in general that a note issued to redeem stock should be subordinated, it rules here that a note issued to redeem a retired employee's stock ownership interest under an ERISA-qualified and regulated Employee Stock Ownership Plan should not be subordinated. *Merrimac Paper Co. v. Harrison (In re Merrimac Paper Co.)*, 420 F.3d 53 (1st Cir. 2005).

6.2.nnn. Court may equitably subordinate a claim in the hands of an innocent transferee. The bank was a member of a lending syndicate. Separately, it engaged in a transaction with the debtor that may have contributed to the misstatement of the debtor's financial statements, securities fraud, and harm to numerous other creditors. After bankruptcy, it sold its loan syndicate claim to an unrelated third party who had had no contacts with the debtor before bankruptcy. The court may subordinate the claim in the hands of the transferee. Section 510(c) addresses subordination of claims, not of creditors. Transfer of a claim does not change the claim's rights or disabilities. Moreover, permitting transfer to cleanse a claim of the subordination risk would permit the transferring creditor to obtain a recovery on the claim, which would then share pro rata with other claims in the case, and prevent compensation to the other claims' holders. Purchasers of claims against debtors are on notice that claims are subject to increased scrutiny in bankruptcy and possible disallowance and have means to protect themselves against the transferor in the transfer documentation. A good faith defense analogous to the good faith purchaser defense in section 550 is not available, because section 550 is limited to good faith transferees of property transferred in avoided transfers, and the consideration for protection of transferees against a claim by the estate does not apply equally to claims against the estate. *Enron Corp. v. Avenue Special Situations Fund II, LP (In re Enron Corp.)*, 333 B.R. 205 (Bankr. S.D.N.Y. 2005).

6.2.ooo. Court may equitably subordinate a claim that is unrelated to the creditor's misconduct. The bank was a member of a lending syndicate. Separately, it engaged in a transaction with the debtor that may have contributed to the misstatement of the debtor's financial statements, securities fraud, and harm to numerous other creditors. The court may equitably subordinate the bank's claim under the syndicated loan even though that claim is wholly unrelated to the bank's conduct that caused the debtor and its creditors harm. Equitable subordination is a remedy designed to compensate creditors for another creditor's misconduct and to ensure an equitable distribution of the estate. It does not require that the misconduct be related to the claim sought to be subordinated. The focus is on compensating other creditors for the injury, which the court may effect from whatever source. *Enron Corp. v. Avenue Special Situations Fund II, LP (In re Enron Corp.)*, 333 B.R. 205 (Bankr. S.D.N.Y. 2005).

6.2.ppp. Section 510(b) subordinates but does not disallow claims. Under a prepetition merger agreement, the debtor had agreed to pay for a target's shares by issuing its own shares. If the market price of its own shares at the time of payment was less than a specified amount, it would have to pay more shares, up to a maximum, and top off any balance with cash. The debtor filed chapter 11 before the

payment and rejected the merger agreement. The target's former shareholders sought recovery, subordinated under section 510(b), on a parity with the debtor's own shareholders. The recovery was proper because the target's former shareholders held an allowable claim for damages for rejection of the merger agreement, measured by the calculation formula based on stock price contained in the merger agreement. Failure to allocate some of the equity's recovery under the plan to the target's former shareholders would have amounted to disallowance of the claim, not just subordination, which is all that section 510(b) requires. *Kaiser Group Int'l, Inc. v. Pippin (In re Kaiser Group Int'l, Inc.)*, 326 B.R. 265 (D. Del. 2005).

6.2.qqq. Claim arising from failure to pay stock compensation is subordinated. The debtor hired the creditor to manage the debtor's IPO. The creditor's compensation was $150,000 in cash and 4.5% of the debtor's stock. The debtor fired the creditor before issuing the stock to him. He sued for money damages and was awarded a substantial sum. The debtor filed bankruptcy and sought to subordinate his claim under section 510(b). The creditor argued that because he sought only damages in the prepetition litigation, not stock, and because the claim had been reduced to judgment before bankruptcy, section 510(b) did not apply. The BAP rejects both arguments. First, the court may look behind the judgment to determine the nature of the underlying claim for purposes of applying a substantive Bankruptcy Code section such as section 510(b). Second, section 510(b) specifically refers to "a claim . . . for damages arising from the purchase or sale" of the debtor's stock, and the definition of claim is a "right to payment, whether or not such right is reduced to judgment." Third, the creditor took equity risk by agreeing to be paid in stock rather than cash. The claim here is therefore within section 510(b)'s reach and is subordinated. *American Wagering, Inc. v. Racusin (In re American Wagering, Inc.)*, 326 B.R. 449 (Bankr. 9th Cir. 2005).

6.2.rrr. Indenture "X-clause" prevents subordinated debt holders from receiving warrants in reorganized debtor. Generally, an indenture for subordinated debt prohibits the subordinated debt holders from recovering anything until senior debt holders are paid in full in cash. If they do, they must turn the recovery over to the senior debt holders. An "X-clause" in the indenture permits the subordinated holders to receive a reorganized debtor's securities that are junior to the securities received by the senior debt holders on their claims. Although the form of the clause is ambiguous on this point, it permits such recovery only when the securities that the senior debt holders recover fully compensate the senior holders. In this case, they did not, and the senior creditors did not accept the plan. Therefore, even though the senior holders received cash, common stock, and warrants, and even though the warrants were junior to the common stock, the subordinated holders could not recover any warrants. *Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136 (2d Cir. 2005).

6.2.sss. Workers compensation carrier's premium claim is entitled to priority under section 507(a)(4). In a *per curiam* decision, the Fourth Circuit follows the Ninth Circuit and disagrees with the Sixth, Eighth, and Tenth Circuits in ruling that unpaid workers compensation insurance premiums incurred in the 180-day period before bankruptcy are entitled to the "contribution to an employee benefit plan" priority of section 507(a)(4). The 2-1 decision produced three opinions. One concludes that the phrase "contribution to an employee benefit plan" unambiguously includes workers compensation insurance premiums because the insurance is for the benefit of the employees. The other two conclude that the phrase is ambiguous and criticize the first opinion for selective review of dictionaries to find otherwise. They both review the legislative history but reach opposite conclusions on whether the premiums are included. One relies in part on an analogy to ERISA to conclude that workers compensation insurance is an employee benefit plan. The other argues that priorities are to be narrowly construed and that the insurance protects the employers from statutory workers compensation liability, not the employee. *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co. (In re Howard Delivery Serv., Inc.)*, 403 F.3d 228 (4th Cir. 2005).

6.2.ttt. Unpaid health insurance premiums for COBRA coverage are entitled to priority. The debtor had terminated numerous employees well before bankruptcy. Many of them maintained COBRA coverage after termination through the debtor's health insurance provider and paid the debtor for their coverage. The health insurance provider was unpaid at the time of the debtor's bankruptcy for coverage within the 180 days before bankruptcy. Based on the Fourth Circuit's recent decision granting section 507(a)(4)

priority to workers compensation insurance claims, the court grants priority to the health insurance provider's claim. The court construes "for services provided within 180 days before" bankruptcy as applying to the provider's, not the just employees', services. *Ivey v. Great-West Life & Annuity Ins. Co. (In re J.G. Furniture Group, Inc.)*, 405 F.3d 191 (4th Cir. 2005).

6.2.uuu. Disappointed bidder's expenses are not limited by break-up fee standard. A disappointed bidder sought reimbursement of its expenses (attorney's fees and expenses) under section 503(b)(1) as an administrative expense claim because its activities conferred a benefit on the estate. The allowable amount is limited only by the reasonableness of the expenses, not by the typical percentage analysis that is applied to a break-up fee. *AgriProcessors, Inc. v. Fokkena (In re Tama Beef Packing, Inc.)*, 321 B.R. 496 (B.A.P. 8th Cir. 2005).

6.2.vvv. Court authorizes critical vendor payments under *Kmart* standards. The debtor in possession apparel manufacturer's fabric suppliers and others refused to ship more product without payment for certain prepetition amounts owing. The debtor in possession had negotiated a deal with the suppliers that they would accept payment of 77.5% of their prepetition claims, waive the balance of 22.5%, ship new goods on ordinary trade terms during the case, and retain their reclamation rights. In exchange, the debtor in possession would pay the 77.5% amount and waive any preference claims. Applying the standards set forth in *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004), the court determines that the agreement is reasonable, that the vendors would not ship without the agreement, that the vendors' goods were unique, and that the payment would benefit disfavored creditors, because the debtor in possession could not get timely shipment of substitute goods and because it would support the debtor in possession's agreement to sell its business under section 363, which required that the debtor in possession maintain operations. The order was issued approximately one month after the date of the filing of the petition. *In re Tropical Sportswear Int'l Corp.*, 320 B.R. 15 (Bankr. M.D. Fla. 2005).

6.2.www. Reclamation creditors are entitled to administrative expense claims where secured inventory lender had been paid in full. The debtor in possession obtained a reclamation order upon the filing of the chapter 11 case, which provided that valid reclamation claims would be entitled to administrative expense priority. A lender had a security interest in all inventory, whose value was more than adequate to pay the secured claim in full. After the inventory had been liquidated, the debtor in possession objected to allowance of the reclamation claims as administrative expenses, arguing that the reclamation creditors' interests were subordinate to the lender's security interest and therefore not valid. The court reviews the case law on the competing interests of secured and reclamation creditors, noting the "plain meaning" line, which reads 546(c) as entitling the reclamation creditor to an administrative expense, and the "valuation" line, which grants administrative expense priority only if the inventory value is sufficient to pay the secured claim. The court adopts the former interpretation, but notes also that because the secured lender was paid in full here, the reclamation creditors were entitled to assert their administrative claims even under the valuation line. The court also finds an equitable estoppel against the debtor in possession on account of the first-day reclamation order. *In re Georgetown Steel Co., LLC*, 317 B.R. 340 (Bankr. D.S.C. 2004).

6.2.xxx. A nonprofit debtor's unemployment compensation reimbursement obligation is not a priority tax. Under New Jersey law, as authorized by Federal law, a nonprofit employer may choose not to make quarterly unemployment tax contributions but instead to reimburse the state if the state makes unemployment compensation payments to the nonprofit's terminated employees. The debtor's reimbursement obligation is not a tax that is entitled to priority. A tax is an involuntary exaction imposed for general public purposes. Unemployment contribution obligations are such an exaction, because the funds benefit the government generally, whether or not the nonprofit's employees are terminated. The reimbursement obligation, however, is imposed to repay the government for the actual cost of unemployment compensation directly related to the nonprofit's terminated employees and is not for general governmental purposes. *Reconstituted Comm. of Unsecured Creditors v. New Jersey Dep't of Labor (In re United Healthcare Sys., Inc.)*, 396 F.3d 247 (3d Cir. 2005).

6.2.yyy. Postpetition, preconversion tax claim is entitled to administrative expense priority in chapter 13. The debtors operated their business in chapter 11 for over a year, but did not pay FICA and

FUTA taxes during the case. They discontinued their business, found employment, and converted their cases to chapter 13. The tax claims were entitled to administrative expense priority in the chapter 13 cases. Section 348(d) provides that a claim that arises during a chapter 11 case is treated as a prepetition claim after conversion, except for administrative expense claims. This section takes precedence over section 1305, which requires that tax claims filed under section 1305 be determined and allowed under section 502 as if they had arisen prepetition. Section 1305 does not, however, address priority, only allowability. Section 348(d) preserves the tax claims' priority status. *United States v. Fowler (In re Fowler)*, 394 F.3d 1208 (9th Cir. 2005).

6.2.zzz. Fraudulent transfer action attorney's fee award against trustee is entitled to administrative priority. The chapter 7 trustee brought an unsuccessful action under section 544(b) and the Alaska Uniform Fraudulent Conveyance Act to avoid a prepetition transfer. Under Alaska law, the defendant in such an action is entitled to attorney's fees. The court grants the fee award administrative expense priority in the chapter 7 case. Noting mixed signals from Ninth Circuit case law on the issue, the court concludes that the fundamental fairness rationale behind the holding of *Reading Co. v. Brown*, 391 U.S. 471 (1968), requires that the estate, for whose benefit the trustee brought the action, should be liable for the fees as an expense of administration. *In re Good Taste, Inc.*, 317 B.R 112 (Bankr. D. Alaska 2004).

6.2.aaaa. Taxes owing under a late-filed tax return are not entitled to priority. The chapter 13 debtor had not filed income tax returns for six years before bankruptcy but did so shortly after filing, in order to obtain plan confirmation. Section 507(a)(8) and section 523(a)(1) reflect a "delicate balance" among the public interest in collecting taxes, protection of creditors from excessive tax claims, and the debtor's fresh start and so must be read together. Section 507(a)(8)(A)(iii) grants priority to income taxes "other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable . . . after, the commencement of the case." Section 523(a)(1)(B) excepts a tax from discharge if a required return was filed late "and after two years before" the petition date. The quoted phrase is open-ended, including returns filed after the petition date, as contrasted with a closed-ended phrase such as "within two years before" the petition date. Therefore, the taxes in this case for the oldest three years, for which returns were filed after the petition date, were excepted from discharge under section 523(a)(1)(B) and therefore not entitled to priority under section 507(a)(8)(A)(iii). *Savaria v. United States (In re Savaria)*, 317 B.R. 396 (B.A.P. 9th Cir. 2004).

6.2.bbbb. Nonimpairment by reinstatement eliminates a default's effects as to all parties, not just the debtor. The holders of the senior secured notes were entitled to a prepayment penalty upon default and acceleration. The holders of the subordinated secured notes had agreed not to receive payment on their notes while any amounts remained owing under the senior notes. The debtor's plan provided for cure and reinstatement of the senior notes, thereby erasing the effect of the default and relieving the debtor of the prepayment penalty obligation. The senior note holders were not entitled to recover the prepayment penalty from the subordinated note holders' recovery, because the de-acceleration and reinstatement of the senior notes entirely eliminated the prepayment penalty obligation as to all parties, not just as to the debtor. *MW Post Portfolio Fund Ltd. v. Norwest Bank Minnesota (In re ONCO Inv. Co.)*, 316 B.R. 163 (Bankr. D. Del. 2004).

6.2.cccc. Stock repurchase note must be equitably subordinated. When the debtor's former officer retired, the debtor repurchased the stock the officer owned in his ESOP account, paying part in cash and part with a note. The debtor was solvent at the time. Before the note was paid off, the debtor filed chapter 11. The officer's claim is equitably subordinated under section 510(c), even though the officer did not engage in any inequitable conduct. As a matter of venerable First Circuit case law, all stock repurchase claims must be equitably subordinated. Though ERISA governs ESOPs, nothing in ERISA restricts subordination, because the claim is strictly on a note issued by the debtor. *Harrison v. Merrimac Paper Co. (In re Merrimac Paper Co.)*, 317 B.R. 215 (D. Mass. 2004).

6.2.dddd. Highway heavy truck fee is a priority excise tax. Internal Revenue Code section 4481 imposes fees on a heavy truck that uses the highways for more than 5000 miles per year, based on the truck's weight. The fee is a tax, because it is a mandatory financial burden to support the government; that

a truck owner may choose to use the truck less than 5000 miles per year does not make the impost any less mandatory. It is not a fee because it is not in exchange for a benefit that is not shared by others who do not pay the fee. The tax is an excise tax, because it is an indirect tax on an activity or transaction, not a direct tax on persons or property. The excise tax here is entitled to priority because the operation of the trucks on the highway constitutes the transaction subject to tax, and the transaction occurred within one year before the petition date. *Trustees of the Trism Liquidating Trust v. Internal Revenue Serv. (In re Trism, Inc.)*, 311 B.R. 509 (B.A.P. 8th Cir. 2004).

6.2.eeee. Gift certificates are "deposits" under section 507(a)(6). The debtor had sold gift certificates. It sought to classify the holders' claims under its plan as general unsecured claims, arguing that "deposit," as used in the section 507(a)(6) consumer deposit priority, applies only to partial payments for goods. The court finds no such limitation and grants the claims priority. *In re WW Warehouse, Inc.*, 313 B.R. 588 (Bankr. D. Mass. 2004).

6.2.ffff. Equitable subordination in Ponzi scheme case requires inequitable conduct. A creditor of a Ponzi scheme debtor's affiliate rolled its loan into a loan to the debtor, with an interest rate and other terms similar to those promised to the equity investors in the Ponzi scheme. The equity investors sought equitable subordination of the creditor's claim. The Tenth Circuit refused, holding that the creditor's position and actions did not amount to inequitable conduct, which was required for equitable subordination. In its opinion, the court expressly limit application of its prior "no fault" subordination decision, *In re CF&I Fabricators, Inc.*, 53 F.3d 1155(10th Cir. 1995), *rev'd on other grounds*, 518 U.S. 213 (1996), to tax penalties. *Sender v. Bronze Group, Ltd.*, 380 F.3d 1292 (10th Cir. 2004).

6.2.gggg. Rule of Explicitness is overruled. The First Circuit concludes that the Rule of Explicitness, a rule of New York law that permits a senior creditor to be paid postpetition interest ahead of a subordinated creditor in a bankruptcy distribution if the subordination agreement is explicit on the point, violates the Bankruptcy Code, because it is a state-made rule that applies only in bankruptcy, thereby disrupting the bankruptcy distribution scheme that Congress established. Instead, the court must apply the general rules of construction of contracts under New York law to determine the parties' intent in the subordination provision. The court remands to the bankruptcy court to conduct the factual inquiry necessary to determine that intent. The decision is directly contrary to *In re Southeast Banking Corp.*, 156 F.3d 1114 (11th Cir. 1998). *HSBC Bank USA v. Branch (In re Bank of New England Corp.)*, 364 F.3d 355 (1st Cir. 2004).

6.2.hhhh. Insurer is entitled to fringe benefit priority for payments made within 180 days before bankruptcy. The debtor terminated the employment of its employees more than 180 days before bankruptcy, but many of them continued their health insurance coverage under COBRA until the petition date. The health insurer merely administered the plan; the debtor reimbursed the insurer for all claims paid, up to a stop-loss amount. The insurer sought priority for unreimbursed payments it had made to former employees within 180 days before bankruptcy. The court awards the priority. Section 507(a)(4), the fringe benefit priority, is not limited to claims of employees, as the section 507(a)(3) priority is, because it does not refer to claims earned for wages, salaries, etc., but rather to "claims for contributions to an employee benefit plan." In addition, the section grants priority to such claims "arising from services rendered within 180 days before the date of the filing of the petition," without limiting the nature of the services rendered. Because the insurer is entitled to the priority, it is reasonable to conclude that the reference is to the services that the insurer, not the employees, rendered, so the payments made within that period are entitled to priority. *Ivey v. Great West Life & Ann. Ins. Co.*, 308 B.R. 752 (M.D.N.C. 2004).

6.2.iiii. Landlord's claim for removal of property at the end of the lease is not entitled to administrative expense priority. Section 365(d)(4) requires a trustee to "timely perform all obligations … arising from and after the order for relief … until such lease is assumed or rejected. …." Under Ninth Circuit precedent, the landlord has an administrative expense priority for any such obligations that are unperformed. In this case, the lease required the debtor to remove improvements from the real property upon termination or expiration of the lease. The debtor in possession rejected the lease without removing the property, and the landlord sought an administrative expense claim for the damages. Applying a "bright-line rule" for entitlement to administrative expense priority, the Ninth Circuit grants the landlord only a

prepetition claim. Section 365(d)(4) applies only until rejection; the lease termination occurred only on rejection; and the removal obligation arose only on termination, so it did not come within the time period covered by section 365(d)(4). *K-4, Inc. v. Midway Engineered Wood Prods., Inc. (In re TreeSource Ind., Inc.)*, 363 F.3d 994 (9th Cir. 2004).

6.2.jjjj. A reclaiming creditor takes priority over new DIP loan. The debtor's prepetition secured lender refinanced its loan under a debtor in possession loan facility. Under the DIP loan, the entire prepetition loan was paid off, and the lender took new liens to secure the DIP loan. Although the reclamation claims asserted against the debtor at the petition date would have been subject to the liens of the prepetition lender as a bona fide purchaser, they were not subject to the subsequent lien imposed in favor of the DIP lender and therefore were valid reclamation claims, entitled to be paid under section 546(c). *In re Phar-Mor, Inc.*, 301 B.R. 482 (Bankr. N.D. Ohio 2003).

6.2.kkkk. Reclamation claims are subordinate to new DIP financing. A reclamation claimant has a right to an administrative claim or lien under section 546(c) only to the extent that it has a valid claim against the debtor outside of bankruptcy. An over-secured creditor may satisfy its claim out of any of its collateral, including inventory that is subject to a right of reclamation, and is not required to marshal for the benefit of the reclamation creditors. Moreover, the reclamation creditors have claims against only their specific goods, not generally against a surplus upon the payoff of the secured creditor's claim. Therefore, the use of the inventory to secure a new DIP facility, the proceeds of which would pay off the prepetition secured lender, amounts to an undifferentiated sale of the inventory in favor of the prepetition secured creditor and renders the reclamation claims valueless. *In re Dairy Mart Convenience Stores, Inc.*, 302 B.R. 128 (Bankr. S.D.N.Y. 2003). *Accord In re Pittsburgh-Canfield Corp.*, 305 B.R. 688 (Bankr. N.D. Ohio 2003).

6.2.llll. Claim under a stock put agreement is not subordinated. Because of disputes between the debtor's two principal stockholders, one stockholder agreed to sell its stock back to the debtor. It entered into a stock put agreement, under which it would retain a 4% interest and have the right to put the balance of the stock to the debtor for a fixed price for a fixed period of time, subject to acceleration upon the occurrence of certain financial condition events. The stock purchase agreement provided that the seller would have no further management, control or voting rights. The triggering events occurred before the petition date, and the stockholder put the stock to the debtor. The debtor sought subordination of the former stockholder's claim under section 510(b). The district court construes the Third Circuit's decision in *In re Telegroup, Inc.*, 281 F.3d 133 (3d Cir. 2002), as creating a hypothetical test, under which the claim should be subordinated if it was indistinguishable from a hypothetical securities fraud claim. The court finds that this claim is not, because the stockholder gave up all management, control, and voting rights and did not stand to lose if the stock declined (even though the stockholder stood to gain if the stock appreciated). *Raven Media Investments LLC v. DirecTV Latin America, LLC (In re DirecTV Latin America, LLC)*, 2004 U.S. Dist. LEXIS 2425 (D. Del. 2004).

6.2.mmmm. Securities "non-purchase" claim is subordinated. The claimants contributed equity to the debtor at its formation and were promised the issuance of shares. Later, the controlling shareholder issued shares to himself but not to the claimants. Still later, the controlling shareholder sold the corporation to a third party at a substantial profit. The claimants sued the controlling shareholder and the corporation for the damages they suffered as a result of not having the shares. They obtained a state court judgment against both the controlling shareholder and the corporation. After the corporation filed bankruptcy, it sought to subordinate the claimants' claims under section 510(b). The court rules that there must be some "causal nexus" between the sale and the damages for subordination under section 510(b). The court finds the nexus in the issuance (sale) of the shares to the controlling shareholder resulting in the damages to the claimants. Relying also on the policy underlying section 510(b) that only investors should bear the risk that equity interests will be wiped out by fraud, the court subordinates the claims. *In re PT-One Communications, Inc.*, 304 B.R. 601 (Bankr. E.D.N.Y. 2004).

6.2.nnnn. Equitable subordination of non-insider claim requires substantial showing. Lehman Brothers, Inc. provided a warehouse financing line to First Alliance Mortgage Company, which was found to have engaged in fraudulent sales practices to the detriment of sub-prime borrowers. Lehman's warehouse

line was secured by First Alliance mortgages. The bankruptcy trustee sought equitable subordination of Lehman's claim, because Lehman provided the line at a time when it knew or reasonably should have known of the debtor's illegal conduct in securing the mortgages. The district court denies equitable subordination. Equitable subordination is a remedial, not a penal, measure and should be used only sparingly. In the case of a non-fiduciary, non-insider, gross and egregious conduct, tantamount to fraud, misrepresentation, over reaching, spoliation or conduct involving moral turpitude are required before a court will equitably subordinate a claim." Lehman's participation in the debtor's scheme, while reprehensible, did not rise to that level in a way that harmed other creditors of the debtor. Accordingly, the remedial measure of equitable subordination was not warranted. The court notes that subordination of a non-insider, non-fiduciary claim is rarely if ever imposed. *Austin v. Chisick (In re First Alliance Mortgage Co.)*, 298 B.R. 652 (C.D. Cal. 2003); *aff'd sub nom. Henry v. Lehman Comm'l Paper, Inc. (In re First Alliance Mortgage Co.)*, 471 F.3d 977 (9th Cir. 2006).

6.2.oooo. State penalties for non-payment of postpetition wages are entitled to administrative expense priority. The debtor-in-possession failed to pay certain wages, resulting in the imposition of a state Labor Code penalty in the employees favor. The penalty is entitled to administrative expense priority, because it was imposed for failure of the debtor-in-possession to comply with postpetition obligations in the operation of its business. *Gonzales v. Gottleib (In re Metro Fulfillment, Inc.)*, 294 B.R. 306 (9th Cir. B.A.P. 2003).

6.2.pppp. Debtor-in-possession need not contract directly for services to be liable for an administrative expense claim. The debtor-in-possession's affiliate, a chapter 11 debtor in a related but unconsolidated case, had contracted prepetition with Verizon to provide telecommunication services. Before bankruptcy, the affiliate transferred the Verizon-served markets to the debtor, who continued to serve those markets. Neither entity had notified Verizon. The affiliate continued to deal directly with Verizon, acting as agent for the debtor. Verizon sought an administrative expense claim against both debtors for postpetition services rendered. The court reviewed the two tests that must be satisfied for payment of an administrative expense: "benefit to the estate" and "a transaction with the debtor-in-possession." The court rules that the services did not benefit the estate of the affiliate. The debtor-in-possession argued that although it received the benefit, it did not enter into a transaction as debtor-in-possession with Verizon. Understandably, the court did not want to leave Verizon without a remedy for the services it had provided. The court determines that the "transaction with the debtor-in-possession" requirement may be met where the debtor-in-possession knowingly desires and accepts the postpetition benefit. *In re Adelphia Business Solutions, Inc.*, 296 B.R. 656 (Bankr. S.D.N.Y. 2003).

6.2.qqqq. Credit card charge-backs do not entitle card processor to consumer deposit priority. Before bankruptcy, the debtor took numerous credit card deposits from consumers for its services. The debtor submitted the credit card charges to a processor, who paid the debtor the amount of the charges and submitted the charges to and received payment from the card issuing banks. When the debtor filed bankruptcy, the customers, who had not received the services, sought reimbursement from the card issuing banks, which sought reimbursement from the processor. The reimbursements were required under the Fair Credit Billing Act and the agreements among the customer, the banks, and the processor. Under the circumstances, the processor subrogated to the claims of the customers against the debtor. Even though the agreements also provided for an assignment of the claims to the processor, the assignment was not voluntary but was required by law and the other agreements. Under the circumstances, the court treated the transaction as a subrogation, with the result that section 507(d), which prohibits subrogation to a priority, applied. The court denied priority to the processor. *Nova Information Systems, Inc. v. Premier Operations, Ltd. (In re Premier Operations)*, 294 B.R. 213 (S.D.N.Y 2003).

6.2.rrrr. Equitable subordination may be only remedial, not punitive. The creditors egregious breach of fiduciary duty in the case resulted in the equitable subordination of its claim. In determining the amount that should be subordinated, the Third Circuit rules that "a claim should be equitably subordinated only to the extent necessary to offset the harm suffered by the debtor and its creditors as a result of the inequitable conduct." In this case, a significant portion of the harm that the other creditors suffered was the attorneys' fees that the estate incurred in litigating not only the subordination of the claims but also other aspects of the creditors' conduct. Thus, the claim was subordinated to the extent necessary so that

the distribution to the creditor would be reduced by the amount of attorneys' fees incurred. The court specifically includes the attorneys' fees incurred as a result of the creditor repeatedly relitigating issues which the court found to be inequitable conduct. *Citicorp Venture Capital, Ltd. v. Committee of Creditors*, 323 F.3d 228 (3d Cir. 2003).

6.2.ssss. Shareholder loans are not automatically recharacterized or subordinated. The shareholder had previously capitalized the debtor with $10 million. When the debtor became financially distressed and could not obtain funds from any other source, it approached the shareholder for a $300,000 loan. The shareholder agreed, but insisted upon collateral. Bankruptcy soon followed. Other creditors sought recharacterization or equitable subordination. The court rules that a shareholder loan at a time of financial distress should not automatically be recharacterized, because the test for undercapitalization as one of the factors in determining recharacterization must be determined as of the inception of the business, rather than at the time of the loan. In addition, the debtor's inability to obtain a loan from any other source should not result in automatic recharacterization, despite some authorities to the contrary. Finally, the claim should not be subordinated by reason of the lender's insider status. The taking of a security interest is not such inequitable conduct as to require subordination, nor does undercapitalization at the time of the loan constitute inequitable conduct that requires subordination. *Farr v. Phase-I Molecular Toxicology, Inc. (In re Phase-I Molecular Toxicology, Inc.)*, 287 B.R. 571 (Bankr. D.N.M. 2002).

6.2.tttt. Retention bonuses are denied administrative expense priority. Before bankruptcy, the debtor promised employees retention bonuses if they worked until the closing of certain retail stores. The debtor filed chapter 11 before the stores were closed. The employees continued working until closure and sought administrative expense priority for their retention bonuses on the grounds that they were not earned until the stores were closed and the employees were terminated. The Third Circuit requires pre-petition and post-petition proration of the retention bonus amounts on the grounds that the pre-petition services do not qualify under the standard of section 503(d)(1) as actual, necessary costs and expenses of preserving the estate. *Former Employees v. Hechinger Investment Co. (In re Hechinger Investment Co.)*, 298 F.3d 219 (3d Cir. 2002).

6.2.uuuu. Post-petition rent is not entitled to a super-priority. Administrative rent under a non-residential lease of real property that section 365(d)(3) requires to be paid is not entitled to priority over the expenses of administration of a superceding chapter 7 case. Similarly, if the chapter 11 estate is insolvent, the administrative rent payable under section 365(b)(3) shares pro rata with other chapter 11 administrative expenses. *Kir Temecula v. LPM Corp. (In re LPM Corp.)*, 300 F.3d 1134 (9th Cir. 2002).

6.2.vvvv. Litigation costs are awarded first priority status. The trustee sued to recover a fraudulent transfer and lost. The bankruptcy court awarded the defendants costs. The First Circuit rules that the costs, awarded under chapter 123 of title 28, are entitled to first priority under section 507(a)(1), because of the express reference to chapter 123 in section 507(a)(1), whether or not the costs would qualify as administrative expenses under section 503(b). *Brandt v. Lazard Freres & Co. (In re HealthCo International, Inc.)*, 310 F.3d 9 (1st Cir. 2002).

6.2.wwww. Equitable subordination and fraudulent transfer claims dismissed. The creditors committee sued the debtor's bank lenders on claims of equitable subordination and fraudulent transfer arising out of the lenders' providing new financing to the debtor in connection with the debtor's issuance of subordinated notes and the acquisition of three businesses. In granting the lenders' motion to dismiss the complaint, the court provides a thorough yet succinct primer on the law of equitable subordination and alter ego liability. In addition, the court rules that the loan, note issuance, and acquisition transactions should not be collapsed, again providing a solid summary of the law governing when transactions should be collapsed. *Official Committee of Unsecured Creditors v. Morgan Stanley & Co., Inc. (In re Sunbeam Corp.)*, 284 B.R. 355 (Bankr. S.D.N.Y. 2002).

6.2.xxxx. Tax lien subordination under section 724 applies only to statutory liens. Under section 724(b), "a lien that secures a tax" is subordinated to payment of certain priority claims. Construing what it considers ambiguous language in the provision, the Ninth Circuit rules that the subordination

provision applies only to statutory tax liens. Therefore, in a case where the IRS received an adequate protection lien in return for turning over funds that it held to secure taxes, the subordination provision did not apply. *Barstow v. United States (In re Markair, Inc.)*, 308 F.3d 1038 (9th Cir. 2002).

6.2.yyyy. Tax lien subordination to priority claims is limited. Section 724(b) subordinates a tax lien to certain priority claims, to the extent of the amount of the tax lien. The Ninth Circuit construes section 724(b)(2) to limit the amount of priority claims that may be paid from property securing the tax lien to the dollar amount of the secured tax claim. Therefore, if there is a surplus after payment of the tax lien and any other secured claims, the funds go to the tax claimant rather than to priority claimants. *North Slope Borough v. Barstow (In re Markair, Inc.)*, 308 F.3d 1057 (9th Cir. 2002).

6.2.zzzz. Unemployment benefit reimbursement obligations are not entitled to administrative expense priority. The debtor non-profit corporation was obligated by state law to reimburse the state for unemployment benefits that the state paid to workers terminated after the filing of the chapter 11 case. The First Circuit rules that the reimbursement payments are administrative expenses only to the extent that they are attributable to work done after the petition. The court reasons that the unemployment compensation would have been paid to the employees even if they had been terminated on the date of the filing of the petition, so that post-petition termination does not increase the priority of the state's reimbursement claim, relying on *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976). *Commonwealth of Massachusetts v. Boston Regional Medical Center, Inc. (In re Boston Regional Medical Center, Inc.)*, 291 F.3d 111 (1st Cir. 2002).

6.2.aaaaa. Post-petition interest on an administrative tax claim has administrative priority. Following four other circuits and overruling the B.A.P., the First Circuit rules that interest accrued during a case on an administrative expense tax claim that is entitled to priority under section 503(b)(1)(B)(i) is also entitled to administrative expense priority, despite the language in section 726(a)(5) that subordinates post-petition interest on claims. The court finds the statutory language ambiguous and so relies on legislative history, historical context (including the Supreme Court's decision in *Nicholas v. United States*, 384 U.S. 678 (1966)), and statutory policy. *United States v. Yellin (In re Weinstein)*, 272 F.3d 39 (1st Cir. 2001).

6.2.bbbbb. Court strictly limits payment of critical vendors. On the debtor's motion for payment of critical vendors, the court finds that other than section 105, the Bankruptcy Code does not authorize such payments and that the case law does not give a court broad powers to approve payment of pre-petition claims. The court rules, however, that claims may be paid if necessary to performance of the debtor-in-possession's fiduciary duty to preserve and maximize the value of the estate. The court requires that the debtor show that it is critical that the debtor deal with the claimant, that failure to deal with the claimant risks the possibility of harm or loss of economic advantage that is disproportionate to the amount of the claimants pre-petition claim, and that there is no practical or legal alternative by which the debtor can obtain goods or services from the claimant (such as by a deposit, C.O.D., or assumption of a contract). *In re Coserv, L.L.C.*, 273 B.R. 487 (Bankr. N.D. Tex. 2002).

6.2.ccccc. Non-profit's unemployment payments in lieu of insurance contributions is not a tax. Under the Federal unemployment insurance scheme, as implemented by the states, non-profit organizations may choose to reimburse the state directly for an unemployment payment the state must make to the non-profit's former employees. The First Circuit holds, in a case of first impression, that the reimbursement obligation is not a "tax," as used in section 507(a)(8). The reimbursement payments do not defray the cost of government, but are straight dollar-for-dollar reimbursements of unemployment benefits paid. *Commonwealth of Massachusetts v. Boston Regional Medical Center, Inc. (In re Boston Regional Medical Center, Inc.)*, 291 F.3d 111 (1st Cir. 2002).

6.2.ddddd. Workers compensation "excise tax" liability arises upon injury. The Arizona Workers Compensation Statute provides for payment of an injured worker from a special fund and for liability on the uninsured employer to reimburse the fund. The Ninth Circuit previously determined that the reimbursement obligation is an "excise tax," within the meaning of section 507(a)(8)(E)(ii). *In re Camilli*, 94 F.3d 1330 (9th Cir. 1996). In this decision, the Ninth Circuit determines that the excise tax is incurred upon the

worker's injury. An excise tax on a transaction occurring more than three years before bankruptcy is dischargeable. In this case, because the injury occurred more than three years before the debtor's bankruptcy, the reimbursement obligation to the state's special fund was discharged. *DeRoche v. Arizona Industrial Commission (In re DeRoche)*, 287 F.3d 751 (9th Cir. 2002).

6.2.eeeee. Section 724 subordinates only statutory tax liens. Section 724(b) subordinates "a lien … that secures an allowed claim for a tax" to certain priority claims that would otherwise be junior to the lien. The district court rules that this provision does not subordinate a judicial lien in favor of the IRS, because the provision applies only to statutory tax liens. The court relies on references later in the section to "such tax lien" and to the legislative history, which uses the same language. *Barstow v. IRS*, 272 B.R. 710 (D. Alaska 2001).

6.2.fffff. Over-secured creditor's unreasonable attorney's fees claim bifurcated. Georgia law permits a creditor, upon a default, to claim attorneys fees equal to 15% of the loan. Here, the creditor made the claim before bankruptcy, so it was entitled to an allowed claim for that amount under section 502(b). The creditor's claim was over-secured, so the creditor sought allowance of the attorneys fees as part of its secured claim under section 506(b). The court rules that the attorneys fees claim must be bifurcated, so that the portion that is "reasonable" is entitled to treatment as a secured claim under section 506(b), while the balance is allowed as a general unsecured claim. *Welzel v. Advocate Realty Investments, LLC (In re Welzel)*, 275 F.3d 1308 (11th Cir. 2001).

6.2.ggggg. Claim for failure to register stock is subordinated under section 510(b). In purchasing assets from the claimant, the debtor agreed to register the common shares given in payment of the purchase price. The debtor did not do so and filed bankruptcy before the claims were registered. The claimants asserted a breach of contract claim. The Third Circuit subordinates the claim under section 510(b), holding that because the claim arose under the contract for the purchase of the common stock, the claim "arises from the purchase or sale" of the stock, as provided in section 510(b), is one "arising." *Baroda Hill Investments, Ltd. v. Telegroup, Inc. (In re Telegroup, Inc.)*, 281 F.3d 133 (3d Cir. 2002).

6.2.hhhhh. Court subordinates claim for failure to register stock. The claimants sold their company to the debtor for cash and stock of the debtor. In a supplement, the debtor agreed to have an initial public offering or to register the shares within 18 months. Instead, the debtor filed chapter 11. The court subordinates the creditor's claim. Following the Third Circuit's broad subordination decision in *In re Telegroup, Inc.*, 281 F.3d 133 (3d Cir. 2002), the court rules that the claim is in connection with the purchase or sale of securities of the debtor, because the creditors received some stock in the debtor in exchange for selling the shares in their company through the debtor. The court dismisses the argument that the claim arises from a supplement rather from the initial share purchase agreement as a basis that the claim did not arise from the purchase of the debtor's stock. *Frankum v. International Wireless Communications Holdings, Inc. (In re International Wireless Communications Holdings, Inc.)*, 279 B.R. 463 (D. Del. 2002).

6.2.iiiii. Securities fraud "retention" claim is subordinated under section 510(b). The investor claimed that he would have sold his securities but for the debtor's fraudulent concealment of information concerning the debtors' true financial condition. He asserts the claim for damages arising from failing to sell as a claim in the chapter 11 case. The Tenth Circuit rules that the claim for fraudulent retention of the securities must be subordinated under section 510(b). Looking to the broad policy of section 510(b) to subordinate all investor claims related to the debtor's illegal conduct with respect to securities, the Tenth Circuit finds that the claim is one "arising from the purchase or sale" of the securities, linking the damages to the original purchase of the security. *Allen v. Geneva Steel Co. (In re Geneva Steel Co.)*, 281 F.3d 1173 (10th Cir. 2002).

6.2.jjjjj. Stock merger agreement is a contract to issue securities of the debtor. The debtor agreed to acquire the seller's business for $200,000 in cash, assumption of $500,000 of liabilities, and issuance of shares in three installments worth $3.5 million. Before all shares were issued, the debtor filed a chapter 11 case. The court concludes that because the obligation to issue shares, was the lion's share of the consideration for the merger, the merger agreement constituted a contract to issue a security of the

debtor and as such could not be assumed under section 365(c)(2). The court departs from the narrower construction of section 365(c)(2) in *In re Teligent*, 268 B.R. 723 (Bankr. S.D.N.Y.), and rules that because it cannot be assumed, the contract must be rejected. *In re Ardent, Inc.*, 275 B.R. 122 (Bankr. D.D.C. 2001).

6.2.kkkkk. Section 506(c) surcharge is paid directly to the administrative claimant. During the course of the chapter 11 case, debtor's counsel incurred $50,000 in fees to try to sell the collateral; a potential purchaser advanced $150,000 under section 364(c)(1) to permit the property to continue operating. After the sales failed and the property was sold at auction, the secured creditor and the debtor's counsel entered into an agreement permitting the debtor's counsel to be paid $50,000 from the collateral as a surcharge under section 506(c). The superpriority administrative claimant objected. The Ninth Circuit rules that by reason of *Hartford Underwriters*, 530 U.S. 1 (2000), the administrative claimant had no standing to object to the surcharge settlement. Moreover, the distribution of the surcharge directly to the debtor's counsel was appropriate, because the result to the administrative claimant should not depend on whether the trustee expended money to benefit the secured creditors collateral or simply incurred a debt to an administrative claimant. The carve out of the collateral must be paid directly to the claimant who benefited the secured creditor. *Debbie Reynolds Hotel & Casino, Inc. v. Calstar Corp., Inc. (In re Debbie Reynolds Resorts, Inc.)*, 255 F.3d 1061 (9th Cir. 2001).

6.2.lllll. Creditor's post-petition attorney's fees under a pre-petition contract are not entitled to administrative expense priority. The chapter 7 trustee sued a creditor post-petition for breach of contract but was unsuccessful in his action. The contract contained a prevailing party attorney's fees clause, so the bankruptcy court awarded the creditor attorney's fees but declined to grant administrative expense priority to the fees. Basing its ruling on a policy analysis of *Reading Co. v. Brown*, 391 U.S. 471 (1968), the Fifth Circuit rules that the creditor is not entitled to administrative expense priority for its attorney's fees. The court does not base its decision primarily on the fact that the contract was a pre-petition contract, for it notes that the trustee commenced the action post-petition, nor on the fact that the trustee did not commit a wrongful act (as in Reading). Rather, it bases its ruling on a balancing of potential injury to the creditor and the other unsecured creditors, who would be substantially penalized by an award of administrative expense priority. *Total Niatome Corp. v. Jack/Wade Drilling, Inc. (In re Jack/Wade Drilling, Inc.)*, 258 F.3d 385 (5th Cir. 2001).

6.2.mmmmm. Post-petition unemployment taxes relating to pre-petition employment is not entitled to administrative expense priority. The debtor self-insured its unemployment insurance, paying amounts to the state retroactively based on unemployment benefits that the state paid to laid-off workers, based on their pre-layoff wages. Shortly after filing bankruptcy, the debtor laid-off most of its employees. The state began paying unemployment benefits to the employees and filed an administrative expense priority claim against the debtor. The B.A.P. rejects the state's argument that the state's date of payment of the benefits is the triggering event for administrative expense priority, looking instead to the pre-petition entity as the employer who incurred the liability to the state for the unemployment benefits. *Commonwealth v. Boston Regional Medical Center, Inc. (In re Boston Regional Medical Center, Inc.)*, 265 B.R. 838 (1st Cir. B.A.P. 2001).

6.2.nnnnn. Section 510(b) takes precedence over section 541(d). A purchaser of securities from the debtor alleged that the purchase had been induced by fraud, such that the court should impress a constructive trust on the purchaser's funds still held by the debtor at the time of bankruptcy. The debtor argued that section 510(b) subordinated a claim for rescission of the purchase of securities. The purchaser argued that section 541(d) prevented the property from becoming property of the estate, because of the debtor's fraud and the purchaser's right to the imposition of a constructive trust, so the debtor never obtained an equitable interest in the funds. The court rules that section 510(b) evidences a Congressional policy to subordinate all securities purchase rescission and claims, even where a constructive trust is alleged. *NationsBank, N.A. v. Commercial Financial Services, Inc. (In re Commercial Financial Services, Inc.)*, 268 B.R. 579 (Bankr. N.D. Okla. 2001).

6.2.ooooo. Indenture subordination provision enforced. The debtor's subordinated indenture contained the standard "double dividend" provision, under which the distribution to the subordinated

noteholders is diverted to the senior noteholders until the senior notes are paid in full. Under the terms of the indenture, the double dividend provision applied only in the event of the dissolution, liquidation, reorganization, or distribution of the assets of the debtor, but another provision, simply prohibiting payments on the subordinated notes, applied in all other circumstances. The Ninth Circuit overruled the objection of an unsecured creditor that the double dividend provision, triggered by the bankruptcy or dissolution language of the indenture constituted an invalid *ipso facto* clause that changed the rights of the debtor upon the filing of the bankruptcy. The Ninth Circuit therefore does not address the issue of whether the indenture is an executory contract to which section 365(e) applies nor the enforceability of the subordination agreement under section 510(a). *Spieker Properties, L.P. v. SPFC Liquidating Trust (In re Southern Pacific Funding Corp.)*, 268 F.3d 712 (9th Cir. 2001).

6.2.ppppp. When is an administrative property tax incurred? Section 503(b)(1)(B)(i) grants administrative expense priority to a tax "incurred by the estate," unless the tax is of a kind specified in section 507(a)(8). The latter section grants pre-petition priority to "a property tax assessed before the commencement of the case." In this case, the tax record date, which determined valuation of the property, occurred on January 1; the debtor filed chapter 11 on January 15; the city council voted the amount of the property tax on May 19; and the tax year began July 1. The Sixth Circuit rules that the tax was "incurred" when imposed by the city council, because that was when the property owner became personally liable for the property tax. The property tax was not "assessed" before the commencement of the case, because the test of when a tax is assessed is essentially the same as when it is incurred. In addition, the taxing agency did not have a contingent claim at the January date of the filing of the petition, because no right to payment, contingent or otherwise, existed until the city imposed the tax. *City of White Plains v. A & S Galleria Real Estate, Inc. (In re Federated Department Stores, Inc.)*, 270 F.3d 994 (6th Cir. 2001).

6.2.qqqqq. A senior lienor does not owe a fiduciary duty to a junior lienor. Once the chapter 11 case failed, the senior creditor, whose lien extended to accounts, inventory, equipment, and real property, foreclosed. The junior lienor, whose lien extended only to accounts and the real property, brought an action against the senior for damages for the senior's failure to marshal and for breach of fiduciary duty. The court rules that marshaling is an equitable doctrine that can be asserted only at the time of the foreclosure on the assets. More importantly, the court rules that a senior secured creditor does not have any fiduciary duty to a junior secured creditor, because the parties are involved in a commercial transaction in which the senior does not act for the junior's benefit and the junior does not place any special confidence or trust in the senior in the transactions. *Simmons Foods, Inc. v. Capital City Bank, Inc.*, 270 B.R. 295 (D. Kan. 2001).

6.2.rrrrr. Severance payment is not entitled to administrative expense priority. Shortly after filing chapter 11, the debtor terminated an executive whose employment contract provided for a severance payment of one year's salary and moved to reject the contract. The executive sought administrative expense priority for the severance payment. The Tenth Circuit rejected the claim. Reasoning that priorities must be narrowly construed, the court ruled that the debtor's liability for the payment arose at the time the contract was entered into by the debtor, not the debtor in possession; that the consideration the executive provided the debtor for the severance payment was given prepetition; and that the short period of postpetition employment did not provide adequate consideration to the estate to support administrative expense priority. *Bachman v. Commercial Financial Services, Inc. (In re Commercial Financial Services, Inc.)*, 246 F.3d 1291 (10th Cir. 2001).

6.2.sssss. Section 510(b), subordinating securities claims, should be read broadly. The claimants sold their companies to the debtor in exchange for the debtor's stock, which was never issued. The Ninth Circuit subordinates the claimants' claims under section 510(b), ruling that section 510(b) applies to any purchase or sale of equity securities, not just to claims for violation of the securities laws, that physical possession of the stock certificates is not required as a condition to subordination, nor is an actual sale required for subordination. The claimants had already transferred the assets to the debtor and received either the stock or the promise of stock in exchange. They could not, on those facts, convert their claim into a general unsecured claim. *American Broadcasting System, Inc. v. Nugent (In re Betacom of Phoenix, Inc.)*, 240 F.3d 823 (9th Cir. 2001).

6.2.ttttt. Section 510(b) subordination applies to claims for debtor's fraud after purchase of notes. The creditor asserted that the debtor's fraud lulled the creditor into holding senior bonds rather than selling them. The Tenth Circuit B.A.P. rules that the claim must be subordinated under section 510(b), giving a broad reading to the statutory language requiring subordination of claims arising from the purchase or sale of a security, based on the policy underlying section 510(b). *Allen v. Geneva Steel Co. (In re Geneva Steel Co.)*, 260 B.R. 517 (10th Cir. B.A.P. 2001).

6.2.uuuuu. Section 510(b) subordination does not require disallowance in a subsidiary's case. The creditor owned Dragon Systems, Inc., which merged into a subsidiary of the debtor, and received common stock of the parent in the merger transaction. Both the debtor and its subsidiary filed chapter 11. The creditor filed claims in both cases, acknowledging that section 510(b) required subordination of its claims in each case to the level of common stock in each case, even though it held common stock only in the parent corporation. The subsidiary argued that the claim should be completely subordinated to the level of common stock in the parent company. The bankruptcy court overruled the debtor's objection, ruling that section 510(b) applies separately in each of the two cases and that the debtor's position would require disallowance, rather than subordination, of the claim in the subsidiary's case. *Learnout & Hauspie Speech Products, N.V. v. Baker (In re Learnout & Hauspie Speech Products, N.V.)*, 264 B.R. 336 (Bankr. D. Del. 2001).

6.2.vvvvv. Post-petition interest on post-petition taxes is subordinated. The Trustee was late in filing tax returns for the estate, incurring interest on the administrative expense taxes. Departing from the Eleventh Circuit's interpretation of sections 503(b) and 726(a), the First Circuit B.A.P. rules that the Bankruptcy Code subordinates to 726(a)(5) priority any post-petition interest incurred on a post-petition tax, effectively holding that the statutory language changes the result from the Bankruptcy Act case of *Nicholas v. United States*, 384 U.S. 678 (1966). *United States v. Yellin (In re Weinstein)*, 251 B.R. 174 (1st Cir. B.A.P. 2000).

6.2.wwwww. Only the trustee may recover administrative expenses from collateral. The Supreme Court reads section 506(c) literally to permit only a trustee to recover administrative expenses from a creditor's collateral. It denied recovery to the insurance company that insured the debtor's operations during the chapter 11 case, although the operations and the insurance ultimately inured to the benefit of the secured creditor from whose collateral the insurer sought recovery. *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 120 S. Ct. 1942 (2000).

6.2.xxxxx. Court limits superpriority claim for lack of adequate protection. Under section 507(b), if the trustee provides adequate protection of a secured creditor's lien and the protection turns out to be inadequate, the creditor is entitled to a superpriority administrative expense for the inadequacy. In this case, however, the court holds that where the secured creditor sought but was denied any provision of adequate protection, if the court was wrong and the creditor should have received additional protection, the creditor's claim will not be entitled to a superpriority administrative expense status. *LNC Investments, Inc. v. First Fidelity Bank*, 247 B.R. 38 (S.D.N.Y. 2000).

6.2.yyyyy. Claim for breach of registration rights agreement is subordinated under section 510(b). When the creditor purchased debentures from the debtor, the debtor granted registration rights both in the purchase agreement and in a separate registrations rights agreement. The bankruptcy court subordinated the claim for failure to register the debentures on demand under section 510(b) as a claim "arising from the purchase" of the debentures, reasoning that the debtor would not have failed to register the debentures and the creditor would not have incurred any damages if the creditor did not purchase the debentures in the first place. *In re Nal Financial Group, Inc.*, 237 B.R. 225 (Bankr. S.D. Fla. 1999).

6.2.zzzzz. Reclamation rights defined. The rights of a seller of goods to the debtor who delivered a prepetition reclamation notice under UCC Section 2-702 is subject to the right of a lender with a security interest in inventory, who qualifies as "good faith purchaser" under section 2-702(3), even though the lender terminated funding before the reclaimed goods were shipped. In addition, the debtor's disposition of the goods, with the proceeds paid to the lender, cut off the reclaiming creditor's rights. As a result, the reclaiming creditor was entitled to neither an administrative priority claim nor a lien under section 546(c). *Galey & Lord, Inc. v. Arley Corp. (In re Arlco, Inc.)*, 239 B.R. 261 (Bankr. S.D.N.Y. 1999).

6.2.aaaaaa. Late filed priority claims retain priority in chapter 7. Resolving an apparent conflict between section 726(a)(1) ("claims of the kind specified in … 507") and section 726(a)(3) ("any allowed unsecured proof of claim which is tardily filed"), the Fourth Circuit rules that late-filed priority claims retain their priority under section 726(a)(1). This decision follows the decisions of the Second, Ninth, and Eleventh Circuits, and departs from the contrary decision of the Fifth Circuit. *Cooper v. Internal Revenue Service*, 167 F.3d 857 (4th Cir. 1999).

6.2.bbbbbb. A punitive criminal fine is not an administrative expense. The debtor in possession was convicted of criminal violations of environmental laws and fined as punishment. The punitive fine was disallowed as an administrative expense because it was not part of the cost of operating or preserving the estate. The court distinguished civil penalties or other fines that may be compensatory rather than punitive. *Pennsylvania Department of Environmental Resources v. Tri-State Clinical Laboratories, Inc.*, 178 F.3d 685 (3d Cir. 1999).

6.2.cccccc. An insider's receipt of note payments may constitute inequitable conduct. The board of the debtor adopted resolutions agreeing not to pay loans made by the directors before loans made by an unrelated creditor, thereby subordinating the directors' claims. When the debtor got in financial trouble, the debtor paid the directors' claims first. The court subordinated the directors' claims, finding that the payment was inequitable conduct that resulted in injury to the outside creditor. *Goode v. Hagerty (In re Systems Impact, Inc.)*, 229 B.R. 363 (Bankr. E.D. Va. 1998).

6.2.dddddd. Liquidation surplus goes to the debtor, not its shareholders. Creditors were paid in full in this chapter 7 case, and the official equity committee (probably left over from a failed chapter 11 case) argued for subordination of a preferred stockholder's interest. The court holds that the surplus goes to the debtor, as required by section 726(a)(6), not to the stockholders, so the court did not reach the equitable subordination issue. *Holders of Class C Common Stock v. Kauthar Sdn. Bhd. (In re Rimsat, Ltd.)*, 229 B.R. 910 (Bankr. N.D. Ind. 1998).

6.2.eeeeee. Prepetition attachment may be perfected only by judgment. The creditor obtained a prejudgment attachment more than 90 days before bankruptcy, but did not obtain the state court judgment required to perfect the attachment lien. A postpetition judgment after relief from the automatic stay would have perfected the lien. In this case, however, the parties stipulated to the allowance of the creditor's claim in the bankruptcy court. The bankruptcy court and the B.A.P. held that the allowance of the claim was the equivalent to a judgment, perfecting the attachment lien, but the Ninth Circuit reversed, holding that the process for allowance of a claim was less protective of the debtor than the process for obtaining judgment in state court. As a result, the allowance did not perfect the judgment. *Diamant v. Kasparian (In re Southern California Plastics, Inc.)*, 165 F.3d 1243 (9th Cir. 1999).

6.2.ffffff. WARN Act liability is an administrative expense. The debtor in possession terminated employees without giving a proper WARN Act notification. Relying on cases determining the priority of severance pay obligations, rather than on a classification of the WARN Act liability as back pay, the court grants the obligation administrative expense priority. *In re Beverage Enterprises, Inc.*, 225 B.R. 111 (Bankr. E.D. Pa. 1998).

6.2.gggggg. Real property tax billing date does not determine priority status. Section 365(d)(3) requires the debtor to perform all obligations under a real property lease arising after the order for relief. In this case, the lease required the debtor to pay real property taxes within one month after being billed by the landlord. The landlord billed the debtor after the order for relief for prepetition real property taxes. In a case of first impression at the court of appeals level, the Seventh Circuit holds that the period to which the taxes relate determines whether the taxes are entitled to administrative expense priority under section 365(d)(3). In this case, they were not. *In re Handy Andy Home Improvement Centers, Inc.*, 144 F.3d 1125 (7th Cir. 1998).

6.2.hhhhhh. Section 510(a) overrules the Rule of Explicitness. The Rule of Explicitness had prohibited senior creditors from receiving postpetition interest and costs out of a distribution to subordinated creditors unless the indenture specifically made clear that the subordination applied to

postpetition interest. The Eleventh Circuit rules that section 510(a), which requires enforcement of subordination agreements "according to applicable non-bankruptcy law" overrules the Rule of Explicitness, which was an equitable doctrine developed by the bankruptcy courts. The specific holding of the case is of limited interest, because a current indenture form includes an explicit provision subordinating claims to postpetition interest. More interestingly, the court states, without explicit discussion, that a principle that applies only in bankruptcy is rendered inapplicable by Congress' reference to applicable non-bankruptcy law in section 510(a). *Chemical Bank v. First Trust of New York (In re Southeast Banking Corp.)*, 156 F.3d 1114 (11th Cir. 1998).

6.2.iiiiii. Subordination of a claim under section 510(b) requires an actual purchase or sale. The creditors had agreed to sell their stock in the debtor to the debtor's new parent, but the sale was never consummated. The creditor's claims were not subordinated under section 510(b), which requires an actual purchase or sale as a condition to subordination, following the Supreme Court's analogous construction of Section 10(b) of the '34 Act in *Blue Chip Stamps v. Manner Drug Stores*, 421 U.S. 723 (1975). *Nugent v. American Broadcasting System, Inc. (In re Betacom of Phoenix, Inc.)*, 225 B.R. 703 (D. Ariz. 1998).

6.2.jjjjjj. Securities fraud indemnification claims are subordinated. The claims of the officers and directors for reimbursement on account of securities fraud claims are not entitled to administrative priority, because the activities giving rise to the claims all occurred pre-petition. Claims of underwriters for indemnification are subordinated under section 510(b), because they arise out of the purchase or sale of a security of the debtor, and section 510(b) is not limited to the claims of stockholders. *In re Mid-American Waste Systems, Inc.*, 228 B.R. 816 (Bankr. D. Del. 1999).

6.2.kkkkkk. Court equitably subordinates claims purchased by insider. A director, on behalf of a major creditor whom the director represented on the board, purchased substantial claims against the debtor "(1) for the dual purpose of making a profit and being able to influence the reorganization in its own self interest (2) with the benefit of non-public information acquired as a fiduciary, and (3) without disclosure to the bankruptcy court, the board, the creditor's committee or the selling noteholders." Finding the conduct "a paradigm case of inequitable conduct by a fiduciary," the court of appeals affirmed the bankruptcy court's decision limiting the creditor's recovery on the claims to the amount paid, but remanded for further factual findings as to whether additional equitable subordination, such as limiting the allowed amount of the claims to the amount paid, was appropriate. *Committee of Creditors v. Citicorp Venture Capital, Ltd.*, 160 F.3d 982 (3d Cir. 1998).

6.2.llllll. Undercapitalization alone does not justify equitable subordination. In the absence of inequitable conduct, fraud, or deceit, or some other form of conduct causing harm to other creditors by a corporation's insiders, loans made by insiders to under-capitalized corporation will not be subject to equitable subordination. The opinion contains a thoughtful discussion of the different kinds of undercapitalization. *In re Lifschultz Fast Freight*, 132 F.3d 339 (7th Cir. 1997).

6.2.mmmmmm. Postpetition attorneys' fees incurred under prepetition contract are not entitled to administrative expense priority. Before bankruptcy, the debtor sued Hayden and obtained a judgment under a contract that had an attorneys' fees clause. After bankruptcy, the state appellate court reversed the judgment and ordered the debtor to pay Hayden's attorneys' fees. Because the contract was entered into pre-petition, the fees arose out of a transaction with the debtor rather than the debtor in possession. The court thus denied administrative expense priority for the fees that Hayden incurred post-petition. The court overruled a prior Ninth Circuit B.A.P. decision, *In re Madden*, 185 B.R. 15 (9th Cir. B.A.P. 1995), which had concluded that the continued prosecution of the case by the estate subjected the estate to an independent administrative expense obligation. *Abercrombie v. Hayden Corp. (In re Abercrombie)*, 139 F.3d 755 (9th Cir. 1998).

6.2.nnnnnn. An exchange for new value during the involuntary gap need not be simultaneous. During the involuntary gap, the debtor transferred $10,000 to an existing unsecured creditor to assist in obtaining funding. Some months later, the new funding was provided, before the order for relief. The court

holds that the subsequent loan satisfied the requirements of section 549(b). *Yancy v. Varner (In re Pucci Shoes, Inc.)*, 120 F.3d 38 (4th Cir. 1997).

6.2.oooooo. Employment tax on pre-petition wages is a pre-petition claim. The debtor paid wages before bankruptcy but filed her petition before the quarterly due date for the employment taxes on the wages paid. Holding that the employment taxes are incurred when the payment of wages was made, rather than when the tax return and the taxes were due to be paid, the Ninth Circuit holds the taxes to be pre-petition priority taxes owing by the debtor rather than administrative expenses owing by the estate. The debtor was not liable, however, for employment taxes on wages paid by the chapter 11 estate. The taxes were administrative expenses allowable against the estate. *Bellus v. United States*, 125 F.3d 821 (9th Cir. 1997).

6.2.pppppp. PBGC claim for plan contributions receives limited priority. Despite Treasury regulations that impose a single plan contribution debt on an employer at year-end, the bankruptcy court may divide the claim into different priorities based on the policies of the Bankruptcy Code. *Pension Benefit Guaranty Corporation v. Sunarhauserman, Inc. (In re Sunarhauserman, Inc.)*, 126 F.3d 811 (6th Cir. 1997).

6.2.qqqqqq. U.S. trustee fees granted priority. Following the decision of the Eighth Circuit, the Ninth Circuit rules that the unpaid quarterly chapter 11 fees of the United States trustee share pro rata with chapter 7 administrative expenses in a case that is converted from chapter 11 to chapter 7. *U.S. Trustee v. Endy (In re Endy)*, 104 F.3d 1154 (9th Cir. 1997).

6.2.rrrrrr. Mortgagee subordinated to mechanic's lien. A mortgagee's extensive involvement, in a construction project, including reviewing plans, draw requests, and change orders and its ability to object to any draw request, was conduct sufficient to result in the subordination under state mechanic's lien law of the mortgage to mechanic's lien securing the claim of the unpaid contractor. *Exectech Partners v. Resolution Trust Corporation (In re Exectech Partners)*, 107 F.3d 677 (8th Cir. 1997).

7. CRIMES

7.1.a. Proceeds of criminal activity that are untraceably commingled in a debtor's bank account are not subject to forfeiture. A law firm partner conducted a Ponzi scheme through his law firm. The Ponzi scheme proceeds were deposited into law firm bank accounts and commingled over several years with legitimate fees that the firm earned. Because of the number of deposits and withdrawals from the account, the Ponzi scheme proceeds could not be traced. Upon the partner's conviction, the law firm bank accounts were forfeited to the government under criminal forfeiture statutes, which provide for forfeiture of property that is involved in, derived from or proceeds of criminal activity. The law firm's bankruptcy trustee sought to set aside the forfeiture on the ground that the bank accounts were property of the law firm, not of the guilty partner, and were not derived from or proceeds of the Ponzi scheme and therefore were not subject to forfeiture. Property obtained as the result of a crime, and any traceable property, is forfeitable, effective as of the time of the crime. However, the government may forfeit proceeds only when it establishes "the requisite nexus between the property and the offense." Where the proceeds are commingled and cannot be traced, the government cannot show the requisite nexus and therefore cannot forfeit the bank accounts. *U.S. v. Rothstein*, ___ F.3d ___, 2013 U.S. App. LEXIS 11793 (11th Cir. June 12, 2013).

7.1.b. Nondisclosure of an unenforceable option may violate 18 U.S.C. § 152. The debtor was a defendant in state court litigation. Because he needed cash, he sold a vacant lot to a friend for its full market value of $220,000, with an oral agreement that the friend would sell it back to the debtor in a year. The debtor lost the state court litigation and filed a chapter 7 case. The debtor did not disclose the oral repurchase agreement in his statement of affairs or at the 341 meeting. Shortly after the 341 meeting, the debtor caused an affiliate to purchase the lot from the friend for $235,000. Section 521 requires disclosure of all assets. Under 18 U.S.C. § 152, concealing an asset or making a false oath in a bankruptcy case is a felony. The oral repurchase agreement was unenforceable under the statute of frauds, so the asset may have been worthless. But section 521 requires disclosure of all assets, no matter what the debtor's opinion of value. Moreover, the statute of frauds is an affirmative defense; it does not render the

agreement invalid. Therefore, the debtor's failure to disclose the agreement was a crime. *U.S. v. Kurlemann*, 708 F.3d 722 (6th Cir. 2013).

7.1.c. Section 510(b) does not subordinate a claim under a tax agreement for tax benefits that accrue based on the debtor's profits. Seven years before bankruptcy, the debtor's former parent spun off the debtor through an IPO of the debtor's stock. In connection with the spin-off, the debtor and its parent entered into a tax agreement, which required the debtor to pay the parent any benefits that the debtor received from use of tax net operating loss carry-forwards that the debtor had at the spin-off. The parent filed a claim in the debtor's bankruptcy case for damages for breach of the tax agreement in an amount equal to the tax benefits the debtor had received and not paid to the parent. Section 510(b) subordinates any claim "for damages arising from the purchase or sale" of a security of the debtor. The courts construe section 510(b) broadly, but only consistent with its intent and purpose, which was to subordinate the claim of a holder who took on a shareholder's risk and return expectations or seeks to recover a contribution to the debtor's equity pool. The risk analysis is the more important consideration and requires section 510(b)'s application if the claimant expected to profit from its agreement with the debtor and participate in corporate profits. Courts look through the form of the agreement and consider all related agreements in a transaction in determining whether the claimant relied on an equity participation. However, the fact that an agreement was part of an equity-related transaction does not require subordination of any resulting claim. Here, the parent did not contract for a return based on profits or stock price performance. It contracted only for a claim based on tax benefits. Even though the tax benefits arose based only on the debtor's profits, the claim was not for a share of profits. Therefore, section 510(b) does not apply. *CIT Group Inc. v. Tyco Int'l Ltd. (In re CIT Group Inc.)*, 460 B.R. 633 (Bankr. S.D.N.Y. 2011).

7.1.d. 18 U.S.C. § 157 requires specific intent to defraud an identifiable victim. A non-attorney advertised that he could stop tenants' evictions in unlawful detainer actions their landlords had brought against them. Instead, he filed chapter 13 petitions for them. He was indicted under 18 U.S.C. § 157, which was added as a bankruptcy crime in 1994. Section 157 makes criminal a scheme or artifice intended to defraud when the person files a title 11 petition or document in a title 11 case or makes a false or fraudulent representation or claim concerning or in relation to a title 11 proceeding, before or after the filing of the petition. It is patterned on the mail fraud statute, 18 U.S.C. § 1341, and thus requires specific intent to defraud a specific identifiable victim or group of victims. Unlike 18 U.S.C. § 152, which applies to fraudulent activities in the bankruptcy case itself, section 157 applies to activities in a bankruptcy case to further a nonbankruptcy scheme to defraud. Here, the government charged an intent to defraud the landlords but proved only an intent to defraud the tenants out of the fees that he charged them. The proof was therefore inadequate to convict. *United States v. Milwitt*, 475 F.3d 1150 (9th Cir. 2007).

7.1.e. Debtor's attorney convicted for mail fraud. The attorney for the debtor-in-possession negotiated a sale of property of the estate without disclosing that the debtor's principal would receive a lucrative employment contract from the buyer, even though the employment agreement was not really binding on the buyer. The letters between the lawyer and the buyer were sufficient to convict the lawyer of mail fraud. *United States v. Rosen*, 130 F.3d 5 (1st Cir. 1997).

8. DISCHARGE

8.1 General

8.1.a. Only the bankruptcy court that grants the discharge may enforce it. The debtor emerged from a chapter 11 case in Delaware and received its discharge. Years later, some claimants brought a class action against the debtor in Florida state court based on pre-confirmation conduct. The reorganized debtor promptly brought an action in the Florida bankruptcy court for a declaration that the claims had been discharged and to enjoin the claimants from continuing the state court action. A bankruptcy court has *in rem* jurisdiction to issue the discharge and the discharge injunction. Under 28 U.S.C. § 1334(e), only the court in which the bankruptcy case is pending has the *in rem* jurisdiction. A creditor who attempts to collect a discharged debt violates the court's discharge order. A bankruptcy court may enforce its own order. The court may enforce a discharge against anyone, whether or not within the territorial jurisdiction of the issuing court, because the order is based on the court's *in rem* jurisdiction and therefore extends to

the whole world, as long as the bankruptcy notice complies with Constitutional due process requirements. Moreover, the issuing court may enforce its order only by a contempt citation, not by issuing a another injunction to order compliance with an existing injunction. However, only the issuing court may enforce the order. Other courts are without jurisdiction to do so. A reorganized debtor may assert the discharge as an affirmative defense in the state court action, may remove the case to the local bankruptcy court and seek transfer to the home bankruptcy court or may reopen the bankruptcy case to obtain relief to enforce the injunction. But the Florida bankruptcy court did not have jurisdiction to grant any of the relief that the reorganized debtor sought there. In the interest of justice, the court transfers the debtor's action to the Delaware bankruptcy court. *Alderwoods Group, Inc. v. Garcia*, 682 F.3d 958 (11th Cir. 2012).

8.1.b. Corporation may not reaffirm a debt without complying with section 524's procedures. The debtor had guaranteed its non-debtor affiliates' debts. After it confirmed its chapter 11 plan, it entered into a new contract with the guaranteed creditor to pay any new claims the creditor might have against the debtor in exchange for the creditor's agreement not to assert any claims for nine years and a new contract to pay the creditor any damages the creditor incurs, and it reaffirmed its guarantee of its affiliates' debts in exchange for the creditor's agreement not to assert claims for nine years. Section 524 makes unenforceable a debt if the consideration for the debt is based in whole or in part on a discharged debt unless the debtor and the creditor comply with procedures set forth in that section, to protect debtors from making unwise contracts to pay discharged debts. Although the contracts here involved new consideration—the agreement not to sue for nine years—part of the consideration was the discharged debt. Section 524 applies equally to a corporate debtor. Therefore, the agreements are not enforceable. *Sandburg Fin. Corp. v. American Rice, Inc. (In re American Rice, Inc.)*, 2011 U.S. App. LEXIS 19590 (5th Cir. Sept. 22, 2011).

8.1.c. Section 525(b) does not prohibit a private employer from refusing to hire based on bankruptcy. The debtor applied for a job, but the prospective employer rejected him, citing his prior bankruptcy as the reason. Section 525(b) does not permit a private employer to "terminate the employment of, or discriminate with respect to employment against" a debtor solely because of the debtor's bankruptcy. By contrast, section 525(a) does not permit a governmental unit to "deny employment to, terminate the employment of, or discriminate with respect to employment against" a debtor solely because of the debtor's bankruptcy. The difference in the two provisions is dispositive. The court may not probe Congress's intentions or purpose where its language is clear, as it is here. Accordingly, section 525(b) does not prohibit a private employer from discriminating in hiring based on a prior bankruptcy. *Meyers v. Toojay's Mgmt. Corp.*, 640 F.3d 1278 (11th Cir. 2011); *accord*, *Burnett v. Stewart Title, Inc. (In re Burnett)*, 635 F.3d 169 (5th Cir. 2011).

8.1.d. Post-discharge prosecution for prebankruptcy fraud and collection under a restitution order does not violate the discharge injunction. Before bankruptcy, the debtor defrauded the creditor in a several financial transactions. The creditor did not seek to except the debt from discharge under section 523(a)(2), and the debt was discharged. After bankruptcy, the creditor contacted the prosecutor, who agreed to prosecute the debtor for securities fraud and to seek a restitution order under which the debtor would be obligated to pay the creditor. The prosecutor did so and obtained a conviction and the restitution order payable to the creditor. Section 523(a)(7) excepts from discharge a debt owing to or for the benefit of a governmental unit for a fine, penalty or forfeiture and not in compensation for actual pecuniary loss. The exception covers a restitution order. A restitution order by its nature is payable to or for the benefit of a governmental unit and not in compensation, because its purpose is rehabilitative and deterrent, which benefits the government, and is therefore not compensatory. Section 524(a) enjoins any act to collect a discharged debt. Contacting the prosecutor where the purpose is to coerce payment of a debt and where the criminal claim is frivolous or unsubstantiated violates the discharge injunction. Here, however, the prosecutor obtained a conviction, so the claim was clearly neither frivolous nor unsubstantiated. Therefore, the contact did not violate the discharge injunction. *Williams v. Meyer (In re Williams)*, 439 B.R. 679 (10th Cir. B.A.P. 2010).

8.1.e. Section 525(b) does not prohibit a private employer from refusing to hire based on bankruptcy. The debtor applied for a job, but the prospective employer rejected him, citing his prior bankruptcy as the reason. Section 525(b) does not permit a private employer to "terminate the

employment of, or discriminate with respect to employment against" a debtor solely because of the debtor's bankruptcy. By contrast, section 525(a) does not permit a governmental unit to "deny employment to, terminate the employment of, or discriminate with respect to employment against" a debtor solely because of the debtor's bankruptcy. Although "discriminate with respect to employment against" could be read broadly to prohibit denial of employment based on bankruptcy, the omission of the specific prohibition against denying employment, which is found in section 525(a), means that Congress did not intend that prohibition to apply to private employers. Therefore, the prospective employer's refusal to hire based on bankruptcy did not violate the anti-discrimination provision of section 525(b). *Rea v. Federated Investors*, 2010 U.S. App. LEXIS 25501 (3d Cir. Dec. 15, 2010).

8.1.f. 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.g. 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.h. 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.i. 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).

8.1.j. Discharge injunction applies only to creditors. The debtor confirmed a chapter 11 plan, which provided a complete discharge and enjoined all creditors from any act to collect or recover any discharged debt. The plan required the debtor to file a statement with the court shortly after the effective date to provide creditors assurance that the debtor had fully disclosed all assets. The plan gave creditors 10 years to pursue a claim arising from a misrepresentation in the statement. The debtor filed the statement. Shortly before the 10 years' expiration, a third party who was not a creditor but who had dealt with the debtor after confirmation wrote to creditors to advise them that the 10 year-period was about the expire and inviting them to contact the third party. Several did, but none contacted the debtor or initiated any proceedings against the debtor. The debtor reopened the bankruptcy case and sought sanctions against the third party for violating the discharge injunction. The discharge injunction, both in section 524 and in the confirmation order in this case, applies only to creditors and is intended to prohibit only collection actions against the debtor. Because the third party was not a creditor and none of the creditors' actions involved any contact with the debtor, the third party did not violate the injunction in such a manner as to warrant sanction, although the court could enjoin the third party from any further action. *Solow v. Kalikow (In re Kalikow)*, 602 F.3d 82 (2d Cir. 2010).

8.1.k. State may declare restitution or reimbursement to be punitive and therefore nondischargeable. The state bar disbarred the debtor. The state bar law requires a disbarred lawyer to pay the costs of the disbarment proceedings. Section 523(a)(7) excepts from discharge a penalty "payable to and for the benefit of a governmental unit and [ ] not in compensation for actual pecuniary loss". The Ninth Circuit Court of Appeals had previously held that such costs assessed against a debtor were dischargeable. The state legislature amended the statute to add that the costs "are penalties … to promote rehabilitation and to protect the public" specifically to make clear the costs are punitive and nondischargeable in bankruptcy. A state's penal and rehabilitative interests are sufficient to place even a restitution award within section 523(a)(7)'s scope. Therefore, the costs are nondischargeable. *State Bar v. Findley (In re Findley)*, 593 F.3d 1048 (9th Cir. 2010).

8.1.l. A creditor's continuing trespass claim is discharged where state law authorizes asserting the claim at any time. The debtor installed fiber optic cable on the creditor's land. The creditor sued for trespass. When the debtor later filed bankruptcy, the creditor did not file a proof of claim. After plan confirmation and discharge, the creditor sought to continue the prepetition action. The debtor sought an injunction. State law recognizes a continuing trespass and permits a plaintiff to sue at any time for past, present and future damages. Because the creditor could have asserted a claim in the bankruptcy case for the future damages arising from the continuing trespass, plan confirmation discharged the claim, and the discharge injunction applied to the creditor's action. *Browning v. MCI, Inc. (In re WorldCom, Inc.)*, 546 F.3d 211 (2d Cir. 2008).

8.1.m. Chapter 11 discharge is not effective against creditor who did not receive notice. The debtor's customer disputed its debt to the debtor before bankruptcy and, in the correspondence about the dispute, asserted that it had claims against the debtor in excess of the amount the debtor claimed against the customer. The debtor did not list the customer as a creditor in its chapter 11 case, but the customer's president was aware of the chapter 11 case. After plan confirmation, the debtor terminated the customer's service, and the customer sued the debtor to enjoin the termination and for damages for the defective prepetition products and services. A known creditor is entitled to formal notice of the case as provided in the Bankruptcy Rules. A creditor is "unknown" if its claim is "merely conceivable, conjectural or speculative" and is "known" if the existence (though not necessarily the amount) of its claim can be discovered through "reasonably diligent efforts". Here, a reasonably diligent inquiry would have revealed the correspondence

with the customer in which it asserted its claim, so it was a "known creditor" entitled to formal notice. The customer's president's actual knowledge of the case did not suffice as the required notice. Due process requires "notice reasonably calculated under all the circumstances, to apprise interested parties of the pendency of the action." Due process is informed by statutory or rule notice requirements, because those requirements provide a creditor notice of what it may expect and may rely upon. Finally, section 523(a)(3), which discharges an individual debtor from claims held by creditors who had actual knowledge of the case, does not apply to corporations, so creditors of a corporation may rely on an expectation of formal notice, rather than being bound by actual knowledge. Because the customer did not receive the required notice here, its claim is not discharged, and the discharge injunction does not apply. *Arch Wireless, Inc. v. Nationwide Paging, Inc. (In re Arch Wireless, Inc.)*, 534 F.3d 76 (1st Cir. 2008).

8.1.n. Plan confirmation discharges lien on property dealt with by the plan. The court allowed a judgment lien creditor's proof of claim as unsecured, because the liened property was of insufficient value to satisfy a senior security interest. The debtor confirmed a chapter 11 plan that provided for the holder of the senior security interest to retain its lien but did not provide anything for the junior judgment lien claim. The plan also provided that confirmation discharges the debtor from all pre-consummation claims. The case was converted to chapter 7 before full consummation of the plan. Confirmation discharged the judgment lien. Section 1141(c) provides, "except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors …". These facts met all section 1141(c)'s requirements for lien discharge: the plan was confirmed, the property was dealt with by the plan, the lien holder participated in the case by filing a proof of claim, and the plan did not preserve the lien. The post-confirmation conversion to chapter 7 did not require otherwise, even though the plan provided for discharge only upon consummation, because the "except" clause in section 1141(c) does not permit a plan to "re-set" the discharge date from confirmation, as section 1141(c) provides, to a different date, such as the plan effective date. *Elixir Indus., Inc. v. City Bank & Trust Co., (In re Ahern Enterps., Inc.)*, 507 F.3d 817 (5th Cir. 2007).

8.1.o. A chapter 13 filing does not toll the six- (now eight-) year bar on successive chapter 7 discharges. The debtor filed chapter 7 in 1996 and received a discharge. She filed chapter 13 cases in 1999, 2000, and 2001. Each case was dismissed without the debtor's completing payments or receiving a discharge. The cases were pending a total of 2 years, 234 days. Six months after her third chapter 13 case was dismissed, the debtor filed a chapter 7 case. The total time between the filing of her first and second chapter 7 petitions was 7 years, 139 days. A creditor obtained a judgment against the debtor in 2001, before her third chapter 13 case, but did nothing to enforce the judgment after the case was dismissed. Section 727(a)(8) bars a discharge if the debtor "has been granted a discharge under [chapter 7 or 11] in a case commenced within six [now 8] years before the date of the filing of the petition." The bar is not subject to equitable or other tolling for the time the debtor was in a chapter 13 case, because it is not a statute of limitations. It does not begin to run when a creditor's claim accrues or is discovered, and it does not set a time in which a creditor may assert its claim. As shown in this case, the creditor here obtained its judgment five years after the first chapter 7 case and after two of the debtor's three chapter 13 cases and would obtain a procedural windfall if it were able to take advantage of a tolling period from those two cases. Therefore, the provision is not tolled by a chapter 13 case and does not bar the debtor's discharge. *Tidewater Fin. Co. v. Williams*, 498 F.3d 249 (4th Cir. 2007).

8.1.p. Court adopts the "prepetition relationship" test to deny discharge of future claim. The debtor manufactured amusement park rides. The chapter 11 plan provided for sale of substantially all the debtor's assets to a new corporation, with the same management, which assumed the debtor's secured debts. Shortly after the plan's effective date, a ride that the debtor manufactured and sold to an operator prepetition injured a rider, who had no prior contact with the debtor or any of its rides. The plan and the confirmation order discharged all claims "which arose, accrued, or grew out of acts performed by the Debtors before the Effective Date". The injured rider argued that the plan did not discharge the claim. The courts have used three principal tests to determine whether a plan discharges future claims such as this one. They all focus on whether the injured party's claim is a "right to payment" as defined in section 101(5). The minority accrual test, set forth in *In re Frenville Co., Inc.*, 744 F.2d 332 (3d Cir. 1984), looks to whether the right to payment accrued prepetition under nonbankruptcy law. Under the conduct test, the

claim arises at the time of the debtor's conduct giving rise to the alleged liability. The prepetition relationship (or "narrow conduct") test is a variation on the conduct test and determines that there is a claim when the debtor and the claimant have a specific relationship when the conduct occurred or when the claim is within the fair contemplation of the parties. The plan discharges a claim only If there is a claim at the time of bankruptcy (or, in some cases, at confirmation). In this case, although the debtor's conduct in manufacturing the ride occurred prepetition, the injured rider had no connection with the debtor before the post-effective date injury. Applying the prepetition relationship test, the court concludes that the plan did not discharge the rider's claim. The plan also did not discharge the operator's tort indemnification claim against the debtor. The prepetition relationship test requires a prepetition connection or relationship related to the claim. The operator had a prepetition contractual relationship with the debtor, but the operator here seeks to pursue the reorganized debtor for a tort contribution claim. The tort relationship between the debtor and the operator did not arise until the accident and injury occurred, so the operator's tort claim did not arise until after the effective date. (The court, in an extensive and careful review of the future claims case law, repeats the case law's focus on whether there is a "claim" or a "right to payment" under section 101(5) as of the petition date, rather than on the more important question under sections 727 and 1141 of when the claim (or right to payment) arises. In each of these situations, there is a "claim", else the creditor would not be seeking payment, but the discharge operates based on when the claim arises.) Finally, the state court may consider successor liability issues, because the plan did not provide for unknown future claimants through a channeling injunction or other means and therefore cannot release a buyer from potential successor liability. *White v. Chance Indus., Inc. (In re Chance Indus., Inc.)*, 367 B.R. 689 (Bankr. D. Kan. 2006).

8.1.q. Plan discharge injunction may not bar forward-looking regulatory enforcement actions. The debtor's plan confirmation order discharged all claims, enjoined any action or proceeding "with respect to any [prepetition] Claim," and retained "exclusive jurisdiction of all matters arising out of, or related to, the Chapter 11 Case and the [Plan]." The CFTC filed a proof of claim for the debtor's prepetition violations of the Commodity Exchange Act. The debtor in possession objected to the claim, the CFTC did not appear, the claim was "expunged and discharged," and the bankruptcy court retained jurisdiction over "all matters arising out of" the objection. The CFTC later brought a separate action in district court to enjoin future violations of the CEA, basing its claim for an injunction on the debtor's prepetition conduct. Neither the confirmation order nor the claim disallowance order prevented the district court from exercising jurisdiction based on the CEA. The district court action sought to enjoin only future (post-confirmation) conduct and did not seek damages for prepetition violations. It was therefore outside the scope of the confirmation order and the claim disallowance order. Moreover, the bankruptcy court may "retain" only such jurisdiction as it has, and a plan confirmation order may not expand its jurisdiction to overtake the jurisdiction that Congress granted the district court to enforce the CEA. *Commodity Futures Trading Comm'n v. NRG Energy, Inc.*, 457 F.3d 776 (8th Cir. 2006).

8.1.r. A discharge may apply only to claims for which proof may be filed. The debtor filed a prepackaged chapter 11 case on February 28. The court set an April 19 prepetition claims filing bar date. The court confirmed the plan on April 30 and set a July 1 bar date for administrative claims arising between February 28 and April 30. The plan became effective on May 13 and purported to discharge all claims arising on or before the effective date. Three female employees of the debtor claimed that they suffered from gender discrimination upon the debtor's payment of certain similarly situated male employees in January, but that they did not learn of the discrimination until "late April or early May." The bankruptcy court may not discharge a claim arising between the confirmation date and the effective date (April 30 to May 13) without permitting a proof of claim to be filed for the claim. Therefore, the claims arising during that period are not discharged. *ZiLOG, Inc. v. Corning (In re ZiLOG, Inc.)*, 450 F.3d 996 (9th Cir. 2006).

8.1.s. Knowledge of the discharge injunction may not be presumed as a matter of law. The creditor and her counsel had notice of the bankruptcy case and of the confirmation order. They nevertheless filed a post-confirmation action against the debtor based on pre-confirmation claims. The court may not award sanctions on summary judgment, that is, without a full evidentiary hearing, because knowledge of the discharge injunction that is embodied in a confirmation order may be inferred after trial as a matter of fact, but is not a presumption implied in law. Although a party with notice of a bankruptcy

may be charged with knowledge of the automatic stay for purposes of awarding damages under section 362(i), a court may not hold a party in contempt unless the party had specific knowledge of the applicable order, not merely knowledge implied in law. Therefore, contempt sanctions against the creditor and her counsel are unwarranted. *ZiLOG, Inc. v. Corning (In re ZiLOG, Inc.)*, 450 F.3d 996 (9th Cir. 2006).

8.1.t. Chapter 11 plan confirmation discharges continuing trespass claim. Years before bankruptcy, the debtor laid fiber optic cable over the creditor's land, and the creditor sued for trespass. The statute of limitations barred the suit, but the creditor claimed continuing trespass. Any such claim, even if valid under state law, was discharged by plan confirmation. *Int'l Paper Corp. v. MCI WorldCom Network Servs., Inc.*, 442 F.3d 633 (8th Cir. 2006). *See also Browning v. MCI, Inc. (In re WorldCom, Inc.)*, 339 B.R. 836 (S.D.N.Y. 2006), *aff'g.* 320 B.R. 772 (Bankr. S.D.N.Y. 2005) (fiber optic cables were a permanent rather than a continuing trespass, and any claim for trespass was therefore prepetition and discharged.).

8.1.u. Discharge did not release liability for post-discharge patent infringement. A patent holder sued the debtor for infringement before bankruptcy. After the district court granted the patent holder's motion for a default, the debtor filed bankruptcy. The district court stayed the action but resumed it after discharge on the patent holder's claim that the debtor continued to infringe after discharge. However, the district court dismissed the action because of the discharge. The Ninth Circuit reverses. The discharge does not affect the postdischarge infringement, because it applies only to claims that arise before the date of the discharge. *Hazelquist v. Guchi Moochie Tackle Co.,* 437 F.3d 1178 (9th Cir. 2006).

8.1.v. Chapter 11 discharge is not effective against creditor who did not receive notice. The debtor's customer disputed its debt to the debtor before bankruptcy and, in the correspondence about the dispute, asserted that it had claims against the debtor in excess of the amount the debtor claimed against the customer. The debtor did not list the customer as a creditor in its chapter 11 case, but the customer's president was aware of the chapter 11 case. After plan confirmation, the debtor terminated the customer's service, and the customer sued the debtor to enjoin the termination and for damages for the defective prepetition products and services. The action does not violate the discharge injunction. A creditor is entitled to formal notice of the case. A discharge is not effective against a creditor who did not receive the constitutionally required "notice reasonably calculated under all the circumstances, to apprise interested parties of the pendency of the action." Because the customer did not receive notice here, its claim is not discharged, and the discharge injunction does not apply. *In re Arch Wireless*, 332 B.R. 241 (Bankr. D. Mass. 2005).

8.1.w. Permanent trespass claim is discharged. The debtor installed fiber optic cable over the creditor's land before bankruptcy. After confirmation of the debtor's chapter 11 plan, the creditor sought to enforce a claim for a continuing trespass against the debtor. The creditor's claim was barred by the chapter 11 discharge. Under applicable nonbankruptcy law, which applied to determine the nature of the creditor's claim, the trespass was a "permanent" trespass, one that is completed by a single act. The continuing presence of the cable on the creditor's land did not transform the trespass into a continuing trespass, which requires additional continuing injury to the creditor. A permanent trespass claim gives rise to a right to payment at the time of the trespass. Because the trespass here occurred prepetition, the creditor's claim was discharged. *MCI, Inc. v. West (In re WorldCom, Inc.)*, 328 B.R. 35 (Bankr. S.D.N.Y. 2005).

8.1.x. Post-confirmation loan is dischargeable upon conversion to chapter 7. The creditor loaned the debtor money to consummate the chapter 11 plan. The plan ultimately failed, and the creditor successfully moved to convert the case to chapter 7. The creditor also sued the debtor in state court to collect the loan. The debtor asked the bankruptcy court to enjoin the creditor from suing on the debt, arguing that it was discharged in the chapter 7 case. The injunction was proper. Because section 348(d) treats post-chapter 11, pre-conversion debts (other than for purposes of section 503) as though they arose before the date of the filing of the petition, the debt is discharged. The chapter 11 trustee had abandoned some property to the debtor during the chapter 11 case. The property was not dealt with in the chapter 11 plan and was therefore not available for distribution in the subsequent chapter 7. The fact that less than all of the debtor's property was available for creditors in the chapter 7 case does not change the result on the discharge issue. *Murdock v. Holquin*, 323 B.R. 275 (N.D. Cal. 2005).

8.1.y. Failure to schedule creditor does not create grounds for denial of discharge. The debtor did not schedule his principal creditor, who discovered the omission later and moved the court to vacate the discharge on the ground that it was obtained through fraud. The creditor argued that if it had notice of the case, it would have searched for assets and perhaps found concealed assets or other grounds for objection to the discharge, so the debtor's intentional omission of the creditor from the schedules resulted in the debtor obtaining the discharge through fraud. The creditor did not, however, make any showing that it had conducted the asset search after it learned of the case or investigated any other grounds for discharge denial. The court concludes, therefore, that the creditor failed to show that the mere failure to list the creditor, even if intentional or fraudulent, allowed the debtor to obtain the discharge when he otherwise would not have obtained it. *White v. Nielsen (In re Nielsen)*, 383 F.3d 922 (9th Cir. 2004).

8.1.z. Section 524(g) is the exclusive authority for an asbestos channeling injunction. The plan proposed a channeling injunction protecting non-debtor affiliates of the debtor who were making substantial contributions to an asbestos claimants' trust. Because the proposed channeling injunction did not meet the requirements of section 524(g), in that the protected parties were not debtors and their potential asbestos liability was not derivative of the debtor's, the court authorized the plan injunction under section 105(a). The court of appeals reverses, holding that an asbestos channeling injunction may be issued only if the terms of section 524(g) are met. The court reasons that the specific provision of section 524(g) controls the more general provision of section 105(a) and that the injunction in favor of non-debtors would grant a third-party release in violation of section 524(e). *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir. 2004).

8.1.aa. Six-year bar runs from petition date to petition date, not conversion date. The debtor filed a chapter 13 case within six years after the petition date of his prior chapter 7 case. More than six years after the prior chapter 7 petition date, the debtor converted the chapter 13 case to chapter 7. Section 727(a)(8) bars a discharge in a chapter 7 case commenced within six years after the date of the filing of the petition commencing a prior chapter 7 case in which the debtor received a discharge. Under section 348, the conversion does not effect a change in the date of the filing of the petition or the commencement of the case. Therefore, the six-year bar applied from the petition date, not the conversion date, and the discharge is denied. Interestingly, the court also dismissed the case, without cause other than the denial of discharge. *In re Hiatt*, 312 B.R. 150 (Bankr. S.D. Ohio 2004).

8.1.bb. Shareholder's diversion of secured creditor's collateral does not bar discharge. Section 727(a)(2) provides for denial of discharge if the debtor, with fraudulent intent, transfers, removes, or conceals "property of the debtor" within one year before bankruptcy. In this case, the corporation's secured creditor objected to the shareholder's discharge because the shareholder had caused the corporation to divert the proceeds of the creditor's collateral and use the proceeds in the operation of the business. Because the collateral was property of the corporation, not of the debtor, the objection to discharge could not be sustained. *Northeast Neb. Econ. Dev. Dist. v. Wagner (In re Wagner)*, 305 B.R. 472 (8th Cir. B.A.P. 2004)

8.1.cc. Honest motive to protect some creditors by diverting funds does not preclude denial of discharge. Section 727(a)(2) provides for denial of discharge if the debtor, within one year before bankruptcy, transferred property of the debtor with actual intent to hinder, delay, or defraud creditors. Here, the debtor suffered a bank account attachment by one creditor. The debtor opened a new bank account at another bank, diverting rents he collected from his tenants to the new account, so that he could continue to pay the mortgages on the rental properties. The attaching creditor argued that the debtor transferred the rents with actual intent to hinder or delay the creditor. The debtor argued that his motive was to protect the mortgagees, because payment of their claims was necessary to preserving the debtor's property. The court rules that an honest motive to prefer one creditor by itself is not a ground for denying discharge, but if the creditor can prove that the debtor's intent was to hinder or delay another creditor, denial is proper. *Cadle Co. v. Marra (In re Marra)*, 308 B.R. 628 (S.D.N.Y. 2004).

8.1.dd. Debtor's attorney's prepetition retainer is discharged. Before bankruptcy, the consumer debtor signed a retainer agreement with his lawyer, promising to pay the fee in installments beginning before bankruptcy and ending after bankruptcy. The debtor's discharge under section 727(b) discharges

the fees. Section 329(b), which gives the bankruptcy court authority to determine the reasonableness of the promised fees, does not detract from the broad reach of the discharge. What is more, the retainer can not be divided into pre- and post-petition portions, permitting nondischargeability of the post-petition portion, because the retainer agreement itself did not provide either for such division or for hourly services, and the Bankruptcy Code treats the agreement as one claim. The court notes the split with the Ninth Circuit's decision in *In re Biggar*, 110 F.3d 685 (9th Cir. 1997). *Bethea v. Robert J. Adams & Assoc.*, 352 F.3d 1125 (7th Cir. 2003).

8.1.ee. Bankruptcy Rule 9024 permits the court to vacate a discharge order. Section 1328(e) permits a court to revoke a discharge "only if (1) such discharge was obtained by the debtor through fraud; and (2) the requesting party did not know of such fraud until after such discharge was granted." Here, the debtor received a tax refund shortly after the chapter 13 trustee had filed a certificate of completion of payments under the plan. Had the trustee known of the tax refund, it would have been property that the trustee would have distributed under the plan, because it related to the prior year, when the debtor was still making payments of its disposable income under the plan. The trustee moved to vacate, not revoke, the discharge under Rule 9024, based on mistake. The bankruptcy court grants the motion and the Tenth Circuit affirms. It reasons that "vacate," which was temporary in this case, differs from "revoke," and that the bankruptcy courts should not be prohibited from correcting their mistakes, despite the statutory language. The court notes the risk of fraud or sharp dealing by debtors if the result were different and concludes that the trustee was not under an obligation to investigate whether the debtors had received the tax refund before the trustee filed his certificate of completion. *Midkiff v. Stewart (In re Midkiff)*, 342 F.3d 1194 (10th Cir. 2003).

8.1.ff. Equitable tolling applies to discharge limitation. Section 727(a)(2) requires denial of discharge if a debtor made a transfer with actual intent to hinder, delay, or defraud creditors within one year before filing bankruptcy. Here, the debtor filed chapter 13 a few days after making a fraudulent transfer. His case was dismissed after more than a year, and he subsequently filed a new chapter 7. Relying on the Supreme Court's equitable tolling decision in *Young v. United States*, 535 U.S. 43 (2002), which tolled the period for determining the priority of tax claims, the court determines that the one-year period in section 727 should similarly be tolled. The court reasons that the creditors were prevented from protecting their claims during the pendency of the chapter 13 case. *Womble v. Pher Partners (In re Womble)*, 299 B.R. 810 (N.D. Tex. 2003).

8.1.gg. Discharge injunction does not prevent action against co-debtor. The debtor failed to carry workers compensation insurance. One of his employees was severely injured and sued before the Worker's Compensation Appeals Board. The debtor filed bankruptcy before the WCAB order became final. After the bankruptcy court entered the debtor's discharge, the injured employee sought a modification of the automatic stay or of the discharge injunction to complete the WCAB proceeding so that he could recover from the Uninsured Employer Fund. The B.A.P. rules that the automatic stay expired upon entry of the discharge, that the discharge injunction cannot be modified because it is statutory (a concurrence argues that this ruling is pure dicta), and that the pursuit of the claim nominally against the debtor before the WCAB solely to reach the proceeds of the UEF does not violate the discharge injunction, because it does not seek a determination of the personal liability of the debtor on the debt. In addition, even if the resulting judgment and the UEF's reimbursement claim against the debtor is non-dischargeable, the discharge injunction does not prohibit it, because the discharge injunction does not apply to non-dischargeable debt. *Ruvacalba v. Munoz (In re Munoz)*, 287 B.R. 546 (9th Cir. B.A.P. 2002).

8.1.hh. F.C.C. cancellation of NextWave licenses is improper discrimination. Section 525(a) prohibits a governmental unit from revoking a license "solely because" the debtor "has not paid a debt that is dischargeable in a case under this title." After NextWave filed chapter 11 and failed to pay for its F.C.C. licenses, the F.C.C. cancelled them, on the grounds that the payment for the licenses was part of the regulatory scheme and that the F.C.C. had only regulatory motives in causing cancellation. The Supreme Court sets aside the F.C.C.'s action, holding that whatever the F.C.C.'s motive, the cancellation arose solely from NextWave's non-payment of the debt, and that there is no regulatory purpose exception to section 525. The Supreme Court also rules that NextWave's obligation was a dischargeable debt, even

though it was also a regulatory condition to retention of the license. *F.C.C. v. NextWave Personal Communications Inc.*, 537 U.S. 293 (2003).

8.1.ii. A public housing lease may not be revoked under section 525(a). The debtor was a lessee in a public housing project operated by a governmental unit. After the debtor's bankruptcy, the lease of the housing unit was automatically rejected under section 365(d)(1), and the past rent claim was discharged. The public housing authority attempted eviction. The debtor claimed that eviction would constitute improper discrimination that is prohibited by section 525(a). Construing the conflict between section 365, which requires that a debtor cure defaults to assume a lease, and section 525(a), which prohibits a governmental unit from discrimination with respect to a grant based solely on the debtor's non-payment of a discharged debt, the Second Circuit concludes that the non-discrimination provision takes priority, because the lease is a "grant" and because of the need to protect the debtor's fresh start. *Stoltz v. Brattleboro Housing Authority (In re Stoltz)*, 315 F.3d 80 (2d Cir. 2002).

8.1.jj. False social security number on a petition warrants denial of discharge. The debtor used a false social security number on her petition and did not disclose her correct number. The district court rules that this statement was material, in that it could have led to discovery of substantial information concerning the administration of the case. In addition, it provides grounds for revocation of the discharge under section 727(d) on the grounds that the discharge was obtained by fraud. The court construes "obtained" broadly to mean that the discharge would not have been obtained had the fraud been uncovered before the time for filing a complaint to object to the discharge, rather than that the fraud resulted in obtaining the discharge. *Tighe v. Valencia (In re Guadarrama)*, 284 B.R. 463 (C.D. Cal. 2002).

8.1.kk. The discharge injunction does not create a private right of action. The debtor brought a class action for damages arising from the creditor's violation of the discharge injunction of section 524. The Ninth Circuit concludes that neither section 524 nor section 105 creates a private right of action but that violation of the discharge injunction is punishable only by contempt. Neither can the debtor pursue a claim for violation of the discharge injunction under the Fair Debt Collection Practices Act, because to permit the FDCPA claim would effectively grant the debtor a private right of action for a discharge injunction violation. *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502 (9th Cir. 2002).

8.1.ll. Use of section 105 limited in discharge complaint. The creditor appeared to prove grounds necessary to deny the debtor his discharge. However, the creditor's complaint was, in the view of the bankruptcy court, deficient to support the allegations. Accordingly, the bankruptcy court denied the discharge under section 105. The bankruptcy appellate panel reverses, concluding that the court could not fashion an independent ground for denial of discharge under section 105, and therefore the order was neither "necessary" nor "appropriate" as required for application of section 105. Accordingly, the B.A.P. remanded to the bankruptcy court to determine whether the discharge should be denied under one of the grounds enumerated in section 727. *Yadidi v. Herzlich (In re Yadidi)*, 274 B.R. 843 (9th Cir. B.A.P. 2002).

8.1.mm. Employer may not discriminate on hiring based on prior bankruptcy. Section 525(b) prohibits discrimination "with respect to employment" against a former debtor, unlike section 525(a) under which a governmental unit may not "deny employment to . . . or discriminate with respect to employment against" a former debtor. Nevertheless, in a case in which a debtor was given an offer of employment that was revoked after the prospective employer reviewed her credit report, the court gives a broad reading to section 525(b) and permits the action for denial of employment to proceed. *Leary v. Warnaco, Inc.*, 251 B.R. 656 (S.D.N.Y. 2000).

8.1.nn. Section 105 authorizes enforcement of the section 524 discharge injunction. A creditor attempted collection of a discharged debt in violation of the section 524 discharge injunction. The debtor brought an action in district court for damages. The court of appeals rules that section 105 grants the district court authority to enforce section 524 by contempt powers that permit remedial monetary sanctions. Moreover, because the injunction was statutory, not individually crafted by the bankruptcy judge, any court could enforce the injunction, not just the issuing court. The district court could refer the matter to the bankruptcy court under 28 U.S.C. § 157. Finally, the remedies available under section 105

preempted any state law claim for unjust enrichment. *Bessette v. Avco Financial Services, Inc.*, 230 F.3d 439 (1st Cir. 2000).

8.1.oo. Section 105 provides no remedy for violation of the discharge injunction. The Sixth Circuit holds that section 105 does not provide a basis for a remedy for violation of section 524 contrary to the First Circuit's decision in *Bessette*. *Pertuso v. Ford Motor Credit Co.*, 233 F.2d 416 (6th Cir. 2000).

8.1.pp. *Frenville* lives! After confirmation of a plan, plaintiffs brought an action against the debtor for injuries arising from the debtor's environmental contamination of a site near the plaintiffs' homes. In determining whether when the claims arose for purposes of the discharge, the Third Circuit reaffirms *In re M. Frenville Co., Inc.*, 744 F.2d 332 (3d Cir. 1984), and looks to the state tort law to determine when the claims accrued. *Jones v. Chemetron Corp.*, 212 F.3d 199 (3d Cir. 2000).

8.1.qq. Overpayment of attorneys' fees under invalid fee agreement held non-dischargeable. The Second Circuit rules that for purposes of the defalcation exception to discharge, section 523(a)(4), an attorney acts in a fiduciary capacity with respect to the client. In this case, the attorney accepted a fee under a fee agreement that was ultimately held by the state court to be invalid. Such conduct constituted a defalcation while acting in a fiduciary capacity. *The Andy Warhol Foundation for Visual Arts, Inc. v. Hayes (In re Hayes)*, 183 F.3d 162 (2d Cir. 1999).

8.1.rr. Failure to keep records may bar discharge even without intent to conceal. Denial of discharge under section 727(a)(3) can be based on a failure to keep adequate financial records, even though the debtor does not intend to conceal his financial condition by failure to keep records. The debtor is held to reasonable commercial standards in keeping records, and requiring the trustee to reconstruct the debtor's entire financial condition from boxes of documents can constitute grounds for denial of discharge. *Peterson v. Scott (In re Scott)*, 172 F.3d 959 (7th Cir. 1999).

8.1.ss. A case need not be reopened to discharge an unlisted debt. Despite some confusion by the lower courts in this area, the Sixth Circuit has ruled that in a no asset case in which no bar date is set, an unlisted debt is discharged, whether or not the debtor purposely omitted the debt from the schedules. Reopening the case to amend the schedules to add the creditor has no effect, and any such motion to reopen should be denied. *Zirnhelt v. Madaj (In re Madage)*, 149 F.3d 467 (6th Cir. 1998).

8.1.tt. Discharge denied on alter ego grounds. The debtor operated a Ponzi scheme through two closely-held corporations, which the court found were her alter egos. Even though section 727(a)(2) provides for denial of discharge upon transfer of property of the *debtor*, the court denied discharge based on the alter ego theory. *Compton v. Bonham (In re Bonham)*, 224 B.R. 114 (Bankr. D. Alaska 1998).

8.1.uu. Failure to disclose valueless contraband is grounds for denial of discharge. Within weeks after filing bankruptcy, the debtors were arrested for and plead guilty to possession of about 15 pounds of marijuana that had been growing on their property for over two years. The debtors did not disclose the marijuana on their schedules. Even though the property would have been valueless to creditors, the court held that the concealment was fraudulent because the debtor stood to benefit from non-disclosure and therefore denied the discharge under paragraphs (2)(A) and (4)(A) of section 727(a). *Fokkena v. Tripp (In re Tripp)*, 224 B.R. 95 (Bankr. N.D. Iowa 1998).

8.1.vv. Attorney-client privilege prevents objection to discharge. While an attorney was representing a client in a dissolution proceeding, the client admitted that he had concealed assets. The client failed to pay the lawyer and filed bankruptcy, again hiding the same assets. The lawyer objected to discharge, but the bankruptcy appellate panel ruled that the lawyer learned of the concealment by a privileged conversation, which could not be revealed in pursuing an objection to discharge. *Dubrow v. Rindlisbacher (In re Rindlisbacher)*, 225 B.R. 180 (9th Cir. B.A.P. 1998).

8.1.ww. Post-confirmation sanctions not discharged. Before bankruptcy, the debtor commenced litigation against its insurance company. After plan confirmation, the trial court granted summary judgment against the debtor and awarded attorneys' fees as sanctions to the insurance company defendant for the

debtor's bad faith in bringing and pursuing the litigation. Because the award was issued after confirmation of the debtor's chapter 11 plan and was not within the actual or presumed contemplation of the parties at the time of the filing of the chapter 11 case, the claim was treated as a claim that arose after confirmation and was therefore not discharged. *Big Yank Corporation v. Liberty Mutual Fire Ins. Co. (In re Water Valley Finishing, Inc.)*, 139 F.3d 325 (2d Cir. 1998).

8.1.xx. Creditor may collect attorney's fees on discharged claim. After discharge of the debtor's obligation, the debtor sued the creditor on matters relating to the loan, which had an attorney fees clause. Despite the discharge, the debtor was liable for attorney fees in the lawsuit. The creditor's attorney fee claim was contingent before the discharge, but because the contingency was not based "upon what others might do," because the debtor "returned to the fray and used the contract as a weapon," the attorney's fee claim was not subject to the discharge. *Siegel v. Federal Home Loan Mortgage Corp.*, 143 F.3d 525 (9th Cir. 1998).

8.1.yy. Discharge objection deadline clarified. Bankruptcy Rule 4004(a) requires a complaint objecting to discharge to be filed within 60 days after the first scheduled meeting of creditors and requires the discharge to be entered "forthwith if no complaint is filed." Section 727(d)(1) permits a creditor to request revocation of a discharge within one year after the discharge is granted if the "discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge." In this case, the discharge was entered 80 days after the bar date, and the creditor learned of the debtor's fraud after the expiration of the 60-day period but before the discharge was entered. A complaint objecting to discharge within one year after entry of the discharge was timely, even though the creditor knew of the fraud before the entry of the discharge. *Citibank, N.A. v. Emery (In re Emery)*, 132 F.3d 892 (2d Cir. 1998).

8.1.zz. Pre-petition attorneys' fees are dischargeable. The attorney for the debtor was to receive his fees in installments after the filing of the debtor's chapter 7 petition. The Ninth Circuit holds that the debtor's obligation to the attorney was dischargeable. *Hessinger & Associates v. U.S. Trustee (In re Biggar)*, 110 F.3d 685 (9th Cir. 1997).

8.1.aaa. Bank account withdrawal as a transfer. An individual debtor withdrew funds from a bank account to hinder an attaching creditor and stash the cash under the mattress. Departing from the ruling of the Seventh Circuit in *In re Agnew*, 818 F.2d 1284 (7th Cir. 1987), the Ninth Circuit holds that the withdrawal from the account was a "transfer" for purposes of the fraudulent transfer grounds for denial of discharge under section 727(a)(2). *Bernard v. Sheaffer (In re Bernard)*, 96 F.3d 1279 (9th Cir. 1996).

8.1.bbb. Insider status may survive resignation as director and officer. An individual who was the sole shareholder, director, and president of a corporate debtor, who managed the corporate debtor's day-to-day operations and established its policies and knew "everything about the corporation that there possibly was to know" remained an insider for purposes of an objection to the discharge of the individual in his own bankruptcy under section 727(a)(7), even though the predicate acts for denial of discharge occurred after the individual's resignation as president and director of the corporate debtor. The definition of insider is not limiting and "encompasses anyone with a single `sufficient close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor.' [citing legislative history]." *In re Krehl*, 86 F.3d 737 (7th Cir. 1996).

8.1.ccc. Partners are fiduciaries. For purposes of the exception to discharge contained in section 523(a)(4) (defalcation while acting in a fiduciary capacity), a partner is a fiduciary to the other partners. Moreover, defalcation includes innocent as well as intentional or negligent failure to properly account for money held in a fiduciary capacity. *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182 (9th Cir. 1996).

8.2 Third Party Releases

8.2.a. Securities class action plaintiff does not have standing to object to third-party release. The plaintiff sued the debtor and its directors and officers in a securities class action before bankruptcy. When the debtor filed bankruptcy, the district court stayed the action as to the debtor. The district court

next designated the plaintiff as lead plaintiff in the class action, but had not yet certified the class when the debtor proposed its plan, which contained an opt-out third-party release of all claims against the directors and officers. The plaintiff opted out of and objected at the confirmation hearing to the release, both on his own behalf and on behalf of the putative class. The bankruptcy court may apply Bankruptcy Rule 7023 (incorporating Fed. R. Civ. Proc. 23) in a contested matter and so may certify a class for purposes of an objection to confirmation. The plaintiff did not request application of Rule 23. His designation as lead plaintiff applied only in the class action, not in the bankruptcy case, and any fiduciary duty to class members he had as lead plaintiff affected only his conduct in the securities class action. Therefore, he did not have standing to object to confirmation on behalf of the class. He did not have standing to object to the release, because he opted out and it therefore did not affect him. And if he had standing to opt out on behalf of the class, then for the same reason, he would not have had standing to object to the release on behalf of the class. *Lucas v. Dynegy, Inc. (In re Dynegy, Inc.)*, ___ B.R. ___, 2013 WL 2413482 (S.D.N.Y. Jun. 4, 2013).

8.2.b. Fourth Circuit permits third-party releases in a plan with specific factual findings to support them. A non-profit debtor proposed a plan that released its officers and directors from claims arising before the effective date, including prepetition claims. The bankruptcy court confirmed the plan and approved the releases, finding that the case was quite a unique case, there were legitimate interests for approving the provisions, the potential for mischief by disgruntled creditors was high, the debtor's obligations to indemnify its directors could result in substantial legal costs, and the provisions would prevent an end run around the plan. Reaffirming its prior decisions and departing from other circuits, the Fourth Circuit rules that section 524(e) does not prohibit third party releases. To permit such a release in a plan, the bankruptcy court need not find a precise fit with the Circuit's prior precedents nor with any other multi-factor test. It may determine what factors may be relevant in each case. However, the court must make specific factual findings in support of its decision and its application of the factors. The bankruptcy court's general statements here did not suffice to support the release's' approval or meaningful appellate review. *Behrmann v. Nat'l Heritage Found.,* 663 F.3d 704 (4th Cir. 2011).

8.2.c. Due process protections prevent a section 363 sale order from releasing future claims. The debtor manufactured truck bodies. During its chapter 11 case, it sold its assets comprising the truck-body production line under section 363 to a competitor, who continued the line. The sale order provided that the sale was free and clear of all claims, including "all debts arising in any way in connection with any acts of the debtor" and that the buyer would not, by virtue of the sale, have any successor liability arising from the asset purchase. After bankruptcy, a truck driver was injured in a truck that the debtor (not the successor) had manufactured and sued the successor under the product-line exception to the general rule against an asset buyer's successor liability. Due process requires that notice reasonably calculated to apprise interested parties of the action precede any order that affects a person's rights. A court cannot provide any notice at all to a person who is injured after a bankruptcy case is closed because of the debtor's prepetition conduct. Therefore, barring such a victim's claim, whether against the debtor or a successor, violates the victim's due process rights to notice. The court declines to address whether the appointment of a future claims representative would permit release of future claims. *Morgan Olson L.L.C. v. Frederico (In re Grumman Olson Indus., Inc.)*, 467 B.R. 694 (S.D.N.Y. 2012).

8.2.d. A bar order in a plan to protect settling defendants in multiple defendant litigation does not provide an improper third-party release. In nonbankruptcy litigation against multiple defendants, a settling defendant risks a contribution or reimbursement claim asserted by nonsettling defendants against whom the plaintiff later obtains a judgment. In such cases, courts have fashioned a bar order, which prohibits a nonsettling defendant from asserting a claim for contribution or reimbursement against a settling defendant. The bar order provides some protection to a nonsettling defendant by providing an appropriate reduction in any judgment that the plaintiff may obtain against it. Such an order is increasingly common in partial settlements in multiple-defendant litigation. Here, the chapter 11 plan incorporated a settlement with some of the defendants in LBO-driven fraudulent transfer litigation and a bar order to protect them from contribution and reimbursement claims that might be asserted by nonsettling defendants who were later found liable. A plan may release a nondebtor only in extraordinary cases involving fairness and necessity to the reorganization. The bar order here does not release or prevent claims against the nonsettling defendants but only reduces their potential liability by an amount that takes

account of the recovery had from the settling defendants. Therefore, it is not an impermissible third-party release. Incidentally, the judgment reduction provision is also consistent with section 550(d), which limits the trustee to a single satisfaction on an avoiding power recovery claim. *In re Tribune Co.*, 464 B.R. 126 (Bankr. D. Del. 2011).

8.2.e. Third party release requires "opt in" and may be required as a condition to distribution under the plan. The debtor's plan provided for a third party release by each creditor who did not, on its ballot, opt out of the release. If the creditor opted out, the creditor was not entitled to receive any consideration under the plan. The court does not have jurisdiction to grant a third party release. A third party release under a plan may come only from a creditor's decision to grant the release. Failure to return a ballot does not sufficiently evidence the creditor's decision to grant a release. Therefore, a release may be effected only by an "opt in" ballot through which a creditor affirmatively agrees to the release. *In re Wash. Mut., Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011).

8.2.f. Court approves exculpation of committee members but not plan sponsors and successor entities. One affiliated debtor was an operating business; the other was a single purpose entity that owned timberland that secured bonds. The debtors proposed a joint plan that provided for the transfer of each debtor's assets to new companies created and owned by two plan sponsors. One plan sponsor was unrelated to the debtors. The other held a large unsecured claim against the operating debtor. The plan provided for exculpation of the plan sponsors, the new companies and the unsecured creditors' committee and its members from liability related to proposing, implementing and administering the plan, except for liability resulting from gross negligence or willful misconduct. Section 524(e) releases only the debtor, not co-liable third parties, and is not intended to provide releases for negligent conduct that occurs during a chapter 11 case or in plan consummation. Exculpation amounts to a release. Therefore, a plan may not exculpate parties other than the debtor or the committee from liability. The discharge may protect the debtor. Section 1103(c) may protect committee members, because it implies they have qualified immunity for actions within the scope of their duties. *Bank of N.Y. Trust Co., N.A. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

8.2.g. Court rejects third party releases under a plan. The debtors liquidated in chapter 11, with the plan providing that all assets would be transferred to another entity in which the debtors would have only a minority interest. The second lien creditor and related entities provided funding for the other entity. The plan provided for exculpation of the creditor for any acts arising in or related to the chapter 11 case and for a complete release of the creditor by all other creditors for any claims against the creditor related to the debtor. The creditor refused to fund without the broad releases. Following the Seventh Circuit's *In re Airdigm Comm'ns, Inc.*, 519 F.3d 640 (7th Cir. 2008), decision, the court rules that section 524(e) does not prevent third party releases, but section 105(a) authorizes them only to the extent appropriate. The court reviews decisions from all other courts of appeals that have addressed the issue and concludes that third party releases for prepetition conduct are appropriate only in mass tort where the releasees provide substantial contributions to the plan and notes that *Airdigm* permitted a third party release only of claims arising in the bankruptcy case. (The court notes, "inclusion in a plan of reorganization of a narrow release of claims relating to the bankruptcy case … now appears to be *de rigueur* in cases filed in New York and Delaware [fn 13: The Southern District of New York and the District of Delaware … are the cradle of innovation. Once a new tactic, pleading or provision, gets approved for use in New York or Delaware, it seems to spread across the country like a highly contagious virus.]"). *Airdigm* does not authorize broad third party releases of non-bankruptcy related claims, does not expand the bankruptcy court's powers under section 105(a) and permits a bankruptcy-related release only as to "participating creditors". Here, the releasing creditors do not receive any consideration for the releases, the plan is essentially a liquidation, the releases run in favor of the creditor's affiliates, who do not appear to be funding the plan, as well as a senior secured creditor and the bankruptcy court does not have a jurisdictional basis to provide releases for claims arising outside the bankruptcy process. Therefore, the court denies confirmation. *In re Berwick Black Cattle Co.*, 394 B.R. 448 (Bankr. C.D. Ill. 2008).

8.2.h. Court may grant third-party release for plan-related activities when "appropriate". The debtor's plan released the entity that financed the plan from liability for "any act or omission arising out of or in connection with … the confirmation of this Plan … except for willful misconduct". There was

adequate proof that the entity would not finance the plan without the release. Section 524(e) provides that a "discharge of a debt of the debtor does not affect the liability of another entity on … such debt". This provision is definitional, unlike its mandatory predecessor, Bankruptcy Act section 17, which provided that the "discharge of a debt of the debtor shall not affect the liability of another entity". It merely describes the discharge's effect and does not prohibit a third party release. Section 1123(b)(6) permits a plan to contain "any appropriate provision not inconsistent with the applicable provisions of this title" and therefore permits a third party release if "appropriate". Whether a release is appropriate is fact-intensive. Here, the release was limited to claims arising out of the reorganization and did not include willful misconduct, and there was adequate evidence that the financier required this release as a condition to financing the plan, which would have failed otherwise. Therefore, the release is appropriate. *Airadigm Comm'ns, Inc. v. Fed. Comm'ns Comm'n (In re Airadigm Comm'ns, Inc.)*, 519 F.3d 640 (7th Cir. 2008).

8.2.i. Bankruptcy court lacks jurisdiction to enjoin actions against a third party that do not affect the estate. The Manville chapter 11 plan contained a broad injunction to protect Manville's insurer from further litigation over asbestos-related claims. By enjoining all claims "arising out of" or "related to" the policies, the bankruptcy court "meant to provide the broadest protection possible to facilitate global finality for [the insurer] as a necessary condition to its significant contribution to the Manville estate". Years later, plaintiffs still filed state court actions against the insurer, not under the policies or for amounts for which the insurer was liable under the policy, but rather for common law or statutory claims for fraud relating to litigation defenses and to nondisclosure. The insurer sought interpretation and enforcement of the plan injunction to stop the litigation. A bankruptcy court has continuing jurisdiction to interpret and enforce its own orders but not to interpret or expand its orders beyond its underlying jurisdiction. A bankruptcy court has jurisdiction to enjoin actions against an insurer that are derivative of the debtor's rights and therefore would deplete funds that would otherwise be property of the estate. It does not, however, have jurisdiction to enjoin actions against an insurer to protect it from its own conduct where a finding of liability would not affect the estate or where the action is not derivative of the policy. In this case, although the state court actions are related to the underlying policies, they are directly against the insurer, not in the right of the debtor as insured, and do not affect policy proceeds or the estate. Therefore, the bankruptcy court did not have jurisdiction to reach these actions in the original plan injunction nor to extend it to cover them now. The insurer's contribution to the plan does not affect the analysis, because permitting such a result would permit parties to create subject matter jurisdiction by consent. The court notes the risk of abuse in enjoining claims against third parties, even those who contribute to the plan. *Travelers Cas. & Sur. Co. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52 (2d Cir. 2008).

8.2.j. Channeling injunction is generally impermissible outside of a plan. The estate asserted claims for indemnification and defense costs reimbursement under its directors and officers liability policies. The insurer disputed the claims. The debtors' directors and officers also asserted claims under the policies. The aggregate of the claims exceeded policy limits. The policies were "first come, first served" policies, so that whichever insured successfully asserted claims under the policies first would get paid, leaving the others without policy proceeds to recover. After plan confirmation, the estate proposed to settle with the insurer by selling the insurer all of the estate's claims under the policies for a cash payment that was less than the amount of the remaining policy limits. The settlement also called for the order approving the sale and settlement to enjoin the other policy claimants from asserting any further claims against the insurer under the policies. A channeling injunction may be permissible in rare cases when it is an essential or dominant part of resolving a chapter 11 case. Full payment of claims may also support a channeling injunction. Neither of those factors is present in this case. The plan had already been confirmed, and the settlement did not involve full payment of claims in the case or even of claims under the policies. Therefore, the court refuses to approve the settlement's channeling injunction. *In re Adelphia Comm'ns Corp.*, 364 B.R. 518 (Bankr. S.D.N.Y. 2007).

8.2.k. Third party release of insurance company is not warranted; separate classification is. The debtor was a law firm that was subject to numerous malpractice claims. The malpractice carrier proposed to contribute a substantial amount to the plan, which would be used to pay separately classified malpractice claims. The court determines that because the insurer had an obligation to pay up to the policy limits to the estate, its contribution under the plan did not provide a basis for a third party release. Similarly, the court disapproves the third party release in favor of the partners, because there was no

showing that the partners' contribution was substantial. Nevertheless, the court permits separate classification of the malpractice claims from the general trade claims, because the insurance proceeds were available only to the malpractice claimants. *In re Mahoney Hawkes, LLP*, 289 B.R. 285 (Bankr. D. Mass. 2002).

8.2.l. Third party releases are appropriate in unusual circumstances. The Sixth Circuit permits a plan to release, and enjoin claims against, a non-debtor, even as to non-consenting creditors, in unusual circumstances. The court overrules the bankruptcy court's reasoning that the Supreme Court's decision in *Groupo Mexicano v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), prohibits such a release, because the Sixth Circuit finds authority for the release not in general equitable jurisprudence but rather in the express terms of the Bankruptcy Code found in section 1123(a)(6) and in section 105(a). However, a release of non-consenting creditors' claims against a non-debtor is permissible only if the following seven factors are present: (1) identity of interests between the debtor and the released non-debtor party (2) the non-debtor's contribution of substantial assets to the reorganization (3) that the injunction is essential to the reorganization (4) that the affected class has voted overwhelmingly to accept the plan (5) full payment (or a mechanism providing for substantially full payment) of the affected classes (6) an opportunity for non-settling claimants to recover in full, and (7) the bankruptcy court's specific factual findings in support of its conclusions. *Class 5 Nevada Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648 (6th Cir. 2002).

8.2.m. Court restricts scope of plan exculpatory clause and release. The plan contained a release of all claims by the debtor against its officers, directors, employees, professionals and creditors. It also contained an exculpation clause that released all claims by anyone against the same entities for their conduct in the chapter 11 case and their participation in the formulation and confirmation of the plan, except for claims arising from willful misconduct or gross negligence. The court rejects the breadth of both. As to the former, the court holds that a showing of substantial contribution by the non-debtor party to the assets of the reorganization and that the release is essential to the reorganization, among other things, are required for a release by the debtor of its claims against third parties. The court permits the release, however, as to certain creditors, who bargained for it in connection with the plan negotiations. The court also restricts the exculpation clause to the extent that it releases claims against creditors for their conduct in the reorganization case, as distinguished from their conduct in connection with the formulation and confirmation of the plan. *In re Genesis Health Ventures, Inc.*, 266 B.R. 591 (Bankr. D. Del. 2001).

8.2.n. Non-mass tort settlement channeling injunction approved. The court approved a settlement of a trustee's claim against the debtor's law firm for pre-petition malpractice where the settlement agreement included the issuance of a channeling injunction to prohibit lawsuits by creditors against the law firm. The court required notice to all creditors before approval of the settlement and limited the injunction to claims that were derivative of the debtor's claims against the law firm. *In re Mrs. Weinberg's Kosher Foods, Inc.*, 278 B.R. 358 (Bankr. S.D.N.Y. 2002).

8.2.o. Third party releases are overturned. The plan released all claims of securities class action plaintiffs against the debtor's directors and officers. Without reaching the issue of whether the third party releases were ever permissible in a chapter 11 plan, the Third Circuit rules that the releases here do not have "the hallmarks of permissible non-consensual releases – fairness, necessity to the reorganization, and specific factual findings to support these conclusions," and reverses the provision of the plan providing for the releases. *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203 (3d Cir. 2000).

8.2.p. Third party releases disapproved. A plan for a corporate debtor that provided releases of all creditor claims against officers and directors could not be approved. The plan instead would be construed to provide for such releases only by creditors who accepted the plan or accepted any distribution under the plan. *In re Zenith Electronics Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999); *accord In re Dow Corning Corp.*, 1999 Bankr. LEXIS 1647 (Bankr. E.D. Mich. 1999) (but limiting releases only to those creditors who accepted the plan).

8.2.q. Third party releases permitted. In a general partnership chapter 11 case, the general partners made substantial contributions to fund the plan, which provided for the release of claims of creditors

against the partners who made contributions. Distinguishing a partnership from a corporation on the ground that the partners were liable to creditors by reason of the nature of the partnership, not by reason of any independent liability, the court approves a release of all partners who contributed under the plan of all claims by all creditors of the partnership. *In re Keck, Mahin & Cate*, 241 B.R. 583 (Bankr. N.D. Ill. 1999).

8.2.r. Third party release under a plan is *res judicata* in subsequent litigation. The debtor's plan provided for releases of its principals. It was confirmed, and no appeal was taken. On an appeal from a judgment in an action by creditors against the principals, the Ninth Circuit holds that the confirmation of the plan was *res judicata* as to the release of the principals, citing *Stoll v. Gottlieb*, 305 U.S. 165 (1938), even though the release provision might not have withstood an attack on a direct appeal. *Trulis v. Barton*, 107 F.3d 685 (9th Cir. 1995).

8.3 Environmental and Mass Tort Liabilities

8.3.a. Dischargeability of an environmental injunction depends on the alternative remedies the agency has under the statute it used to obtain the injunction. The debtor had acquired and operated on a manufacturing site from which the debtor and the prior owners had discharged pollutants into the groundwater. The debtor ceased operations at the site long before its bankruptcy. However, local groundwater pollution remained, and it threatened to migrate and damage additional groundwater sources. The debtor entered into agreements with the state environmental department to remediate the property under the state's water quality act, even though at that time it no longer owned the site. The water quality act permits the state to require clean-up but does not provide for the state to remediate and seek reimbursement. The state's hazardous waste act and CERCLA authorize such a procedure, but the state did not invoke either of those statutes. A claim includes a right to an equitable remedy if breach of performance gives rise to a right to payment. An environmental injunction is a claim and is therefore dischargeable based on, among other things, whether the pollution is ongoing and whether the enforcing agency has a right to payment in lieu of enforcing the injunction. Whether an enforcing agency has an alternative right to payment depends on the statute under which the agency moves. Even though the agency might have an alternative right to payment under some statute, the court may consider its right to payment only under the statute the agency is using. Otherwise, all environmental injunctions would be dischargeable, because the state (or federal government) always has the right to remediate a site to protect the public health. Here, the state acted only under the water quality act, which did not give it an alternative right to payment. In addition, an injunction aimed at preventing further environmental damage, even directed at a site at which the debtor no longer operates or even owns, is not a claim, as a land owner has no right to pay to pollute. Therefore, the injunction is not a claim and is not dischargeable. *Mark IV Indus., Inc. v. New Mexico Enviro. Dept. (In re Mark IV Indus., Inc.)*, 459 B.R. 173 (S.D.N.Y. 2011).

8.3.b. Environmental remediation obligation for which the state does not have a damage remedy is nondischaregeable. The debtor owned and operated a business for many years. It sold the property on which it operated but continued to operate under an agreement with the buyer for another year. The operations over the years resulted in substantial environmental contamination to the ground. The debtor and the state environment department negotiated a remediation plan, which the debtor began implementing before bankruptcy. The debtor and the department disputed whether remaining pollutants on the property were continuing to migrate to ground water. The state's environmental statute under which the department required the debtor to remediate the pollution, did not permit the department to sue for money damages for clean up expenses, although another statute permitted the department to seek compensation if a polluter did not remediate and the department were required to do so in the polluter's stead. The department filed a proof of claim in the debtor's chapter 11 case. An obligation is dischargeable only if it is a "debt", that is, a liability on a "claim", which is a right to payment or to an equitable remedy if the remedy gives rise to a right to payment. Application of the definition to environmental remediation obligations has bedeviled the courts. The general rule is that an environmental remediation obligation is not a dischargeable debt if the debtor is capable of performing the remediation and if the pollution is on-going or, if it is not on-going, if the environmental agency does not have the option of seeking payment in place of enforcing a remediation decree. Here, the debtor has continued access to the site, through the cooperation of the buyer, to perform remediation. Although it is unclear

whether the pollution is on-going, the department does not have the option of pursuing a damages remedy under the statute that it is using to enforce the remediation option. Even though it might have that option under another statute, the absence of a damages remedy under the particular statute disqualifies the obligation from being a debt, and the debt is nondischargeable. *Mark IV Indus., Inc. v. N.M. Enviro. Dept. (In re Mark IV Indus., Inc.)*, 438 B.R. 460 (Bankr. S.D.N.Y. 2010).

8.3.c. RCRA cleanup order, which may not be satisfied by payment of money damages, is not a discharged claim. Years after the debtor emerged from a chapter 11 reorganization, the EPA sought an injunction under the Resource Conservation and Recovery Act (RCRA) ordering the debtor to clean up a major hydrocarbon spill on land the debtor's predecessor in interest formerly owned. The debtor had no internal capability to clean up the spill and would have had to hire an outside firm to perform the work. The debtor's chapter 11 discharge released the debtor from every claim, which is defined as including "a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment". This language applies to an equitable claim that can be satisfied by a money judgment if the equitable remedy is unavailable, for example, if the defendant has already sold the property that was to be conveyed to the plaintiff. To qualify within the definition, the equitable remedy must give rise to a right to payment to the holder of an equitable remedy. Thus, an injunction that requires the defendant to expend funds to a third party to comply, such as the injunction sought here, does not qualify as a "claim" if the plaintiff is not entitled to payment in lieu of the injunction. RCRA permits only an injunction, not a money damage claim, for nonperformance of a cleanup obligation. Therefore, the equitable remedy the EPA sought was not discharged in the debtor's chapter 11 case. The court distinguishes *Ohio v. Kovacs*, 469 U.S. 274 (1985), on the basis that the defendant there had not complied with the injunction and the state had obtained the appointment of a receiver to obtain the money needed to pay for the cleanup, thereby creating a claim for money damages. *U.S. v. Apex Oil Co.*, 579 F.3d 734 (7th Cir. 2009).

8.3.d. Nondebtors may not sue asbestos legal representative for determination of non-liability. The debtor's non-debtor subsidiary brought a declaratory judgment action in federal district court against the debtor's future claimants' legal representative, who was appointed in the debtor's chapter 11 case, for a determination that the subsidiaries were not liable to future claimants for the debtor's asbestos liabilities under successor liability or alter ego theories. The legal representative cannot bind future claimants in a nonbankruptcy action, because his appointment is limited to the application of section 524(g) in the bankruptcy case. In addition, he does not act as a guardian ad litem for the future claimants. Therefore, the court dismisses the action. *G-I Holdings, Inc. v. Bennet (In re G-I Holdings, Inc.)*, 328 B.R. 691 (D.N.J. 2005).

8.3.e. Contingent claim arising under a prepetition indemnification agreement is discharged. Long before bankruptcy and long before the passage of any environmental laws, the debtor acquired real property from the creditor and indemnified the creditor in writing, in very broad language, for any losses relating to the property. Although the creditor filed a proof of claim against the debtor for other matters, it did not file a proof of claim for anything related to the indemnification agreement. After bankruptcy, state environmental laws were enacted that would have made the creditor liable for activities on the property, and the creditor sought indemnification from the debtor. Finding that the claim was a simple contract claim on the indemnification agreement, which arose at the time of the signing of the indemnification agreement, the Second Circuit holds that the contingent claim was discharged in the debtor's bankruptcy. *Olin Corp. v. Riverwood Int'l Corp. (In re Manville Forest Products Corp.)*, 209 F.3d 125 (2d Cir. 2000).

8.3.f. Late mass tort claimants permitted to participate in plan settlement fund. The mass tort debtor reorganized, creating a fund for the mass tort claimants, many of whom were not known at the time the chapter 11 plan was confirmed in 1986. Because they were unknown and an exhaustive noticing procedure would have been prohibitively expensive, the court excluded unknown tort claimants from the bar date. In an action twelve years later to require the subsequently identified tort claimants to share in the ample fund rather than pursue claims against the reorganized debtor, the court holds that the claimants have prepetition claims. Because the bar date did not apply to them, they are permitted to file claims, which are not considered late file, and to share in the settlement fund, rather than pursuing full recovery on their claims against the reorganized debtor. Finally, discrediting *In re M. Frenville Co.*, 744 F.2d 332 (3d Cir. 1984), the court holds that the subsequent tort claimants had claims that were

discharged by the confirmation order. *Emons Industries, Inc. v. Allen (In re Emons Industries, Inc.)*, 220 B.R. 182 (Bankr. S.D.N.Y. 1998).

8.3.g. CERCLA claims not discharged; RCRA claims discharged. Applying its decision in *In re Chicago, Milwaukee, St. P. & Pac. R.R.*, 974 F.2d 775 (7th Cir. 1972) (a Bankruptcy Act case) to the Bankruptcy Code chapter 11 case of *A.M. International, Inc.*, the Seventh Circuit ruled that CERCLA response costs of which the claimant was unaware by the time of the bar date in the chapter 11 case were not discharged by the confirmation of the plan. On the other hand, an order under section 7002 of RCRA directing the former debtor to clean up a site cannot, under RCRA, be converted into a monetary obligation, so it is not a claim that was discharged in the debtor's prior chapter 11 case. *A.M. International, Inc. v. Datacard Corporation*, 106 F.3d 1342 (7th Cir. 1997).

8.3.h. CERCLA contribution claim discharged in Bankruptcy Act case. The reorganization plan of the Reading Company under section 77 of the former Bankruptcy Act was confirmed with an order that contained a discharge injunction, three weeks after Congress enacted CERCLA. Because the United States EPA had knowledge at the time CERCLA was enacted of the particular hazardous site, of the Reading Company's connection to that site, and of Reading Company's reorganization, the claim was discharged in the case. As a result, the claim of Conrail against the Reading Company for contribution, which relies by its nature on the joint liability of two parties to a third party (in this case, the United States), could not be pursued against the Reading Company. *In re Reading Company*, 115 F.3d 1111 (3d Cir. 1997).

9. EXECUTORY CONTRACTS

9.1.a. Purchase orders may be rejected separately from a master purchase agreement. The debtor entered into a master purchase agreement with a parts supplier. The master purchase agreement set forth general terms and conditions but did not authorize or obligate either party to purchase or sell parts, which would be authorized by separate purchase orders. A debtor in possession may assume or reject only a complete contract, not parts of a contract. Whether various contractual relationships are separate or indivisible is a question of applicable nonbankruptcy law. Applicable nonbankruptcy law (here, Kansas law) looks to the parties' intent. A contract is divisible where performance is divided into more than one part, the number of parts due from each party is the same and each party's performance of a part is the agreed exchange for the other party's part. Here, the master purchase agreement acted as an option contract, giving the debtor the right to buy parts from the supplier but not obligating it to do so. Therefore, each purchase order under the agreement was a separate contract that could be assumed or rejected independently of the other purchase orders. *In re Hawker Beechcraft, Inc.*, ___ B.R. ___, 2013 Bankr. LEXIS 2409 (Bankr. S.D.N.Y. June 13, 2013).

9.1.b. Reorganized debtor retains rights as licensee despite discharge of related obligations. In exchange for a perpetual, royalty-free technology license to produce aircraft parts, the debtor agreed to indemnify the licensor for any liability resulting from any alleged design defect. In the debtor's later chapter 11 case, it did not assume or reject the license agreement, and the licensor did not file a proof of claim. After plan confirmation, the reorganized debtor refused to indemnify the licensor for a claim, the licensor sent notice of license termination and the licensor sued the debtor for damages and for a declaration that the debtor had no license or other rights to the licensor's intellectual property. The license agreement was not an executory contract because only the debtor had remaining obligations. Therefore, the license agreement continued to bind the debtor, though confirmation discharged the debtor from any prepetition claims. A claim arises prepetition if the debtor's conduct giving rise to the claim occurred prepetition or if the parties had a prepetition relationship. The licensor's indemnification claims under the agreement arose prepetition because the relevant conduct here is the debtor's execution of the license agreement, and the parties had a prepetition relationship. Therefore, plan confirmation discharged the licensor's indemnification claim, so the licensor could not terminate the agreement based on the debtor's failure to abide by the indemnification agreement after confirmation. However, the licensor retains any claim against the debtor for post-confirmation violation of the licensing agreement. *Lycoming Engines v. Superior Air Parts, Inc. (In re Superior Air Parts, Inc.)*, 487 B.R. 728 (Bankr. N.D. Tex. 2012).

9.1.c. Solar power supply contract is a forward contract. The debtor contracted to supply electricity to an electric utility from a solar power plant that the debtor would construct. The contract fixed the price of electricity, based on a very small production operating cost ($200,000 annually) and a very large capital cost ($50 million). The supply obligation started three years after PUC approval of the contract and ended 20 years after first supply. The debtor failed to post cash collateral required under the contract, the utility sent a notice of default and within the cure period, the debtor filed a chapter 11 case. The debtor moved for a determination of the applicability of the automatic stay to the utility's postpetition termination of the contract. Section 556 protects any contractual right of a forward contract merchant to liquidate, terminate or accelerate a forward contract, despite the automatic stay. Section 101(25) defines "forward contract." To meet the definition, the contract's subject must be primarily a commodity, not primarily ancillary services related to the commodity, the contract must have a maturity date more than two days after the contract date, the quantity and time elements should be fixed at contracting and the contract must have a relation to the financial markets. Although the largest part of the cost of producing the electricity for sale was the capital cost of building the debtor's facility, the only thing that the utility purchased under the contract was electricity, which is a commodity. The contract did not have a formal "maturity date," but based on its 20-year term, it would mature more than two days after contracting. The contract contemplated a minimum quantity of electricity over the contract term and specified a price. Finally, because the utility's contract to purchase solar power from the debtor was part of the utility's hedging strategy, the contract bore a relation to the financial markets. Therefore, the contract is a forward contract, and the automatic stay does not prohibit its postpetition termination. *Clear Peak Energy, Inc. v. So. Calif. Edison Co. (In re Clear Peak Energy, Inc.)*, 488 B.R. 647 (Bankr. D. Ariz. 2013).

9.1.d. 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.e. 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.f. 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).

9.1.g. Trademark license rejection does not deprive the licensee of the right to use. The debtor contracted with a manufacturer to produce the debtor's product for sale to the debtor's customers. It licensed its trademark to the manufacturer. The license permitted the manufacturer to sell the product on its own if the debtor did not itself purchase the product. Three months later, creditors filed an involuntary petition against the debtor. The trustee sold the debtor's business and rejected the manufacturing and license agreement. Section 365(a) permits a trustee to reject an executory contract. Section 365(g) provides, "the rejection of an executory contract … constitutes a breach of such contract". Outside bankruptcy, a breach does not terminate the non-breaching party's rights under a contract. Section 365(g) transports that result into bankruptcy, while protecting the debtor from specific performance as a remedy. Rejection is not the functional equivalent of rescission, nor is it an avoiding power. Section 365(n) protects a licensee's right to use "intellectual property", as defined. The definition does not include trademarks. The "omission is just an omission". It does not create an implication that trademarks, unprotected under section 365(n), are vulnerable under section 365 generally. Section 365's general principles apply to trademark licenses as they do to all other executory contracts. Therefore, the trustee's rejection does not prevent the manufacturer from using the licensed trademark. *Sunbeam Prods., Inc. v. Chicago Am. Mfg, LLC*, 686 F.3d 372 (7th Cir. 2012).

9.1.h. Debtor's prepetition breach does not make a contract non-executory. The debtor entered into a technology license agreement with a licensee that required substantial continuing performance from both parties as of the petition date. The debtor committed material breaches of the agreement before bankruptcy. Under applicable nonbankruptcy law, the breaches excused the licensee from further performance under the agreement. Under the Countryman definition, for purposes of section 365, an executory contract is one "under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other." Outside of bankruptcy, where one party has committed a material breach, the other party is excused from performance. Accordingly, a court might conclude that where the debtor has breached, the nondebtor party is excused from performance, so that the nondebtor party no longer has any obligations under the contract. However, such a reading would render all breached contracts non-executory, essentially eviscerating section 365. Importantly, Countryman observed that a contract in which the nondebtor party had no further obligation should not be considered an executory contract, because the estate has whatever benefit it was entitled to under the contract, and the only remaining performance is a liability of the debtor, as to which assumption would serve no purpose other than to elevate a general unsecured claim's priority. Thus, the Countryman definition should be read to exempt from the definition only those contracts under which the debtor has already received the full benefit of the nondebtor party's performance before bankruptcy. Under that interpretation, the license agreement here remained executory. *In re Kemeta, LLC*, 470 B.R. 304 (Bankr. D. Del. 2012).

9.1.i. Rejection of master lessee's lease permits master lessor to terminate sublease. Before bankruptcy, the debtor lessee subleased real property to an unrelated third party. The master lease permitted the lessor to terminate it if the lessee became the subject of a bankruptcy case. The sublease provided that it terminates if the master lease terminates. In the debtor's chapter 11 case, the debtor in possession did not timely assume the lease, which was then deemed rejected under section 365(d)(4). Section 365(d)(4) requires the trustee to surrender possession upon such a deemed rejection, which

could create a conflict with section 365(h), which protects a sublessee's right to possession of real property under a rejected lease. Rejection constitutes a breach, not a termination. Section 365(e) prohibits a lessor from terminating a lease because of the lessee's bankruptcy. However, once the lease is rejected, it is no longer property of the estate and is not protected by the automatic stay. Section 365(e) applies only during the bankruptcy case and does not affect the lessor's rights outside of bankruptcy. Therefore, applicable nonbankruptcy law governs the master lessor's rights against the sublessee. In this case, Alabama law permits the lessor to enforce the ipso facto clause and to terminate the master lease based on the rejection and consequent breach. The sublease then automatically terminates, because of the sublease provision that so provides. *Cahaba Forests, LLC v. Hay*, 2012 U.S. Dist. LEXIS 13877 (M.D. Ala. Feb. 6, 2012).

9.1.j. Contract counterparty's claim for WARN Act liability resulting from contract rejection is a prepetition claim. The debtor in possession rejected a transportation agreement with a trucking company. The trucking company laid off its employees immediately after the rejection. The employees sued the trucking company in state court for a WARN Act violation. The trucking company sought permission from the bankruptcy court to cross-claim in the state court against the debtor in possession either as a controlling employer or for contribution. Under section 365(g), any claim arising from rejection of an executory contract is treated as a prepetition claim. Even though the liability that the trucking company may have incurred to its employees as a result of the rejection of the transportation agreement occurred postpetition, the trucking company's claim against the debtor arising from the rejection is treated as a prepetition claim, and pursuit of such a claim is permissible only by filing a proof of claim in the bankruptcy case. *Grocery Haulers, Inc. v. The Great Atlantic & Pac. Tea Co, Inc. (In re The Great Atl. & Pac. Tea Co., Inc.)*, 2012 WL 264187 (S.D.N.Y. Jan. 30, 2012).

9.1.k. Contract that limits debtor's right to assign claims to a section 524(g) trust is unenforceable. Before bankruptcy, the debtor entered into a settlement agreement with its general liability insurer relating to asbestos claims. The debtor warranted that it had not assigned and would not assign any claims against the insurer and that it would not assist others in pursuing claims against the insurer. The agreement required arbitration of disputes. As its asbestos woes mounted, the debtor began negotiations with its other insurers and with asbestos claimants over a possible bankruptcy plan, which would provide for assigning contribution claims that other insurers might have against the settling insurer to the debtor, who would assign them under a plan to an asbestos trust under section 524(g). The insurer filed a proof of claim for breach of the settlement agreement, alleging that the negotiations for the debtor's receipt of claims against the insurer and their assignment to the asbestos trust violated the settlement agreement's anti-assignment provision. Public policy prohibits enforcement of a debtor's prepetition waiver of bankruptcy rights, to prevent astute creditors from routinely requiring such waivers. The settlement agreement provisions therefore were unenforceable to the extent that they would have prohibited the debtor from proposing or confirming a plan that used section 524(g)'s benefits, and any claim for breach of such a provision should be disallowed. *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011 (9th Cir. 2012).

9.1.l. Sublease termination defeats subtenant's attornment obligation. The debtor leased real property from the owner and subleased it to the tenant. The sublease required the tenant to attorn to the owner if the owner "terminates the Master Lease [or] otherwise succeeds to the interest of" the debtor under the lease. In the chapter 11 case, the debtor in possession rejected the lease and the sublease, stating in its rejection motion that it intended to treat the sublease as terminated under section 365(h). The tenant responded that it too intended to treat the sublease as terminated under section 365(h). The owner objected, but its objection was overruled. The owner then sought to enforce the attornment provision against the tenant. Attornment requires a tenant to be the tenant of a new landlord if the landlord succeeds to the prior owner's rights. Here, the tenant agreed to attorn if the owner terminates the lease or succeeds to the debtor's interest in the lease. Neither happened. Rather, not only by the rejection but also be agreement between the debtor and the tenant, the sublease terminated. Therefore, the tenant was released from any further obligation, either to the debtor or to the owner. *Green Tree Servicing, LLC v. DBSI Landmark Towers, LLC*, 652 F.3d 910 (8th Cir. 2011).

9.1.m. A debtor in possession may not assign a trademark license without the licensor's consent. The debtor sublicensed a trademark. Upon the expiration of the sublicense, the debtor contracted with the sublicensor to perform services related to the trademarked goods, which the debtor performed until its chapter 11 case. In the case, the debtor in possession moved for authority to assign the services agreement as part of a sale of its business. The sublicensor, arguing that the agreement still amounted to a trademark sublicense, objected. A debtor in possession may assume and assign an executory contract even if the contract prohibits or restricts assignment, unless "applicable law" entitles the counterparty to refuse to accept performance from the assignee. The court explains at length why trademark law would entitle a trademark licensor to do so but ultimately determines that the agreement is not a trademark license, so the debtor in possession may assign it. *In re XMH Corp.*, 647 F.3d 690 (7th Cir. 2011).

9.1.n. A contract whose default termination provision requires additional postpetition action to terminate becomes property of the estate. The debtor's lease provided that if the debtor did not cure the default within 60 days after notice, "this Agreement may be terminated and all of the rights of [the debtor] shall cease … and [the counterparty] may at once take possession …." Before bankruptcy, the debtor's contract counterparty sent notice of termination for default under the contract provision. Creditors filed an involuntary petition against the debtor before the expiration of the notice period. Under section 365(a), the trustee may assume an executory contract of the debtor, but a contract that has terminated by its terms before bankruptcy or that expires or terminates by its terms after bankruptcy may not be assumed, because it is no longer an executory contract of the debtor. Because this contract provided only that it "may be terminated", additional action by the counterparty was required before the contract terminated. The petition was filed before the expiration of the notice period. The automatic stay prohibited the counterparty from taking the additional action. As a result, the contract became property of the estate, and the trustee could assume it. *C.O.P. Coal Devel. Co. v. C.W. Mining Co. (In re C.W. Mining Co.)*, 641 F.3d 1235 (10th Cir. 2011).

9.1.o. Contract assumption does not require cure of provision requiring payment of other creditors. The debtor's plan proposed to assume an executory supply contract that required the debtor to stay current with all obligations to other vendors. The contract counterparty objected to assumption on the ground that the plan did not provide for cure of the default of that provision. A plan may provide for assumption of an executory contract if, among other things, all defaults under the contract, other than financial or insolvency-type defaults, are either cured or promptly will be cured. However, a cross-default provision in a contract, such as the provision here requiring that the debtor remain current with other vendors, is inherently suspect, because it may prevent assumption of a contract because of defaults under entirely separate agreements. Enforcement of such a provision would contravene the bankruptcy policy against enforcement of *ipso facto* clauses and impermissibly hamper reorganization. Therefore, the plan may provide for assumption without payment of all other vendors' claims. *In re Jennifer Convertibles, Inc.*, 2011 Bankr. LEXIS 342 (Bankr. S.D.N.Y. Feb. 4, 2011).

9.1.p. "Actions in furtherance" of bankruptcy, without board action, may be an ISDA event of default. The parties' interest rate swap agreement on the 1987 ISDA form provided that an event of default would occur if a party "is dissolved", "becomes insolvent or fails of is unable or admits in writing its inability generally to pay its debts as they become due", "institutes or has instituted against it a proceeding seeking … relief under any bankruptcy or insolvency law", "has a resolution passed for its winding up or liquidation" or "takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the foregoing acts". One party encountered severe financial difficulty, resulting in enormous loans from the Federal Reserve Bank of New York to keep it afloat. Before it received the loans, it began bankruptcy preparations. After it received the loans, it began to take steps to wind down and liquidate its business. After announcing further losses, it again instructed its attorneys to prepare for an imminent bankruptcy. A second round of FRBNY loans prevented a bankruptcy. The bankruptcy preparations were "actions in furtherance of" instituting a proceeding seeking bankruptcy relief. The contract did not require corporate action to trigger an event of default, just "any action in furtherance". Similarly, the termination of businesses and steps to wind down operations were in furtherance of winding up or liquidation and similarly triggered an event of default. *Brookfield Asset Mgmt., Inc. v. AIG Fin. Prods. Corp.*, 2010 U.S. Dist. LEXIS 103272 (S.D.N.Y. Sept. 29, 2010).

9.1.q. Bankruptcy Code preempts state law restricting debtor's successor's right to contract. During bankruptcy, the debtor in possession car manufacturer rejected dealership contracts, with the court's approval, and sold its remaining business to a successor. Several states adopted laws requiring the successor to grant a dealer franchise to a rejected dealer before granting a franchise to anyone else in the same geographic area. Congress may preempt state law expressly, by occupying the field or where local law conflicts with federal law or makes it impossible for a party to enjoy rights granted under federal law. The Bankruptcy Code reflects comprehensive federal regulation of bankruptcy and the adjustment of rights between a debtor and its creditors. The state statutes would conflict with that regulation and would prevent the successor from enjoying rights that it obtained in the debtor's bankruptcy case. Therefore, the state statutes are unconstitutional as applied to the successor. *Old Carco LLC v. Kroger (In re Old Carco LLC)*, 442 B.R. 196 (S.D.N.Y. 2010).

9.1.r. Joint debtors' LLC agreement is not an executory contract, and their interests become property of the estate. Individual debtors filed a joint petition. They owned all the membership interests in an LLC. The applicable LLC statute defines a member's interest as the right to share profits and losses and receive distributions of assets and provides that an assignment does not entitle the assignee to participate in management. However, section 541(a)(1) includes in property of the estate all of the debtors' interests in property, including contract rights, which include rights to participate in management. An executory contract is one under which the obligations of both parties are so far unperformed that the failure of either to complete performance would constitute a material breach and excuse the other party's performance. Here, the only parties to the LLC agreement are the joint debtors in the case; there is no "other party". Therefore, application of executory contract analysis does not serve any of the purposes of section 365, and all the debtors' interests, including their management rights, became property of the estate. *Fursman v. Ulrich (In re First Protection, Inc.)*, 440 B.R. 821 (9th Cir. B.A.P. 2010).

9.1.s. Section 365(d)(3) requires payment of postpetition semiannual farm rent even though the land provided no benefit to the estate. The debtor farmer's land lease required two annual payments, on April 1 and December 1 of each year. The debtor filed bankruptcy on November 29, after he had harvested the annual crop. The debtor in possession rejected the lease the following March. Section 365(d)(3) requires that a debtor in possession "timely perform all the obligations of the debtor … arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1)". The section is unambiguous that the debtor in possession must pay December 1 rent payment obligation, which arose after the order for relief. Section 503(b) allows administrative expenses, including, in section 503(b)(1), the costs and expenses of preserving the estate. Section 365(d)(3) excludes section 503(b)(1), but not the general statement of section 503(b), from consideration, and "including" is not limiting. Therefore, even though the land provided no benefit to the estate because the year's crop had already been harvested, section 503(b) grants the section 365(d)(3) payment obligation administrative expense priority. *Burival v. Roehrich (In re Burival)*, 613 F.3d 810 (8th Cir. 2010).

9.1.t. Trustee may not reject prepetition court specific performance order. The debtor contracted to sell real property but defaulted. The buyer obtained a final order of specific performance before the debtor filed bankruptcy. An executory contract is one under which the parties' obligations "are so far unperformed that the failure of either complete performance would constitute a material breach excusing performance of the other". A prepetition specific performance order renders the underlying contract non-executory; the order is deemed to have "executed" the contract. Where a prepetition order can be expressed as a claim, it is subject to discharge in the bankruptcy, thereby preventing a party with an equitable remedy that can be reduced to money from obtaining more favorable treatment in bankruptcy. In this case, however, the specific performance order could not be reduced to money, because it involved the transfer of a unique parcel of land. Therefore, the order is not a claim, the executory contract has been performed and the trustee may not reject the contract and resell the land. *In re Acevedo*, 2010 Bankr. LEXIS 2915 (Bankr. S.D.N.Y. Sept. 10, 2010).

9.1.u. Debtor in possession may not reject substantially performed trademark license agreement. The debtor had sold a business line 10 years before bankruptcy and entered into several agreements that were still in force as of the bankruptcy filing. One agreement was a trademark licensing

agreement that gave the buyer a perpetual, royalty free license of the debtor's trademark in the operation of the business line and obligated the debtor not to use the trademark in that business line. The debtor desired to reenter that business line. It moved to reject the agreement as an executory contract so that it would no longer be bound by the obligation not to use the trademark. An executory contract is one under which sufficient performance remains on both sides so that the failure to perform would constitute a material breach excusing the other party's performance. Under New York law, which governed this contract, a breach is material and excuses the other party's performance only if the contract has not been substantially performed. In this case, the ongoing obligation not to use the trademark in a single business line and associated obligations on the buyer did not amount to substantial performance, which had already been rendered in connection with the sale itself. Therefore, the contract was not an executory contract and could not be rejected. Judge Ambro's concurrence argues that rejection should not permit the debtor in possession to rescind a trademark license, even though trademarks are not within the scope of intellectual property that section 365(n) protects, but it does not address rejection's effect on the debtor's obligation not to use the trademark. *In re Exide Techs.*, 607 F.3d 957 (3d Cir. 2010).

9.1.v. Estate is liable for postpetition "stub rent" as an administrative expense. The debtor filed its chapter 11 petition on June 9. It had not paid rent due on June 1. The debtor in possession immediately began going out of business sales, which proved financially successful. The debtor in possession paid rent due on July 1, but disputed its obligation to pay "stub rent" for the period from June 9 to June 30 as an administrative expense. Section 365(d)(3) requires a trustee to perform all the debtor's obligations under a lease, "notwithstanding section 503(b)(1)". The "notwithstanding" clause excuses only the lessor's compliance with section 503(b)(1) to demand performance of postpetition obligations. It does not exclude section 503(b)(1)'s operation on leases. Section 503(b)(1) entitles a third party to an administrative expense for providing something of benefit to the estate. The debtor in possession's use of the leased premises for 21 days in June provided a benefit, so the lessor is entitled to an administrative expense for the reasonable value of the premises for that period. *In re Goody's Family Clothing Inc.*, 610 F.3d 812 (3d Cir. 2010).

9.1.w. Section 1114's restriction on modification of retiree benefit plans applies to plans that by their terms permit modification. The debtor provided retiree benefits for retirees under collective bargaining agreements, but the agreements permitted the debtor to modify the benefits at any time. The debtor in possession moved under section 363(b) to terminate retiree benefits but did not move to terminate under section 1114 or comply with any of section 1114's negotiation requirements. Section 1114(e) provides, "[n]otwithstanding any other provision of this title, the trustee shall pay and shall not modify any retiree benefits" without court approval or retiree representative agreement. The plain language of section 1114 prohibits modification, even if the plan itself permits it. The legislative history does not suggest otherwise and in fact supports the plain language, and the result is not absurd, even though it grants retirees greater protection in bankruptcy than they had before bankruptcy. Therefore, the debtor in possession may not modify the retiree benefits without compliance with section 1114. *IUE-CWA v. Visteon Corp. (In re Visteon Corp.)*, 612 F.3d 210 (3d Cir. 2010).

9.1.x. Municipality may reject collective bargaining agreement in a chapter 9 case without regard to section 1113. The municipal debtor moved to reject a collective bargaining agreement (CBA) with one of the city's unions. Sections 103(f) and 901 specify which Bankruptcy Code sections apply in a chapter 9 case. Section 365 applies, but section 1113 does not. Therefore, the limitations on rejection of CBA's that apply in a chapter 11 case under section 1113 do not restrict a municipal debtor's ability to reject a CBA. The standards set forth in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984), apply instead. Section 903 preserves a state's ability to control its municipalities, "by legislation or otherwise", in a chapter 9 case. A municipality may file a chapter 9 case only if specifically authorized under state law. However, when a state authorizes a municipality to file a chapter 9 case, its authorization constitutes a declaration that the benefits of chapter 9 take precedence over control of its municipalities. Therefore, it may not restrict which aspects of chapter 9 are available to the municipality. In addition, federal law may preempt state law, and the Bankruptcy Code does so in general. It does so here as well, even though regulation of municipal labor relations is traditionally an area subject to state control. In any event, the state statute authorizing the city to file chapter 9 here does not explicitly identify state labor law as an

exception of the general grant of authority to file. *I.B.E.W. v. City of Vallejo (In re City of Vallejo)*, 2010 U.S. Dist. LEXIS 67598 (E.D. Cal. June 14, 2010).

9.1.y. *Ipso facto* clause prohibition applies to a priority "flip" clause in a synthetic CDO. The U.S. debtor entered into a credit default swap with a synthetic collateralized debt obligation SPV (CDO), which issued notes. The notes' proceeds were held as collateral for the CDO's obligations under both the notes and the swap. The security agreement, which was governed by English law, provided that the security interest of the debtor, as swap counterparty, had priority over the security interest of the noteholders, unless the debtor defaulted under the swap and amounts become payable after sale of the collateral. The debtor's U.S. parent guaranteed the debtor's performance under the swap. The parent filed bankruptcy, defaulting the swap. The debtor filed bankruptcy three weeks later. The collateral trustee issued a notice of default and terminated the swap one month later, citing the debtor's bankruptcy (rather than the parent's bankruptcy) as the event of default. An executory contract is a contract under which the obligation of the debtor and the counterparty are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other. The swap's outstanding payment obligations make it an executory contract. The United States has a strong interest in having a U.S. bankruptcy court resolve issues of bankruptcy law that protect a U.S. debtor more than the foreign law governing the contract would protect the U.S. debtor. Therefore, section 365 protections apply. Section 365(e) prohibits the enforcement of a contractual provision that modifies or terminates a debtor's rights under a contract based on "the commencement of a case under this title". Section 365(e) prevented the priority reversal, because it became effective only upon disposition of the collateral, which had not occurred as of the debtor's bankruptcy. In addition, the default notice specified the debtor's, not the parent's, bankruptcy as the event of default. Even if the reversal became effective upon the parent's bankruptcy filing, section 365(e) prevented it. The parent commenced "a case" under the Bankruptcy Code. Because of the close relationship between the parent and the subsidiary in these cases, the commencement of the parent's case was sufficient to invoke section 36(e)'s protection and invalidate the priority reversal as against the debtor. *Lehman Bros. Special Financing Inc. v. BNY Corp. Trustee Servs. Ltd. (In re Lehman Bros. Holdings Inc.)*, 422 B.R. 407 (Bankr. S.D.N.Y. 2010).

9.1.z. Debtor in possession may exercise expiring option within 60 days after the order for relief under section 108(b). The debtor had an option to purchase loans secured by real property. The option had a firm expiration time and a "time is of the essence" provision. The debtor filed a chapter 11 case the day before the option expired. Whether a contract is an executory contract for purposes of section 365 is determined at the petition date, and in general a debtor in possession may assume or reject a contract at any time before plan confirmation. However, the debtor in possession may not assume a contract under section 365 after it expires, because nonperformance after expiration of a "time is of the essence" deadline constitutes a default, which is not curable under state law. Section 365(b)(1)(A)-(C) does not permit cure of nonmonetary defaults, except those relating to a penalty provision or to real property leases. Therefore, the debtor in possession here may not assume the option because it cannot cure the default arising upon the option deadline's expiration. Under section 108(b), if an agreement fixes a period in which the debtor may "cure a default, or perform any other similar act" and the period has not expired as of the petition date, the period is extended to at least 60 days after the order for relief. Although the agreement does not permit cure of a default within a fixed period, it permits a "similar act", which includes exercising the option. Therefore, the debtor in possession may exercise the option within 60 days after the order for relief, despite the inapplicability of section 365. In re Empire Equities Capital Corp., 405 B.R. 687 (Bankr. S.D.N.Y. 2009).

9.1.aa. A nondebtor party may stop performance upon a rejection motion and claim resulting damages upon a later assumption motion. The debtor leased real property and subleased it to another tenant. The sublease contemplated that the tenant would take possession and make improvements to the space, that the lease would start four months after the debtor delivered possession and that the rent obligation would start three months after the lease start date. The subtenant planned to use the space as part of a larger campus and had sequenced its improvements and moving as part of a larger move process. The debtor filed its chapter 11 case 10 days after the subtenant took possession. Two days later, the debtor in possession moved to reject both the master lease and the sublease. The subtenant immediately stopped construction of the improvements and re-planned and re-sequenced its move process. In doing so, it incurred expenses to relocate employees and lease other space. Two months later, the debtor in possession reached agreement with the master lessor to assume and assign both the master lease and the sublease to

the master lessor. Assumption would have permitted the subtenant to resume construction and move into the space approximately seven months later than originally expected. To assume a lease, a debtor in possession must cure defaults and compensate for actual pecuniary loss that the lessee incurred as a result of any default. The lessee acted reasonably in stopping construction and re-planning its campus move. Therefore, the expenses the subtenant incurred in re-planning were allowable and must be paid to compensate the subtenant. In addition, the subtenant's rental obligation would not begin until seven months after the date originally contemplated. Because the debtor in possession could not compensate all such losses and still provide adequate assurance of future performance, the court denies the motion to assume and assign the sublease. *In re DBSI, Inc.*, 405 B.R. 698 (Bankr. D. Del. 2009).

9.1.bb. A debtor in possession may reject an executory contract despite state law that imposes limits on termination. The debtor in possession automobile manufacturer sought authority to reject dealer franchise agreements in connection with the sale of its business. State laws restrict an automobile manufacturer's ability to terminate franchise agreements by imposing waiting periods, vehicle buy-back requirements, "good cause" hearings, limitations on permissible termination grounds and termination fees or enhanced damage claims. In addition, the federal Automobile Dealers Day in Court Act, 15 U.S.C. § 1221, authorizes damages for bad faith termination of a dealer agreement. Section 365 authorizes rejection, that is, authorization of non-performance, of executory contracts. Section 365 and other Bankruptcy Code sections contain express limitations on rejection, or the effect of rejection, of certain contracts, such as collective bargaining agreements and leases of real property. In addition, certain other federal statutes, such as the Federal Power Act, impose a public interest consideration in certain regulated contractual relationships. In the absence of such a federal statute, the standard for rejection of an executory contract is the business judgment rule, not a public interest standard. The business judgment standard does not require that the debtor in possession make the best business decision or even one that the court would make, only a reasonable business decision. It also does not consider the effect of rejection on the contract counterparty or its community. The ADDCA does not evidence a federal public interest, as it provides only for damages, not a regulatory scheme. A federal law preempts a state statute that interferes with or is contrary to federal law. Preemption may be express or may result from Congressional action that occupies a field of regulation or legislation or that is in conflict with the state law. The state dealer protection laws provide only economic regulation and protection, not protection against any imminent health or safety risks. They conflict with the Bankruptcy Code's authorization to a debtor in possession not to perform executory contracts. The Bankruptcy Code therefore preempts them. Finally, section 959(a) of title 28, which requires a debtor in possession to abide by all applicable nonbankruptcy laws in the operation of a business, does not restrict section 365's scope. Because the debtor in possession demonstrated sound business judgment in rejecting the dealer agreements, the court grants its motion to approve rejection. *In re Old Carco LLC*, 406 B.R. 180 (Bankr. S.D.N.Y. 2009).

9.1.cc. The court may approve contract rejection without consideration of the public interest. The debtor processes chicken. It contracts with growers to grow the chicken for processing. One of its plants was losing money because of low prices for processed chicken. The only way to reduce losses was to reduce the plant's production. The debtor in possession could reduce production by rejecting some grower contracts or by renegotiating most or all grower contracts to reduce volumes. The debtor chose to reject 26 grower contracts. The rejection would have devastating effects on the growers whose contracts were selected and perhaps on their communities as well. The debtor in possession selected contracts for rejection based on a "tournament" system, which was the system the debtor had used to measure cost per pound of grown chicken, based on the five most recent flocks, with some adjustments for extraordinary events, such as diseased flocks. The growers alleged that the debtor in possession selected the contracts for rejection either in retaliation for grower organizing actions or in violation of the Packers and Stockyard Act (PSA) or because the selected growers were largely Hispanic. Generally, the court should approve a rejection motion if the debtor in possession used reasonable business judgment in deciding to reject. The court must place itself in the decision maker's shoes and determine whether the decision maker's assumptions were reasonable and whether the conclusions are reasonable. The court may not second guess the debtor in possession's selection of one business strategy that leads to rejection over another business strategy that does not, or one contract selection method over another, as long as the selections are rational and reasonable. However, a decision based on retaliation or ethnic discrimination would not be rational and therefore not reasonable. In this case, the counterparties did not present probative evidence that any such factors motivated the debtor in possession's selections. In addition, the court need

not consider the effect on the counterparty or the public interest in determining whether the decision is reasonable, unless there is a specific federal statute that evinces a contrary policy. Examples include the Federal Power Act, which regulates pricing and contract formation and termination among wholesale power generators and their customers, as construed in *In re Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004), or the "law of the shop" that collective bargaining agreements create under the National Labor Relations Act, as applied in *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984). The PSA does not impose a similar regulatory regime here, because it does not regulate contracts between growers and processors. *In re Pilgrim's Pride Corp.*, 403 B.R. 413 (Bankr. N.D. Tex. 2009).

9.1.dd. Auto dealer customer finance contracts are not non-assumable financial accommodation contracts. The debtor car dealer had agreements with auto finance companies under which they would buy car loans that the dealer originated with its customers and that met certain underwriting criteria. The dealer retained no liability for amounts owing on the car loans. The agreements were terminable at will by the finance companies. After the debtor filed its chapter 11 case, the finance companies terminated the contracts. Section 365(c) prohibits assumption of a contract "to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor". Section 365(c) does not define what a financial accommodation is, but the term should be construed narrowly. Otherwise, all contracts that involved any extension of credit to the debtor would qualify, and the subsection would largely eviscerate section 365's provisions authorizing assumption of executory contracts. Section 365(c) applies only where credit extension to the debtor party is the contract's principal purpose. Here, because the finance agreements were solely for the sale of customer loan contracts and did not involve extending credit to the debtor at all, section 365(c) does not apply. Applicable nonbankruptcy law permits a party to a contract that is terminable at will to terminate only in good faith. In light of the strong bankruptcy policy of section 365(e), which prohibits enforcement of a contract termination provision based on the filing of a chapter 11 petition or the debtor's financial condition, termination based on the debtor's chapter 11 filing is not in good faith. In addition, because the contract is property of the estate, termination violates the automatic stay. Therefore, the finance companies must continue to purchase conforming paper from the debtor in possession until the contract is rejected or the finance companies obtain stay relief. *In re Ernie Haire Ford, Inc.*, 403 B.R. 750 (Bankr. M.D. Fla. 2009).

9.1.ee. Mortgage sale and servicing agreement is severable. The debtor originated and serviced mortgage loans. The debtor had entered into a master sale and servicing agreement with a buyer providing for the debtor to sell loans periodically and for a subsidiary to service the loans. The agreement required the debtor to repurchase nonconforming loans. The servicing subsidiary agreed to indemnity the buyer for losses resulting from the debtor's failure to repurchase nonconforming loans. The buyer intended the repurchase indemnity obligation to permit it to terminate the subsidiary's servicing agreement and move its money out of the subsidiary when the debtor's enterprise was in financial distress. As of the petition date, the buyer had no unperformed obligations under the agreement, so the agreement was not an executory contract. The debtor in possession subsidiary sought to sell the servicing agreement without repurchasing nonconforming loans that the debtor parent had sold to the buyer before bankruptcy. Under section 363(f), the debtor in possession may sell an asset free and clear of interests, which include claims and setoff rights, but not free of rights, such as recoupment, arising under the same agreement. If the sale and servicing agreement were a single agreement, then the debtor in possession could not sell free and clear of the repurchase obligation. Applicable nonbankruptcy law determines whether the sale portion or the agreement was severable from the servicing portion. Agreements are severable if the nature and purposes of the agreements differ, the consideration for each is separate and the parties' obligations are not interrelated. Sale and servicing are different purposes, the price to purchase the loans was separate from the consideration for servicing the loans, and the sale obligations were independent of the servicing obligations. A cross-default provision between two agreements permits the non-debtor party to impose on the estate the cost of a substantially unrelated agreement and therefore is insufficient in and of itself to integrate two otherwise severable agreements. This "cross-default rule" carries out section 365(f)'s rule against anti-assignment clauses but applies equally to non-executory contracts and is reflected in section 363(*l*). Because the indemnity provision was intended as a financial early warning signal, it should be treated as an ipso facto clause rather than as integrating the agreements. Therefore, the debtor in possession may sell the servicing agreement without assuming or curing the repurchase obligation under the sale agreement. *DB Structured Prods., Inc. v. Am. Home Mortgage Holdings, Inc (Am. Home Mortgage Holdings, Inc.)*, 402 B.R. 87 (Bankr. D. Del. 2009).

9.1.ff. Municipal debtor may reject collective bargaining agreement under *Bildisco* standard. The chapter 9 municipal debtor sought approval to reject a collective bargaining agreement under section 365. State law restricts a municipality's ability to modify a collective bargaining agreement. The State had consented to the municipality's chapter 9 filing. The State cannot condition its consent on any limitation on the municipality's use of chapter 9's powers, because once the State consents, the Bankruptcy Code preempts any otherwise applicable State law. Section 1113 does not apply in a chapter 9 case. The only applicable standard, therefore, for rejection of a collective bargaining agreement is that set forth in *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513 (1984), which applies to this case. *In re City of Vallejo*, 403 B.R. 72 (Bankr. E.D. Ca. 2009).

9.1.gg. Whether a contract is executory is determined as of the petition date. The debtor had entered into a contract with a developer for the construction and sale-leaseback of a retail store. After bankruptcy, the developer completed construction and tendered the purchase price and the previously agreed form of lease to the debtor in possession. The debtor in possession moved to reject the contract. The contract was executory as of the commencement of the case. Section 365 gives the debtor in possession until confirmation or until an earlier date that the court orders to decide whether to assume or reject a contract. The contract's postpetition expiration by its own terms or the debtor in possession's action in terminating the contract can render a contract that was executory at the petition date no longer executory. In those circumstances, the debtor in possession may not assume or reject the contract, because it is no longer an executory contract. But permitting the non-debtor party's postpetition action, such as tendering full performance under the contract, to cause the contract no longer to be an executory contract would improperly allow the non-debtor party to deprive the debtor in possession of the breathing spell and evaluation period that section 365 provides. Therefore, whether the contract is executory is determined at the petition date, and whether the debtor in possession may assume or reject is not based on any action that the non-debtor may have taken during the case. Accordingly, the debtor in possession here may reject the contract as an executory contract, keep the real estate, and relegate the counterparty's rights to a general unsecured claim. *COR Route 5 Co., LLC v. Penn Traffic Co. (In re Penn Traffic Co.)*, 524 F.3d 373 (2d Cir. 2008).

9.1.hh. Lease determines when an indemnity obligation arises. Before bankruptcy, the debtor contracted but did not pay for work on its leased premises. The contractor filed a mechanics lien after bankruptcy and sued the landlord to foreclose the lien. The landlord incurred attorney's fees and the cost of a bond to release the lien. The lease required the debtor to keep the property free of liens and to indemnify the landlord from loss or costs, including attorney's fees, arising from the recordation of any liens. Section 365(d)(3) requires the debtor in possession to "timely perform all the obligations of the debtor … arising from and after the order for relief under any unexpired lease of nonresidential real property until such lease is assumed or rejected". "Obligation", as used in this section, differs from a state "cause of action", which accrues as defined by state law, or a "claim", which is a Bankruptcy Code defined term that includes contingent and unmatured rights to payment. Rather, the lease determines what an obligation is and when it arises, which does not depend on an accrual approach. Here, the debtor breached the obligation to keep the property free from liens prepetition, because a mechanics lien arises on the property when the work is performed, even though the lien is not perfected until later. Therefore, section 365(d)(3) did not require the debtor in possession to perform the obligation to keep the property free of liens. However, the obligation to indemnify arose when the landlord incurred the loss and costs, which was postpetition. Section 365(d)(3) therefore requires the debtor in possession to pay the fees incurred after bankruptcy and before rejection. *In re Designed Doors, Inc.*, 389 B.R. 832 (Bankr. D. Ariz. 2008).

9.1.ii. Lessor under a rejected lease must mitigate damages, but only to the extent of actual mitigating recoveries. The debtor rejected a personal property lease. Applicable nonbankruptcy law requires a lessor to mitigate damages. The lessor relet the property for the same rent to another lessee for a longer term, but the other lessee failed soon thereafter. Section 502(b)(1) disallows a claim to the extent it is unenforceable under applicable nonbankruptcy law. Because the claim would be unenforceable to the extent the lessor did not mitigate its damages, the lessor's claim will be similarly disallowed in a bankruptcy case. However, a rejection damages claim is determined as of the petition date, and mitigation can occur only after rejection. Even so, the lessor's post-rejection actual mitigation, rather than a hypothetical mitigation as of the petition date, applies to claim allowance. In addition, the bankruptcy court must use the

actual results of the lessor's mitigation, if that is available as of the time of claim allowance. Here, because the later lessee breached, the lessor's claim is reduced only by the amount the lessor actually collected from the later lessee, not by the amount the lessor contracted to collect. *Giant Eagle, Inc. v. Phar-Mor, Inc.*, 528 F.3d 455 (6th Cir. 2008).

9.1.jj. Whether an LLC operating agreement is an executory contract must be determined on the facts of each case. The debtor was a non-managing 48.5% member in an LLC. The debtor had no ongoing obligations under the LLC operating agreement. The operating agreement provided for the LLC's dissolution upon a member's bankruptcy. Whether an LLC operating agreement is an executory contract depends on whether the agreement's terms meets the definition of an executory contract, that is, whether there are obligations on both parties, the breach of which by one would excuse performance by the other. Here, there were no such obligations, so the operating agreement was not an executory contract. As such, section 365(e)'s anti-ipso facto provisions do not apply, and the bankruptcy caused the LLC to dissolve. *Meiburger v. Endeka Enterps., L.L.C. (In re Tsiaoushis)*, 383 B.R. 616 (Bankr. E.D. Va. 2007).

9.1.kk. Workers' compensation insurance policy is not an executory contract. The debtor's workers' compensation policy was to expire two weeks after the petition date. The policy required the debtor to reimburse the insurer for the policy deductible amounts and the insurer to pay all claims incurred during the policy period. The DIP agreed to assume and extend the policy for four months and to post cash collateral to secure its reimbursement obligation. No objection was filed, and the bankruptcy court approved. The unreimbursed deductible amounts later far exceeded the collateral posted, but nearly all amounts arose from prepetition injuries. Later, the chapter 7 trustee sought to revise the assumption order to limit the collateral's use to unreimbursed deductibles for postpetition injuries. The policy was not an executory contract, because the insurer was obligated to pay prepetition claims whether or not the debtor complied with or violated its reimbursement obligation. Therefore, the assumption order was improper as authorizing something the Bankruptcy Code does not permit, and the order would thus be interpreted to permit reimbursement only of postpetition injury deductibles. *Zurich Am. Ins. Co. v. Int'l Fibercom, Inc. (In re Int'l Fibercom, Inc.)*, 503 F.3d 933 (9th Cir. 2007).

9.1.ll. Debtor in possession may assume a patent license. A patent licensor moved to require the debtor in possession to reject the patent license or for stay relief to permit the licensor to terminate it. The debtor was not in default under the license (except for the bankruptcy filing). The license permitted the debtor to assign it with the licensor's consent, not to be unreasonably withheld. The debtor in possession had not moved yet to assume or assign the license. Though the statute prohibits a "trustee" from assuming a non-assignable contract, the rule for a debtor in possession differs. A debtor in possession's performance does not deprive the licensor of its bargain, as might be the case with a trustee's performance. As the Supreme Court noted in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984), for certain purposes, "it is sensible to view the debtor-in-possession as the same 'entity' which existed before the filing of the bankruptcy petition." Therefore, the debtor in possession may assume the license, and the court denies the licensor's motion. *In re Aerobox Composite Structures, LLC*, 373 B.R. 135 (Bankr. D. N. Mex. 2007).

9.1.mm. Assignment requires adequate assurance of performance of material and economically significant contract terms. The debtor acquired a Tulsa warehouse facility from a customer and contemporaneously entered into a long-term agreement to supply the customer goods "from the Tulsa Facility". The customer required supply "from the Tulsa Facility" to maintain employee and electronic ordering system continuity. After bankruptcy, the debtor in possession moved to assign the supply agreement, but, with the assignee's consent, rejected the Tulsa facility lease, so the assignee would supply the customer from another facility. Section 365(f) permits a DIP to assign the agreement if it can provide "adequate assurance of future performance" by the assignee. The adequate assurance requirement applies only to contract terms that are "material and economically significant". A contract term is material if it was integral to the bargained-for exchange. It is economically significant if performance is required to give the contract counterparty the full benefit of its bargain. Here, the "Tulsa Facility" clause was integral to the supply agreement. Not enforcing it would burden the customer in an economically significant way by depriving it of the expediency it expected from the Tulsa facility. Therefore, the DIP may not assign the contract without compliance with the clause. *In re Fleming Cos.*, 499 F.3d 300 (3d Cir. 2007).

9.1.nn. The debtor in possession may not assume a franchise agreement that licenses a trademark. The debtor was a franchisee. The franchise agreement contained a license of the franchisor's trademark. Under the Lanham Act, a nonexclusive trademark license is absolutely nonassignable. Section 365(c)(1) therefore prohibits the debtor in possession from assuming the franchise agreement. The prohibition in section 365(c)(1) applies equally to debtors in possession and to trustees, because DIPs have all the rights and powers, and are subject to all the duties and obligations, of a trustee. Unless the license agreement itself permits assignment, the DIP may not assume the franchise agreement. *Wellington Vision, Inc. v. Pearle Vision, Inc. (In re Wellington Vision, Inc.)*, 364 B.R. 129 (S.D. Fla. 2007).

9.1.oo. Contract rejection does not cause a reversion of transferred assets. The debtor recording company entered into a recording contract with a singer. The contract provided for the singer's transfer of copyrights to the debtor; in exchange, the debtor would record, distribute, and promote the singer's recordings and would pay royalties on the copyrights. The debtor in possession rejected the agreement in its chapter 11 case. Rejection does not rescind the contract. It only relieves the debtor in possession of executory obligations, such as the obligations to distribute and promote recordings and to pay royalties. It does not unwind fully executed portions of the rejected contract, and it does not obligate the debtor in possession to return property that has been transferred to it under the contract. *Thompkins v. Lil' Joe Records, Inc.*, 476 F.3d 1294 (11th Cir. 2007).

9.1.pp. Debtor may assume a partnership agreement even after the expiration of the default cure period. The debtor general partner defaulted under the partnership agreement. The default permitted the limited partner to remove the general partner, after notice and an opportunity to cure the default. The limited partner gave notice, and the general partner failed to cure within the agreement's cure period, but the limited partner's subsequent attempt to remove the general partner was technically deficient. The general partner filed chapter 11 shortly thereafter. Because the removal was ineffective, the automatic stay prevented the limited partner from removing the general partner after bankruptcy. The partnership agreement is an executory contract that the general partner could assume. Even though the default cure period had expired, the debtor may cure and assume, as long as the contract had not been effectively terminated before bankruptcy. *In re St. Casimir Dev. Corp.*, 358 B.R. 24 (S.D. N.Y. 2007).

9.1.qq. Unscheduled executory contract rides through a chapter 11 case. The debtor omitted an executory contract from its schedules. The debtor confirmed a 100% payment plan, which also did not mention the contract. Contract litigation, which had been stayed pending settlement negotiations during the chapter 11 case, restarted after plan confirmation. The contract rode through the chapter 11 case, even though it was not scheduled. Section 1123(b) permits but does not require assumption or rejection of all executory contracts. Section 1141(b) vests all property of the estate in the reorganized debtor, except as provided in the plan or the confirmation order. Whether the debtor is judicially estopped from pursuing its claim against the contract counterparty in the state court litigation is for the state court to decide, not the bankruptcy court. *In re JZ, LLC*, 357 B.R. 816 (Bankr. D. Ida. 2006), *aff'd sub nom. Diamond Z Trailer, Inc. v. JZ L.L.C. (In re JZ L.L.C.)*, 371 B.R. 412 (9th Cir. B.A.P. 2007).

9.1.rr. Bankruptcy court may enjoin a strike under a rejected RLA-governed collective bargaining agreement. Section 1113 permits a trustee to reject a collective bargaining agreement or to impose modifications only with court approval. The Railway Labor Act explicitly requires the parties to maintain the status quo, under Section 6, and implicitly under Section 2 (First), after an agreement has expired, and thereby prevents unilateral modifications and a strike. In addition, Section 2 (First) explicitly requires the parties to make all reasonable efforts to make and maintain agreements. The Norris-LaGuardia Act deprives federal courts of jurisdiction to enjoin a strike, except in limited circumstances, including to enforce the RLA's provisions. In this case, the debtor in possession obtained court approval to reject and to impose modifications, after the employees had rejected their union's contract modification recommendations. The employees threatened a strike, and the DIP sought to enjoin them. Section 1113 authorizes the court to impose new terms, which is inconsistent with the RLA's status quo requirements applicable to a breached contract. Therefore, the rejection of an RLA-governed collective bargaining agreement constitutes an abrogation of the contract, not a mere breach, as would be the case for a non-labor contract or perhaps even for an NRLA-governed labor contract. The status quo provisions therefore no longer apply. The requirement to make all reasonable efforts to make an agreement continues to apply,

however, and the court may enjoin the breach of that requirement. *Northwest Airlines Corp. v. Assoc. of Flight Attendants-CWA (In re Northwest Airlines Corp.)*, 483 F.3d 160 (2d Cir. 2007).

9.1.ss. Contract rejection is governed by the business judgment rule and does not require compliance with nonbankruptcy notice requirements. The debtor in possession independent practice association terminated a contract with a provider physician during bankruptcy in accordance with the contract's terms. The physician filed an adversary proceeding alleging violations of state law governing contracts with provider networks. The DIP then moved to reject the contract. The nonbankruptcy business judgment rule applies equally to the business judgment to reject an executory contract. The bankruptcy court should presume that the DIP "acted prudently, on an informed bases, in good faith, and in the honest believe that the action taken was in the best interests of the bankruptcy estate" and should approve rejection unless the DIP's "conclusions that rejection would be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice." The court need not weigh the adverse effect of rejection on the other party unless the effect is so disproportionate to the advantage to the estate that it shows that rejection could not be a sound business judgment. The DIP need not comply with any contractual or nonbankruptcy law notice requirements for contract termination, because the power to reject supersedes any such requirement. Rejection does not, however, affect substantive rights, so the estate may be subject to claims for termination, even arising from rejection, such as for retaliatory termination. *Agarwal v. Pomona Valley Med. Grp. (In re Pomona Valley Med. Grp.)*, 476 F.3d 665 (9th Cir. 2007).

9.1.tt. "Surrender" in section 502(b)(6) may require landlord consent. An individual subleased stores to his closely held corporation. After the individual defaulted under one lease, his lessor sued. In the action, the individual stipulated with the lessor for return of the premises. After further litigation, the lessor obtained a judgment against the individual for unpaid rent and for future damages for breach. After the litigation concluded and about three years after the individual turned over possession to the lessor, the individual and his closely held corporation agreed to sell the assets related to the business. The buyer insisted that the sale occur through chapter 11 cases, which both the individual and the corporation filed. An auction ensued in the cases, and the final price permitted payment in full of all individual and corporate creditors, with a surplus for the individual. The individual objected to the lessor's claim under section 502(b)(6). Although section 502(b)(6) was intended to protect creditors from the dilutive effect of large landlord claims, it applies equally in a surplus case, and the court may not change that result using equitable powers under section 105(a). (The court may, however, examine whether the debtor filed bankruptcy in bad faith, without need for bankruptcy relief, simply to impose the landlord damages cap, and may dismiss if that is the case.) In this case, the individual debtor turned over possession of the premises prepetition. The turnover did not constitute "surrender" or "repossession" for purposes of section 502(b)(6)(A). Under applicable nonbankruptcy law, "surrender" occurs only when the landlord accepts it. Because the landlord here accepted possession but did not accept lease termination and instead continued to pursue its lease damages claim, it did not accept surrender. The landlord damages cap therefore runs from the petition date, and the rent for the post-turn-over, prepetition period is treated as accrued, unpaid rent that is not subject to the cap. *1500 Mineral Spring Assocs., LP v. Gencarelli*, 353 B.R. 771 (D.R.I. 2006).

9.1.uu. Contract rejection damages are determined as of the petition date. The debtor had entered into a supply contract one month before the date of the filing of the petition. The debtor in possession continued to perform under the contract for one year postpetition, until the supply price rose substantially, and then rejected the contract. Section 502(g) provides that a claim for rejection damages "shall be determined, and shall be allowed … or disallowed …, the same as if such claim had arisen before the date of the filing of the petition." To give the word "determined" meaning separate from "allowed or disallowed," the section must be interpreted as requiring calculation of damage claims as of the petition date, not the rejection date. Therefore, the counterparty's damage claim is disallowed, as there was no price movement in the short period between the contract date and the petition date. The counterparty should protect itself from such a risk by a motion under section 365(d)(2) to fix a time for the debtor in possession to assume or reject the contract. *Taunton Mun. Lighting Plant v. Enron Corp. (In re Enron)*, 354 B.R. 652 (S.D.N.Y. 2006).

9.1.vv. Court denies implied assumption and refuses to order assumption as a remedy for lack of notice. The debtor in possession sold its assets in a section 363 sale. The sale contract and notice provided that contracts to be assumed would be listed and counterparties would receive direct notice. The chapter 11 plan then provided for rejection of all contracts that were not assumed. Several contract counterparties did not receive adequate notice of the sale or of procedures relating to contract assumptions in the sale, but they were not included on any assumption list. They nevertheless provided post-sale services to the buyer under the contracts, who took the services and paid for them at the contract rates. The liquidating trustee under the plan later sued the counterparties to recover preferences. Under *In re Superior Toy & Mfg. Co.*, 78 F.3d 1169 (7th Cir. 1996), a counterparty to an assumed contract is not liable under the preference statute for prepetition contract payments. *Superior Toy* does not protect the counterparties here. The buyer's use of the contracts did not amount to an implied assumption, which requires court approval under section 365. Nor would the court order the contracts assumed as a remedy for lack of notice, as the assumption decision rests with the trustee or debtor in possession. *Gray v. Western Envtl. Servs. & Testing (In re Dehon, Inc.)*, 352 B.R. 546 (Bankr. D. Mass. 2006).

9.1.ww. Rejection does not terminate a lease. The debtor rejected a real property lease. The lessor filed a claim for damages. The lessor's secured lender had a security interest in rents owing under the lease, but not in damages arising from lease termination. Rejection operates only as a breach of the lease but does not terminate the lease. Termination requires some other, affirmative lessor action. Attempting to relet the premises alone does not suffice. The lessor took no other action in this case. Therefore, the secured lender's security interest in the rents attached to the debtor's payment on the lease rejection damage claim. *Cal. Pub. Employees Retirement Sys. v. Stanton (In re CP Holdings, Inc.)*, 349 B.R. 189 (8th Cir. B.A.P. 2006).

9.1.xx. Deferred rent is not subject to the section 502(b)(6) cap on lessor's damages. Section 502(b)(6) caps a lessor's claim for damages resulting from termination of a real property lease but does not cap a claim for "any unpaid rent due under such lease, without acceleration," on the petition date. Where a lease provides for deferred rent, which accrues during the lease term but is not payable until later, and the lessee files bankruptcy before the date on which it is payable, the cap does not apply. In this provision, "due" means owing, not matured. The deferred rent is past rent that is not subject to the cap. *RM 18 Corp. v. Aztex Ass'n (In re Malease 14FK Corp.)*, 351 B.R. 34 (Bankr. E.D.N.Y. 2006).

9.1.yy. A cross-default clause does not integrate economically separate agreements. The debtor airline leased airport facilities from the city. In a separate transaction some years later, the city issued non-recourse tax exempt bonds, the proceeds of which were loaned to the airline to finance the airline's construction of facilities at the airport. The airline's unsecured note obligation to the city was pledged to the bondholders, and the city had no liability on the bonds beyond what the airline paid on its note obligation. The airline's reorganization plan restructured the note obligation. The airport lease cross-defaulted if the airline defaulted under the note obligation. The city argued that the airline could assume the lease only if it cured the note obligation default. The loss of the lease would cause substantial economic harm to the airline. Non-enforcement of the cross-default provision would not affect the city's obligation to the bondholders, its ability to finance in the future, or airport operations or finances. Whether a cross-default clause is enforceable as a condition to cure and assumption depends on whether the two agreements are economically interdependent, that is, whether the consideration for one agreement supports the other. A statement of intent that the agreements be integrated cannot overcome economic realities, and a cross-default clause cannot integrate otherwise severable agreements. The court must look to the economic substance of the deal. The court rejects section 365(f)'s anti-assignment prohibition and the bankruptcy court's equitable power as bases for refusing to require cure of a cross-default clause, adopting instead an analysis that determines the scope of the contract to be assumed. Here, the airport facilities lease was not economically linked to the bonds in a way that the city would lose the benefit of its lease bargain if the airline did not pay the bonds. Therefore, the airline could assume the lease without curing the note obligation default. *United Air Lines, Inc. v. U.S. Bank Trust N.A. (In re UAL Corp.)*, 346 B.R. 456 (Bankr. N.D. Ill. 2006).

9.1.zz. An unexercised option is not an executory contract. As of the petition date, the debtor had an option to require a lender to purchase and lease equipment to it. The debtor did not assume or reject

the option under the confirmed plan, which revested all of the estate's assets in the debtor. Under the Countryman definition, which applies in the Fourth Circuit, an option is not an executory contract because the debtor has no performance obligation unless and until it exercises the option. The definition of executory contract for purposes of section 365(c)(2), relating to financial accommodation contracts, does not differ from the general definition applicable under section 365. The option was only an asset of the debtor's estate and revested in the debtor upon reorganization. The reorganized debtor may therefore exercise the option. *BNY Cap. Funding LLC v. US Airways, Inc.* 345 B.R. 549 (E.D. Va. 2006).

9.1.aaa. The court may enjoin an airline union strike after the debtor-air carrier rejects a collective bargaining agreement. Section 6 of the Railway Labor Act, which applies to labor relations between an air carrier and its unions, requires a mediation process under the National Mediation Board before an employer may unilaterally impose changes in employment terms or conditions or a union may strike. Despite the anti-injunction provisions of the Norris-LaGuardia Act, a court may enjoin unilateral action if the employer or union violates the "status quo" requirements of section 6. A bankruptcy court may authorize rejection of a collective bargaining agreement under section 1113 and authorize the debtor in possession to impose changes in employment terms and conditions unilaterally only if it determines that the union did not act in good faith in rejecting the debtor in possession-employer's proposal for the changes, the changes are required for the survival of the debtor, and rejection is fair and equitable. By imposing the changes after bankruptcy court approval, the debtor does not violate or terminate the section 6 mediation process, because Congress specifically authorized the court to approve the action. The union is therefore required to continue to comply with the status quo requirements of that section, and the court may enjoin a strike that would violate its section 6 obligations. In this case, the injunction is warranted because the inability of the airline to impose the changes could lead to its economic demise. The result differs significantly from the operation of section 6 and the ability of a solvent employer to make unilateral changes during the section 6 mediation procedure, because section 1113 permits the employer, subject to extensive substantive and procedural requirements, to make changes once authorized by the bankruptcy court, and from the operation of section 1113 and the Norris-LaGuardia Act in the context of the National Labor Relations Act, which does not have a similar mediation procedure and status quo requirement. *Northwest Airlines Corp. v. Ass'n of Flight Attendants (In re Northwest Airlines Corp.)*, 349 B.R. 338 (S.D.N.Y. 2006).

9.1.bbb. Installment land sale contract is an executory contract under Ohio law. Under Ohio law, once a purchaser has paid more than 20% of the purchase price or has paid for more than five years, the seller may not obtain a forfeiture under the contract but must undertake a judicial foreclosure proceeding to divest the purchaser of its rights under the contract. Under Sixth Circuit's application of the Countryman test, an installment land sale contract is an executory contract, because breach of the purchaser's continuing payment obligation would excuse the seller from further performance, and the seller's failure or impairment of its ability to deliver title would excuse the purchaser from making further payments. The Ohio statute affects only the seller's remedies and does not alter the underlying nature of the installment land sale contract as an executory contract under the Countryman test. *O'Brien v. Ravenswood Apts. (In re Ravenswood Apts.)*, 338 B.R. 307 (6th Cir. B.A.P. 2006).

9.1.ccc. Remedies for rejection of a land purchase contract. The debtor agreed in writing to lease 70% of a parcel to a tenant and later (but before the lease term began) agreed orally to sell the tenant the entire parcel. The buyer occupied the 70% parcel and, with the debtor's consent mortgaged the entire parcel to finance improvements. The debtor filed chapter 11 and rejected the sale agreement. Section 365(i) permits a buyer in possession under a rejected contract to sell real estate either to surrender possession and claim for damages or to remain in possession, tender the balance of the purchase price, offset by any damages, and complete the sale, despite the rejection. Specific performance under applicable nonbankruptcy law is therefore not available, because the federal bankruptcy remedy preempts the field of remedies for a breach arising from rejection. Here, however, the buyer went into possession under the lease, not under the purchase agreement, so section 365(i) is not available. The debtor also moved to reject the lease. Because the buyer was in possession under the lease, section 365(h), which allows a lessee to remain in possession following a debtor-lessor's lease rejection, applies. Finally, the buyer has a dischargeable claim for the sale agreement rejection. Although the buyer had a specific

performance right under nonbankruptcy law, the right can be reduced to a monetary claim. *In re Nickel Midway Pier, LLC*, 341 B.R. 486 (D.N.J. 2006).

9.1.ddd. Fifth Circuit adopts "actual test," requires stay relief before contract termination. The debtor had entered into a Western States Power Pool Agreement with Bonneville Power Administration to sell power to BPA at BPA's option. When the debtor filed chapter 11, BPA terminated the agreement. The debtor in possession sought rescission of the termination and damages for an automatic stay violation. The agreement is not a "safe harbor" forward contract, because BPA cannot be a forward contract merchant, because it is not a "person," as the forward contract merchant definition requires. BPA may not terminate the agreement under the section 365(e)(2)(A) exception to the *ipso facto* termination prohibition. Although the federal Anti-Assignment Act may apply to this agreement, it does not in fact apply, because the debtor in possession made no attempt to assume or assign the contract, and the *ipso facto* exception applies only to actual facts, not to hypothetical situations. The reference to "applicable law" in that exception "must apply to a set of circumstances; BPA creates smoke and erects mirrors when it argues that a contract not assignable as a matter of law, even if no such assignment existed in fact and no excuse existed in fact for the nondebtor party to refuse acceptance of performance in a particular situation, satisfies the language chosen by Congress in drafting the § 365(e)(2)(A) exception." In so adopting the "actual test" for the exception, the court rejects the more equivocal reasoning of the First Circuit's *Summit Land* decision and rules that the language is unambiguous. Finally, BPA may not terminate a non-safe harbor contract without automatic stay relief, even if the *ipso facto* termination exception applies, to assure orderly administration of the estate. *Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.)*, 440 F.3d 238 (5th Cir. 2006).

9.1.eee. UCC true lease test requires determination of parties' reasonable expectations at the time of the lease. The debtor leased telecommunications equipment before bankruptcy. In the subsequent bankruptcy, the debtor in possession attempted to recharacterize the lease as a secured transaction. UCC section 1-201(37) provides a "bright line" test for determining that a transaction under which the lessee is obligated for a lease term that is not subject to termination is a security interest if one of four conditions is met. One of those conditions is that the lessee has an option to acquire the property for nominal consideration at the end of the lease. Consideration may be nominal if it is less that the lessee's reasonably predictable cost of performing under the lease. That is, if the economic realities are that the lessee would exercise the purchase option rather than return the equipment, the consideration is nominal. In applying the test, the court must determine the reasonably predictable (that is, the anticipated or projected) cost of performance, as of the time of the transaction, not as of the expiration of the term, because whether a transaction is a lease or security interest is determined as of the time of transaction, not at some later time. This examination does not return to an "intent of the parties" analysis, because the parties' expectations at the time reflect the economic realities surrounding the transaction, which determines whether it is a lease or security interest. *WorldCom, Inc. v. Gen. Elec. Global Asset Mgmt. Servs. (In re WorldCom, Inc.)*, 339 B.R. 56 (Bankr. S.D.N.Y. 2006).

9.1.fff. Trademark license rejection deprives licensee of further use of the mark. In connection with a sale of assets, the debtor licensed a trademark to the buyer. The sale agreement, the license agreement, and other related agreements were an integrated contract. Nevertheless, even though the license agreement was part of that contract, the license agreement was an executory contract, because there were unperformed material obligations relating to use, restrictions on use, and maintenance of the registration on the trademark. In authorizing the rejection, the court must not substitute its judgment for the debtor in possession's judgment, if the debtor in possession engaged in a sufficiently thorough and considered decision-making process (although the court then proceeded to consider each of the factors of the rejection decision independently). Upon rejection, the right to use the trademark reverts to the estate. Even though rejection does not terminate the license agreement, it relieves the debtor in possession of the obligations to protect the mark and not interfere with its use by the licensee. Rejection's benefit is the estate's reacquisition of the right to use the mark. Without that, rejection would not offer meaningful relief, which would be an absurd result. However, the court allows the licensee a two-year transition period to mitigate any harsh result on the licensee. *In re Exide Techs.*, 340 B.R. 222 (Bankr. D. Del. 2006).

9.1.ggg. Right of first refusal in an LLC operating agreement, which is not executory, is enforceable. The debtor owned a 20% interest in an LLC. The LLC operating agreement did not impose any present performance obligations on the debtor, only contingent future obligations if certain events occur. The operating agreement is therefore not within the Seventh Circuit's narrow definition of "executory contract." The operating agreement contained a right of first refusal, under which the LLC and the other members had a right to purchase the debtor's interest if the debtor attempted to sell it to a third party. The right was not contingent on the debtor's financial condition or whether the debtor was in bankruptcy. The provision was therefore not an invalid ipso facto clause under section 365(e) or (f). Moreover, even if it were, section 365 does not apply, because the agreement is not an executory contract. *In re Capital Acqs. & Mgmt. Corp.*, 341 B.R. 632 (Bankr. N.D. Ill. 2006).

9.1.hhh. Trademark license agreement is not assumable. Under the "hypothetical test," a debtor in possession may not assume an executory contract if the contract is nonassignable as a matter of nonbankruptcy law, unless the counterparty consents. Thus, a debtor in possession may not assume a copyright license or a non-exclusive patent license. The same rule applies to a non-exclusive trademark license. It is the same kind of intellectual property, governed by similar federal law, and protects the licensor against the ability of a non-exclusive licensee to sublicense or assign the intellectual property. *N.C.P. Mktg. Group, Inc. v. Blanks (In re N.C.P. Mktg. Group, Inc.)*, 337 B.R. 230 (D. Nev. 2005).

9.1.iii. Bankruptcy court does not have jurisdiction to authorize rejection of power purchase agreements. The debtor provided electric power under wholesale contracts that are subject to FERC's jurisdiction. The debtor in possession moved to reject the contracts under section 365 because the contract sale prices were substantially below market. It offered to continue to supply the customers, but at market prices. Under the filed rate doctrine, FERC has exclusive jurisdiction over rates charged under such contracts. Under the Bankruptcy Code, a bankruptcy court has broad power to permit the rejection of a contract, but only if rejection does not interfere with the jurisdiction of a regulatory agency or if the Bankruptcy Code specifically authorizes the interference. Authorizing rejection of these contracts would interfere with FERC's jurisdiction and the filed rate doctrine, in part because the rejection was motivated by the debtor in possession's desire to change the price at which it would supply power to the customers, not by its desire to exit the business entirely. The case therefore differs from the Fifth Circuit's decision in *In re Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004), which authorized rejection where the debtor in possession did not seek price renegotiation. The wholesale price of electricity is an issue solely for FERC. Therefore, the bankruptcy court does not have subject matter jurisdiction to authorize rejection of these power purchase contracts. *Calif. Dep't of Water Res. v. Calpine Corp. (In re Calpine Corp.)*, 337 B.R. 27 (S.D.N.Y. 2006).

9.1.jjj. Abandonment of a contract terminates any interest in the contract. The debtor had contracted to build a methane gas recovery facility on a landfill and, separately, to sell the gas. The debtor's lenders had a security interest in both contracts (among other assets). The debtor breached both contracts. The debtor's chapter 11 trustee settled disputes with the landfill operator and the gas purchaser over the debtor's breaches by agreeing to accept a small payment and a release of claims from both counterparties and to give up the estate's right to the gas. The lenders proposed instead that they waive a portion of their secured claim, make a larger payment to the estate, and indemnify the estate against the counterparties' claims, in exchange for the trustee's abandonment of the right to collect the gas, The lenders would then use their security interest to step into the debtor's shoes to complete the facility and sell the gas. Abandonment would not, however, transfer the rights to the lenders. First, only an asset can be abandoned, not a liability. The trustee could therefore not abandon the debtor's obligation to perform under the contract. Nor could the trustee abandon the entire contract as a single property interest. Unlike abandonment of tangible property, abandonment of a contract causes the contract to cease to exist. *In re Resource Tech. Corp.*, 430 F.3d 884 (7th Cir. 2005).

9.1.kkk. Entire interest in LLC becomes property of the estate. The operating agreement for the LLC in which debtor had an interest, as supported by state law, provides that a member's bankruptcy divests the member's right to participate in management or operation of the LLC, leaving the member with only an economic interest. Section 541(c) preempts both state law and the operating agreement on this point, so that the debtor's trustee succeeds to the debtor's full interest as a member. In addition, because the

operating agreement imposes no continuing obligations on the debtor, the agreement is not an executory contract. (*See* the court's prior decision in this case, 319 B.R. 200 (Bankr. D. Ariz. 2005).) Therefore, the limitations of sections 365(c) and (e) do not apply to restrict the trustee's ability to obtain information from the LLC or to participate fully as a member. *Movitz v. Fiesta Invs., LLC (In re Ehmann)*, 334 B.R. 437 (Bankr. D. Ariz. 2005).

9.1.lll. Bankruptcy court permits going out of business sales despite lease restrictions. The debtor's leases prohibited the debtor from conducting going out of business sales. Nevertheless, the debtor in possession sought authority to conduct such sales. The court grants the authority. First, a restriction on such sales is based on the insolvency or financial condition of the debtor and is therefore not enforceable under section 365(b)(2). Second, section 363(b) governs use of property of the estate, not section 365. When the lease has not been assumed, its terms do not bind the debtor in possession, and section 365 does not apply. Section 363 requires that the debtor in possession provide the landlord adequate protection, which can be accomplished by reasonable restrictions on the sales without need for strict compliance with the lease. *In re Friedman's, Inc.*, 336 B.R. 880 (Bankr. D.S.C. 2005).

9.1.mmm. Section 365(g) is limited to determining claim priorities, not contractual rights. Before bankruptcy, the debtor licensed its trademark to a manufacturer, who was permitted under the license to sell the product to its own customers directly, with the debtor's permission. After bankruptcy, without assuming the license agreement, the debtor in possession agreed with the manufacturer to amend the license agreement to allow the manufacturer to sell without the debtor's permission. The amendment provided that if the debtor committed a new and material breach of the agreement, the manufacturer would be entitled to continue to use the trademarks without permission. The debtor in possession sold its assets to an unrelated entity and rejected the license agreement. The rejection constituted a new material breach, but section 365(g), which deems a rejection breach to have occurred immediately before bankruptcy, does eliminate the effect of the amendment on a theory that the rejection breach occurred before the amendment. Section 365(g)'s main purpose is to determine claim priorities, not to determine the contracting parties' contractual rights. Therefore, the manufacturer retained the trademark license. *A & L Labs., Inc. v. Bou-Matic LLC*, 429 F.3d 775 (8th Cir. 2005).

9.1.nnn. Court disallows setoff under an unassumed executory contract. The debtor entered into a prepetition contract with a collection agency, under which the agency collected delinquent amounts from the debtor's clients. The agency remitted the entire collection to the debtor, who then paid the agency its percentage, although the contract authorized setoff. At the petition date, the debtor owed the agency for prepetition collections. The day after the petition date, the debtor in possession cancelled its contract with the agency, though it did not appear to reject it. The agency continued to make collections and offset the amounts collected against its prepetition claim against the debtor, rather than remitting the amounts to the estate. The agency may not offset these amounts, because the claim was prepetition and the debt was postpetition and therefore not mutual. Because the debtor in possession terminated the agency contract and did not retain the agency, the agency's work was as a volunteer, and it was not entitled to compensation. *Universal Guar. Life Ins. Co. v. Health Receivables Mgmt., Inc. (In re Health Mgmt. Ltd. P'ship.)*, 332 B.R. 360 (Bankr. C.D. Ill. 2005).

9.1.ooo. Remedies for rejection of a land purchase contract. The debtor agreed to lease 70% of a parcel to a tenant and separately agreed to sell the tenant the entire parcel. The buyer occupied the 70% parcel and, with the debtor's consent mortgaged the entire parcel to finance improvements. The debtor filed chapter 11 and rejected the purchase agreement. Section 365(i) permits a buyer in possession under a rejected contract to sell real estate to surrender possession and claim for damages or to remain in possession, tender the balance of the purchase price, offset by any damages, and complete the sale, despite the rejection. Specific performance under applicable nonbankruptcy law is therefore not available, because the federal bankruptcy remedy preempts the field of remedies for a breach arising from rejection. The buyer has a dischargeable claim, despite the availability of a specific performance right under nonbankruptcy law, because the right can be reduced to a monetary claim. Finally, the buyer's year-round possession of a significant portion of the property and the right to mortgage the property qualifies it for the relief in section 365(i), despite some mechanical problems with implementing the language of section

365(i) for a buyer in only partial possession. *In re Nickel Midway Pier, LLC*, 332 B.R. 262 (Bankr. D.N.J. 2005).

9.1.ppp. Surety bond is not an executory contract. The surety issued bonds to guarantee the debtor construction contractor's performance on construction jobs. The surety sought stay relief to cancel the bonds after bankruptcy, arguing that the bonds were financial accommodation contracts that section 365(c)(2) prohibits the debtor in possession from assuming. The Countryman test concludes that a contract is executory if the contract remains so far unperformed on both sides that a material breach by one party would excuse performance by the other. In this case, the debtor had no remaining performance obligation to the surety; all premiums had been paid. Moreover, the debtor's breach would not excuse the surety from future performance. Indeed, the debtor's breach triggers the surety's obligation to perform to the project owner. Finally, even if the contract were executory, it is not a covered financial accommodation contract, because the surety had already extended the financial accommodation to or for the benefit of the debtor before bankruptcy. *United Surety & Indem. Co. v. Maxon Eng'g Servs., Inc. (In re Maxon Eng'g Servs., Inc.)*, 324 B.R. 429 (1st Cir. B.A.P. 2005).

9.1.qqq. Section 365(e) protects the estate, not a co-obligor. A surety company issued, in favor of the debtor's creditor, a bond on which the debtor was jointly liable. Upon the debtor's bankruptcy, the creditor made demand on the bond and sued the surety company for payment. The surety company argued that section 365(e) prevented the creditor from demanding payment based on the debtor's bankruptcy filing. Without addressing whether the surety bond was an executory contract, the court concludes that the section 365(e) prohibition on enforcement of ipso facto clauses does not apply to protect a non-debtor party to a contract. Therefore, the surety was liable to the creditor, despite the debtor's bankruptcy. *Liberty Mut. Ins. Co. v. Greenwich Ins. Co.*, 417 F.3d 193 (1st Cir. 2005).

9.1.rrr. Prepetition consent permits contract assignment, despite section 365(c). The debtor was a party to a patent license agreement that permitted the debtor to assign the agreement upon a sale of the debtor's entire business. Normally, patent law makes a patent agreement non-assignable, and section 365(c) would therefore prohibit assignment, because section 365(c) makes a contract non-assignable if applicable nonbankruptcy law prohibits assignment and the counterparty does not consent. However, the non-debtor counterparty's consent in the contract itself takes the contract out of the patent law prohibition on assignment, so section 365(c) does not apply. *In re Quantegy, Inc.*, 326 B.R. 467 (Bankr. M.D. Ala. 2005).

9.1.sss. Contract rejection does not affect arbitration provision. The debtor sought to prevent arbitration of its dispute with its contract counterparty by arguing that upon rejection of the contract, the arbitration clause no longer applied. However, rejection constitutes a breach, no more, and a party should not be able to excuse itself from performing a contract term (the arbitration agreement) by its own breach. Therefore, the arbitration clause continues to apply after rejection. *Madison Foods, Inc. v. Fleming Cos., Inc. (In re Fleming Cos.)*, 325 B.R 687 (Bankr. D. Del. 2005).

9.1.ttt. Rejection claim is determined as of the petition date, not the rejection date. The debtor had issued its lenders warrants to purchase its common stock. As provided in the plan, the debtor in possession rejected the warrant contracts immediately after confirmation. The creditors' damage claim is based on the difference between the debtor's stock price immediately before the date of the filing of the petition and the warrant exercise price. Section 365(g) makes rejection effective immediately before the date of the filing of the petition, and section 502(g) provides that a rejection damage claim shall be determined and allowed the same as if the claim had arisen before the date of the filing of the petition. These provisions expressly override applicable nonbankruptcy law, embodied in UCC section 2-713, which provides for calculation of damages based on market price as of the time when the contract party learns of the breach. *Bank of Montreal v. American HomePatient, Inc. (In re American HomePatient, Inc.)*, 414 F.3d 614 (6th Cir. 2005).

9.1.uuu. Whether a contract is executory is not necessarily determined as of the petition date. The debtor had entered into an agreement with a developer for the construction and sale-leaseback of a retail store. After bankruptcy, the developer completed construction and tendered the purchase price and

the previously agreed form of lease to the debtor in possession. The debtor in possession moved to reject the contract. Although the contract may have been executory as of the commencement of the case, whether it was an executory contract that could be rejected under section 365 should be determined as of the date of the motion to reject. By then, the only remaining performance was the debtor in possession's, not the developers. Although the developer had remaining obligations—it had not yet actually paid the purchase price or leased the property to the debtor—it had been prevented from performing them only by the debtor in possession's refusal to perform. Under contract law, a party may not deprive another of contractual rights by virtue of its own breach. Under the Countryman test, a contract is executory if it is so far unperformed that the nonperformance by one party would excuse performance by the other. The debtor in possession's refusal to perform was a contract breach, so the developer's nonperformance did not excuse the debtor's nonperformance. Therefore, the contract was not executory and could not be rejected. *In re Penn Traffic Co.*, 322 B.R. 63 (Bankr. S.D.N.Y. 2005).

9.1.vvv. The "hypothetical test" does not apply to a debtor in possession's assumption of a contract or lease. The debtor's lease contained a standard *ipso facto* clause, allowing the lessor to terminate upon the lessee/debtor's bankruptcy filing. The debtor in possession moved to assume the lease. Section 365(c)(1) provides that "a trustee may not assume or assign" an executory contract or unexpired lease if applicable law excuses the non-debtor party "from accepting performance from . . . an entity other than the debtor or the debtor in possession." This limitation does not apply to a debtor in possession's assumption of a contract of lease. Although section 1107(a) grants a debtor in possession all of the rights and powers of a trustee, "subject to any limitations on a trustee," a debtor in possession is not the equivalent of a trustee. Because a trustee is an entity other than the debtor in possession, section 365(c)(1) must be read differently when a debtor in possession moves to assume (although not to assign) a contract or lease. Otherwise, the section 365(c)(1) limitation would effectively read "a debtor in possession may not assume a contract if the counterparty is excused from accepting performance from an entity other than the debtor in possession." Such a reading would be nonsensical. Therefore, the debtor in possession may assume a contract, despite an *ipso facto* clause. *In re Footstar, Inc.*, 323 B.R. 566 (Bankr. S.D.N.Y. 2005). By the same reasoning, the non-debtor counterparty may not terminate the contract or lease, despite section 365(e)(2). Although section 365(e)(2) was not amended in 1984 in parallel with the amendment to section 365(c)(1), the result is the same. The lessor cannot be excused from accepting performance from the trustee (as provided in section 365(e)(2)). Section 365(e)(2) does not apply because there is no trustee, and the section cannot be applied hypothetically without confounding Congress' intent to prevent enforcement of *ipso facto* clauses. *In re Footstar, Inc.*, 337 B.R. 785 (Bankr. S.D.N.Y. 2005).

9.1.www. Federal law determines that section 365 applies only to true leases; state law determines whether a lease is a true lease. The debtor leased facilities from the city for a rent that equaled the debt service on the municipal bonds that the city issued to finance the construction of the facilities. The debtor in possession challenged the lease, claiming it was a disguised financing, and that section 365 therefore does not apply. Whether the word "lease" in section 365 applies to transactions that are leases in form or only in substance is a question of federal law. Congress intended section 365 to apply only to true leases, that is, leases that have the economic substance of a lease, not just the form. However, state law determines whether the economic substance of a particular lease is of a true lease or of a secured financing (unless state law looked only to form, because that would conflict with Congressional policy in section 365). California law applies to this transaction. It should be determined by state court decisions, rather than bankruptcy court decisions. Under California law, the lease is a secured financing: The rent is measured by the amount borrowed and is payable whether or not the tenant continues to occupy the facility. The payment includes interest only during the term of the lease and a balloon payment at the end. The debtor acquired the facility at the end of the lease for no additional consideration, and the lease terminates early if the debtor pays off the entire loan amount. *United Air Lines, Inc. v. HSBC Bank USA*, 416 F.3d 609 (7th Cir. 2005).

9.1.xxx. "Economic realities" test does not apply to determination of true lease. The debtor leased facilities from the city for a rent that equaled the debt service on the municipal bonds that the city issued to finance the construction of the facilities. The debtor in possession challenged the lease, claiming it was a disguised financing. The district court overrules the bankruptcy court's application of the economic

realities test to determine whether the transaction is a true lease or a disguised financing. Instead, applicable nonbankruptcy law applies. Under applicable Colorado law here, the intent of the parties at the time of the transaction determines the characterization of the transaction. The most important factor is whether the lessee obtains any equity in the leased property, such as through a below-market or nominal price purchase option. Here, the debtor/lessee had no such equity, so the transaction was a true lease. *United Air Lines, Inc. v. HSBC Bank USA*, 322 B.R. 347 (N.D. Ill. 2005), *but see United Air Lines, Inc. v. HSBC Bank USA*, 416 F.3d 609 (7th Cir. 2005).

9.1.yyy. Personal property lessor's postpetition claim under the lease is an administrative expense. The debtor leased a telephone system. The debtor in possession stopped paying on the lease after the chapter 11 filing and stopped using the system during the chapter 11 case. The lessor did not seek payment until 13 months after the filing. The lessor was entitled to a claim under section 365(d)(10) for the entire period during the chapter 11 case commencing 61 days after the order for relief, even though it did not seek payment earlier. The lessor now sought immediate payment of the amount owing. The court notes the majority view, which holds that a personal property lessor is entitled to an administrative expense claim that arises directly under section 365(d), not under section 503(b), because section 365(d) says that the lessor is entitled to a claim "notwithstanding section 503(b)(1)," and the minority view, which holds that the lessor does not have an administrative expense claim, but only an obligation of the trustee, which the lessor must either seek to enforce or lose. The court tracks a middle course, finding that the lessor has an administrative expense claim under section 503(b), not under section 503(b)(1) which bases the claim on "use and occupancy" of leased premises. Otherwise, the lessor could not be paid under the Bankruptcy Code's priority scheme, because section 507 provides for first priority only for administrative expenses allowed under section 503. The lessor is therefore to be treated to the same as other administrative expense claimants. Its claim is not necessarily entitled to immediate payment during the case, because a general administrative expense claim is not entitled to superpriority, and the claim is subordinated to chapter 7 administrative expenses under section 726(b). In addition, the bankruptcy court may not make an equitable adjustment under section 365(d)(10) of the lessor's claim when the trustee fails to perform. The court may modify only the trustee's actual performance, including the trustee's ongoing payment obligation. *CIT Communications Fin. Corp. v. Midway Airlines Corp. (In re Midway Airlines Corp.)*, 406 F.3d 229 (4th Cir. 2005).

9.1.zzz. Lessor collaboration to collect postpetition aircraft lease payments under section 1110 does not violate the antitrust laws. The bankruptcy judge enjoined aircraft lessors from taking possession of aircraft under section 1110, because the debtor in possession asserted that by acting in concert to collect amounts owing, the lessors violated the antitrust laws. Characterizing that claim as "thin to the point of invisibility," the court concludes that competition occurs at the time credit is extended and would continue during the chapter 11 case by allowing the debtor in possession and the lessor to compete in the market for leasing aircraft. Allowing the debtor in possession to assert an antitrust claim here would result in a monopsony, by prohibiting the lessor from dealing with any other potential lessees for the aircraft. *United Airlines, Inc. v. U.S. Bank N.A.*, 406 F.3d 918 (7th Cir. 2005).

9.1.aaaa. An LLC operating agreement is not an executory contract. The debtor was a nonmanaging member of an LLC. The operating agreement imposed no obligations or duties on nonmanaging members but did make member's interests nontransferable unless the managing member admitted the transferee as a member. Because of the absence of reciprocal obligations, the agreement was not an executory contract, so section 365(c) and (e)(2) did not apply to restrict transfer of the debtor's interest to the trustee. Rather, section 541(c)(1) applied to make the restriction on transfer into the estate unenforceable, so the trustee succeeded to all of the debtor's rights under the agreement. *Movitz v. Fiesta Invs., LLC (In re Ehmann)*, 319 B.R. 200 (Bankr. D. Ariz. 2005).

9.1.bbbb. Court may authorize retroactive lease rejection. The debtor in possession moved for approval of the rejection of a lease of nonresidential real property on the date of the filing of the petition, sought a prompt hearing and rejection retroactive to the date of the filing of the motion, because a large rent payment was due between the motion and hearing dates. The court may properly authorize retroactive rejection based on the equities of the case, whether or not the landlord has regained possession. In this case, because the debtor had never occupied the premises, the debtor acted very promptly after the filing

of the case and the motion, and the landlord's motive in opposing retroactive rejection was to run up administrative rent rather than to gain access to the premises to permit reletting, the bankruptcy court did not abuse its discretion in authorizing rejection that was retroactive to the date of the filing of the motion. *Pacific Shores Dev., LLC v. At Home Corp. (In re At Home Corp.)*, 392 F.3d 1064 (9th Cir. 2004).

9.1.cccc. Defaulting party may collect termination payment under power supply agreement. The debtor and its customer entered into a power supply agreement using the Western States Power Pool (WSPP) standard form agreement. Under the WSPP agreement, upon a termination of the contract, the relative positions of the parties are calculated based on current market prices for electricity, and the "out-of-the-money" party must pay the net position to the "in-the-money" party. When the debtor defaulted, the customer terminated the agreement. The debtor, who was in-the-money, sought payment from the customer, who defended on the grounds that it should not have to pay the defaulting party under Utah law, which governs the contract. However, Utah law requires the enforcement of the express terms of the contract. As this contract provided for the non-defaulting party to pay the debtor, the court enforces the contract according to its terms. *Mirant Americas Energy Marketing, LP v. Vernon (In re Mirant Corp.)*, 319 B.R. 489 (Bankr. N.D. Tex. 2004).

9.1.dddd. Whether a lease is a "true lease" is determined under state law. Property rights in bankruptcy are determined under state law, unless a clear federal interest requires that federal law apply. The legislative history of section 365 does not manifest such a clear federal interest, so determining whether a lease is a "true lease" to which section 365 applies is based on state law. In this case, to finance improvements at a municipal airport, the debtor entered into a lease/lease-back transaction, under which it leased its airport facility to a municipal agency. The municipal agency issued tax-exempt bonds, the proceeds of which were used to construct improvements on the airport property. It leased the property back to the debtor for rental payments equal to the debt service payments on the municipal bonds. The lease-backs terminated upon payment of the bonds. Under applicable state law, the transactions were true leases, based on the intent of the parties. The triple-net nature of the lease terms, the matching of the rent to a debt repayment schedule, and the debtor's ability to terminate the lease by a lump sum payment of the remaining rent did not render the transaction a disguised security interest. *HSBC Bank USA v. United Air Lines, Inc.*, 317 B.R. 335 (N.D. Ill. 2004).

9.1.eeee. Debtor in possession may not reject executory portions of a non-severable contract. Before bankruptcy, the debtor entered into an agreement to purchase the creditor's power plants and a related agreement to supply power to the creditor from those plants for a period of years at a below-market price. The pricing of the asset purchase agreement and of the power purchase agreement were related. Accordingly, the court concludes that the agreements are not severable. Because they are not severable and because the parties have already performed the asset purchase agreement in full, the debtor in possession may not reject its remaining executory obligations under the power purchase agreement. *In re Mirant Corp.*, 318 B.R. 100 (N.D. Tex. 2004).

9.1.ffff. Rejection of a FERC-regulated power purchase agreement may be permitted only under the public interest standard. The debtor in possession sought approval of the rejection of a FERC-regulated power purchase agreement. Because rejection might implicate FERC approval, the filed rate doctrine, and the risk of interruption of electric service to the power purchaser's customers, the court imposes a standard for approval of rejection that is higher than the business judgment standard. When applying the higher standard, the court would give FERC an opportunity to investigate and to appear and be heard. The court would require that the debtor in possession show that the contract burdens the estate, that the equities balance in favor of rejection, and that the debtor could not reorganize without rejection. If rejection would compromise the public interest in any respect, lead to unjust or excessive rates, or cause any disruption in the supply of electricity, rejection would not be approved. *In re Mirant Corp.*, 318 B.R. 100 (N.D. Tex. 2004).

9.1.gggg. Partial assumption and assignment of collective bargaining agreement permitted by union's failure to object. The buyer of the estate's assets assumed the collective bargaining agreement, but only as to claims arising after the closing of the sale, leaving pre-closing obligations as the estate's liability. After closing, the buyer refused to honor pre-closing obligations, and the union won an arbitration

award, which the buyer moved the bankruptcy court to vacate. The assumption and assignment was not an improper partial assumption because the union did not object to the terms of the assumption and assignment at the sale hearing. What's more, the partial assumption did not impose the entire obligation of the agreement on the buyer, only the portion that it had agreed to assume. The court therefore vacated the award. *Tenet Healthcare Philadelphia, Inc. v. National Union of Hosp. Employees (In re Allegheny Health, Educ. and Res. Found.)*, 383 F.3d 169 (3d Cir. 2004).

9.1.hhhh. Section 1113 applies to an expired collective bargaining agreement. The debtor in possession began negotiations with its union well before the expiration date of the collective bargaining agreement, providing the union with adequate information as required under section 1113 and making reasonable proposals. The debtor in possession did not reach an agreement before the CBA expired. The union argued that the CBA's expiration made section 1113 inapplicable and that the company would have to bargain to impasse before it could unilaterally change terms and conditions of employment and would then be subject to an unfair labor practice charge if it did so unreasonably. The court overrules the union's arguments and permits rejection, because the company remained subject to the contract terms until impasse, even after expiration. A debtor in possession should not be penalized with the risk of an unfair labor practice charge nor be pressured into an early rejection decision by an impending contract expiration. *In re Ormet Corp.*, 316 B.R. 662 (Bankr. S.D. Ohio 2004).

9.1.iiii. Coal Act benefits may be modified under section 1114. After a failed attempt at reorganizing, the debtor proposed a liquidating plan, under which it would sell assets free and clear of Coal Act obligations to retirees. Because the Coal Act applies generally to all coal operators, while section 1114 applies only to operators in chapter 11 who meet stringent requirements to permit modification of benefits, section 1114's modification authority takes precedence over the Coal Act's modification prohibition. Section 1114's requirement that the proposed modification be "necessary to permit reorganization" must be read as "necessary to confirmation of a plan" so as not to require a conversion to chapter 7 when a chapter 11 liquidating plan is appropriate. *In re Horizon Natural Res. Co.*, 316 B.R. 268 (Bankr. E.D. Ky. 2004).

9.1.jjjj. Swap counterparty need not terminate immediately after bankruptcy to preserve right to terminate. During the seven weeks after the bankruptcy filing, the debtor and its swap agreement counterparty engaged in negotiations over a buy-out of the swap agreement. When the negotiations were unsuccessful, the counterparty terminated the swap agreement under section 560 and the exception to the automatic stay in section 362(b)(17). The counterparty did not waive its right to terminate because of the delay. The termination was still as a result of the bankruptcy filing, as permitted by section 560. *In re Mirant Corp.*, 314 B.R. 346 (Bankr. N.D. Tex. 2004).

9.1.kkkk. Debtor in possession not required to defend landlord in prepetition personal injury action. Under its real property lease, the debtor had agreed to indemnify the landlord and hold him harmless from any claims of third parties arising from the debtor's occupation of the premises or its operations on the premises. Before bankruptcy, a tort plaintiff sued the debtor and the landlord for personal injury on the premises. After bankruptcy, the automatic stay prevented the suit from moving forward against the debtor but not against the landlord. The landlord sought to require the debtor in possession to continue to defend and pay the landlord's attorney's fees under section 365(d)(3), arguing that the obligations to do so arose after the date of the filing of the petition. The court rules otherwise, holding that the defense obligation arose prepetition, and, as a matter of state (Texas) law, the indemnification obligation did not arise until the landlord's liability to the tort plaintiff became fixed and certain, such as by judgment, and not before. Therefore, the attorney's fee demand was premature. *In re FFP Operating P'ship*, 2004 Bankr. LEXIS 896 (Bankr. N.D. Tex. 2004).

9.1.llll. Treatment under section 365 requires "true lease." To finance improvements at various municipal airports, the debtor entered into lease/lease-back transactions, under which it leased its airport facility to a municipal agency. The municipal agency issued tax exempt bonds, the proceeds of which were used to construct improvements on the airport property. It leased the property back to the debtor for rental payments equal to the debt service payments on the municipal bonds. The lease-backs terminated upon payment of the bonds. The lease-backs were not true leases, because the municipal agency did not have

any of the benefits or risks of ownership at the end of the lease-back term. Accordingly, section 365 and the landlord protections of sections 365(d)(3) and (d)(4) did not apply. *United Airlines, Inc. v. HCS Bank USA (In re UAL Corp.)*, 307 B.R 618 (Bankr. N.D. Ill. 2004), *rev'd*, 317 B.R. 335 (N.D. Ill. 2004).

9.1.mmmm. Fourth Circuit adopts "hypothetical test" to prohibit assumption of non-assignable contracts. Following the Third, Ninth, and Eleventh Circuits, the Fourth Circuit adopts the hypothetical (or "literal") test in construing section 365(c)(1). As a result, an executory contract that is nonassignable as a matter of applicable nonbankruptcy law, whatever the contract itself provides, may not be assumed, even by a debtor in possession in a chapter 11 case. The provision applies only where the applicable law imposes nonassignability based on the identity of the contracting party rather than on a general prohibition on assignment. In this case, the licensed software was copyrighted, and the Copyright Act prohibits assignment of a nonexclusive copyright license. Thus, the debtor in possession could not assume the nonexclusive software license agreement. *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257 (4th Cir. 2004).

9.1.nnnn. Contractual consent to assignment does not render contract assumable. A nonexclusive software license could be assigned, under the express terms of the license, to a successor in interest to substantially all of the debtor's assets. The debtor in possession argued that this contract provision permitted it to assume the contract in its chapter 11 case, despite the prohibition on assumption and assignment of this kind of contract in section 365(c). The Fourth Circuit disagrees, holding that a consent to assignment does not constitute a consent to assumption. *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.)*, 361 F.3d 257 (4th Cir. 2004).

9.1.oooo. Credit card processing agreement is not a financial accommodation contract. Under a credit card processing agreement and the rules and agreements governing the VISA and MasterCard networks, if a merchant incurs chargebacks to its customers, for example, by reason of customer returns of merchandise or the merchant's inability to deliver a prepaid service, the card processor bears the risk of loss. It must advance funds to the customers' card-issuing banks and seek recovery from the merchant. This contingent obligation, even if characterized as a guarantee of the merchant's obligations on the chargebacks, does not make the processing agreement an executory contract to extend financial accommodations to the merchant/debtor, which may not be assumed under section 365(c)(2). To determine whether the contract is a financial accommodation contract, the court must evaluate the entire contract, not just whether the contract has incidental financial accommodation terms, such as short extensions of credit. The test is an objective one, not based on the principal purpose of the contract or the parties' intent. This contract provided for processing credit card payments that had been made by the debtor's customers, and the contingent chargeback obligation did not render it an unassumable financial accommodation contract. *In re United Airlines, Inc.*, 368 F.3d 720 (7th Cir. 2004).

9.1.pppp. Shopping center lease use restriction is enforced. The debtor operated an auto parts store in a shopping center. The lease restricted the use of the premises to the sale of auto parts. The debtor in possession sought to assign the lease to a discount clothing retailer, and the landlord objected. The court enforced the restrictive use covenant under section 365(b)(3)(C), under which adequate assurance of performance of a shopping center lease requires that the assumption or assignment be "subject to all the provisions thereof, including … a … use … provision." This section prevails over section 365(f)(1)'s general anti-assignment prohibition because it is more specific. Although the lease required the tenant to use the premises only under a specific trade name, the landlord did not press that ground against assignment, and the court did not reach whether that provision would be enforceable. *Congress Fin. Corp. v. West Town Ctr. LLC (In re Trak Auto Corp.)*, 367 F.3d 237 (4th Cir. 2004).

9.1.qqqq. Landlord's claim for removal of property at the end of the lease is not entitled to administrative expense priority. Section 365(d)(3) requires a trustee to "timely perform all obligations … arising from and after the order for relief … until such lease is assumed or rejected … ." Under Ninth Circuit precedent, the landlord has an administrative expense priority for any such obligations that are unperformed. In this case, the lease required the debtor to remove improvements from the real property upon termination or expiration of the lease. The debtor in possession rejected the lease without removing the property, and the landlord sought an administrative expense claim for the damages. Applying a "bright-

line rule" for entitlement to administrative expense priority, the Ninth Circuit grants the landlord only a prepetition claim. Section 365(d)(3) applies only until rejection; the lease termination occurred only on rejection; and the removal obligation arose only on termination, so it did not come within the time period covered by section 365(d)(3). *K-4, Inc. v. Midway Engineered Wood Prods., Inc. (In re TreeSource Ind., Inc.)*, 363 F.3d 994 (9th Cir. 2004).

9.1.rrrr. Swap contract safe harbor applies only to contract termination, not litigation. Before bankruptcy, the debtor had entered into a swap contract, which the counterparty terminated under the safe harbor of section 560 shortly after the debtor filed chapter 11. The swap required a settlement payment upon contract termination, based on market prices. In this case, the counterparty became liable to the debtor for the payment. After termination, the counterparty challenged the validity of the contract and of the termination by bringing a state court action against the debtor. The bankruptcy court rules that the action is stayed. The swap contract safe harbor in section 560 applies only to termination based on bankruptcy or financial condition, not for any other reason such as contract invalidity, and does not apply to litigation over the contract, which must be centralized in the bankruptcy court. *In re Enron Corp.*, 306 B.R. 465 (Bankr. S.D.N.Y. 2004).

9.1.ssss. True lease or security interest? The debtor had entered into an agreement for the counterparty to install energy saver light fixtures. The debtor would pay the counterparty over a period of up to eight years based on the expected energy cost savings. At the end of the term of the agreement, the counterparty had the option of removing the equipment and replacing it with equipment comparable to the prior equipment originally, abandoning the equipment or negotiating with the debtor for an additional lease term or for a buyout. The cost of removal would have exceeded the value of the equipment removed. After bankruptcy, the debtor sought to recharacterize the agreement as a disguised security interest, while the counterparty sought treatment as a lessor. The court determines the transaction is a disguised security interest. It relies on the 1995 version of section 1-201(37) of the UCC. The agreement does not meet the bright line test for recharacterization of a security interest, because the lease term does not exceed the useful life of the equipment, the debtor does not have a nominal purchase or re-lease option, and the debtor is not contractually bound to renew the lease or to become the owner of the goods. Nevertheless, because the economics and the lease negotiation dynamics dictate that counterparty must abandon the equipment at the end of the lease term, the court determines that the transaction is a disguised security interest. The court notes the departure in the 1995 version of the UCC from the "intent of the parties" test to the "economic realities of the transaction" test. The court discounts the importance of the accounting and tax treatment of the transaction. *Duke Energy Royal, LLC v. Pillowtex Corp. (In re Pillowtex, Inc.)*, 349 F.3d 711 (3d Cir. 2003).

9.1.tttt. Federal Anti-Assignment Act does not bar contract assumption. The debtor had a contract to supply power to the Bonneville Power Administration. The BPA argued that the Federal Anti-Assignment Act, 41 U.S.C. § 15, bars assumption or assignment of the contract and that the Act is enforceable under section 365(c)(1). The court concludes that the Anti-Assignment Act does not prohibit assumption because otherwise a debtor in possession would not be able to assume any agreements with the United States or its agencies. In addition, assumption gives the government what it bargains for because a debtor in possession is the same business with which it contracted. Finally, the court concludes that the 1984 amendment to section 365(c)(1)(A) was designed to permit a debtor in possession to assume otherwise unassignable contracts. The court notes that Congress's failure to enact a comparable amendment to section 365(e) does not permit the counterparty to terminate a nonassumable contract. It reasons that section 365(c)(1) limits the trustee's rights and powers and therefore had to be amended to prevent application of section 1107(a), under which the debtor in possession's rights and powers are identical to those of a trustee. Section 365(e)(2) does not similarly limit a right or power and may not be used by a counterparty as an offensive weapon to penalize an estate. *In re Mirant Corp.*, 303 B.R. 319 (Bankr. N.D. Tex. 2003).

9.1.uuuu. Stay relief to permit contract termination is denied. The debtor's counterparty sought stay relief to permit contract termination under an *ipso facto* clause. If the counterparty terminated the contract, it could retain the debtor's deposit and would have an additional claim. If it could not and the contract expired by its terms, the counterparty would have to refund the deposit to the estate and would

not have a claim. The counterparty's desire for such a windfall did not constitute cause for relief from the automatic stay. *In re Mirant Corp.*, 303 B.R. 319 (Bankr. N.D. Tex. 2003).

9.1.vvvv. Post-petition, pre-rejection rent may not be prorated. The debtor rejected its real property lease on November 3. It attempted to pay only one-tenth of a month's rent, prorating the rent for November. The Seventh Circuit rules that because the obligation to pay November rent arose on November 1, section 365(b)(3) obligates the debtor in possession to pay the month's rent in full. The Seventh Circuit rejects application of *In re Handy Andy Home Improvements Centers, Inc.*, 144 F.3d 1125 (7th Cir. 1998), which permitted proration of real property taxes that arose pre- and post-petition but that were billed post-petition, on the ground that Handy Andy involved pre-petition claims. Here, section 365(b)(3) explicitly requires performance of post-petition obligations that arise before rejection. *Ha-lo Ind., Inc. v. Centerpoint Props. Trust*, 342 F.3d 794 (7th Cir. 2003).

9.1.wwww. Denial of a motion to reject a collective bargaining agreement is *res judicata*. The debtor negotiated with the union, could not reach an agreement, and brought a motion to reject the collective bargaining agreement. The court denied the motion. The debtor then made a new proposal to the union, taking into consideration the court's ruling on the first motion. The union rejected the second proposal, and the debtor filed another motion to reject. The court rules that the ruling on the first motion was *res judicata*, precluding the debtor from seeking ever again to reject the agreement in the case. The court imposes this result so as to prevent the debtor in possession from using the court to advise it on what kind of proposal will support rejection. *In re Fulton Bellows & Components, Inc.*, 301 B.R. 723 (Bankr. E.D. Tenn. 2003).

9.1.xxxx. Real property lease rejection is effective as of date of motion. Because the debtor in possession did not wish to incur administrative rent under section 365(b)(3), it filed a motion to reject the lease on the petition date and sought an order making the rejection effective as of the date of the filing of the motion. On appeal, the district court rules that the bankruptcy court's order making the rejection retroactive was not an abuse of discretion. The court rules that whether to make a rejection effective as of the motion date is a question for the discretion of the bankruptcy court. In this case, because the only issue was whether the debtor should be liable for administrative rent, the bankruptcy court properly authorized the early rejection date. *Pacific Shores Dev., LLC v. At Home Corp. (In re At Home Corp.)*, 292 B.R. 195 (N.D. Cal. 2003).

9.1.yyyy. Buyer of debtor's intellectual property loses right to royalties. The buyer of the debtor's business acquired the debtor's intellectual property but specifically excluded a license of that property to a third party. The debtor in possession rejected the license agreement, but the licensee elected to retain the license and continue to pay royalties under section 365(n). Section 365(n)(2) leaves the royalties with the debtor, even though the buyer owns the intellectual property, because that section requires the licensee to make "royalty payments due under such contract," which means that the royalties are connected to the contract, not the intellectual property. The court rejects an analogy to section 365(h), on the grounds that real property issues are "fraught with state law property principles not applicable in the intellectual property context." *Schlumberger Resource Mgmt. Servs., Inc. v. Cellnet Data Systems, Inc. (In re Cellnet Data Systems, Inc.)*, 327 F.3d 242 (3d Cir. 2003).

9.1.zzzz. Section 1114 prohibits modification of retiree benefits. The debtor provided retiree health benefits before bankruptcy. The benefits plan permitted the debtor to modify or terminate the benefits at any time. Nevertheless, once the debtor had filed its chapter 11 case, section 1114 prohibits the termination of benefits without compliance with the procedures set forth in that section. *In re Farmland Industries, Inc.*, 294 B.R. 903 (Bankr. W.D. Mo. 2003).

9.1.aaaaa. Court may permit "ride through" of unassumable executory contract. Once the bankruptcy court determined that the debtors could not assume a license agreement under section 365(c)(1), the debtors sought to amend their plan to delete any reference to the contract and allow it to ride through the chapter 11 case. The court traces the history of "ride through" and notes that all prior decisions involved contracts that were inadvertently left unassumed or unrejected. When confronted in this case with the counterparty's motion to require the debtor to reject the contract, the

court notes the potential anomaly under which a debtor would have fewer rights in bankruptcy than outside of bankruptcy, which it finds inconsistent with the reorganization principles of chapter 11. The court ultimately determines that an order fixing a time within which to assume or reject under section 365(b)(2) is entirely discretionary and that the court may instead refuse to set a time and allow the contract to ride through, subject to any rights after bankruptcy that the parties would have under the contract. *In re Hernandez*, 287 B.R. 795 (Bankr. D. Ariz. 2002).

9.1.bbbbb. To assume a contract, debtor need not cure non-monetary defaults, but … . The debtor/lessor leased computer equipment under a lease that it wished to assume under its plan. The debtor had failed to deliver some of the equipment, substituting loaner equipment instead. The lessee objected to assumption on the grounds that the non-monetary defaults could not be cured, as decided in *In re Claremont Acquisition Corp.*, 113 F.3d 1039 (9th Cir. 1997). The First Circuit B.A.P. rejects this reading of section 365(b)(2)(D), holding that the non-monetary defaults need not be cured to assume the lease. However, under the Second Circuit's decision in *Orion Pictures Corp. v. Showtime Networks, Inc.*, 4 F.3d 1095 (2d Cir. 1993), the monetary damages that the lessee might have suffered from the debtor's non-monetary breach would have to be determined in the context of an evidentiary hearing in a court of competent jurisdiction. Thus, the debtor assumed the leases without a determination of its ultimate liability for cure. *Eagle Ins. Co. v. BankVest Cap. Corp. (In re BankVest Cap. Corp)*, 290 B.R. 443 (1st Cir. B.A.P. 2003).

9.1.ccccc. Property held by Qualified Like-kind Exchange Intermediary must be conveyed to the buyer. The debtor was a Qualified Intermediary for like-kind exchange transactions under section 1031 of the Internal Revenue Code. Its client had completed all of its obligations under the like-kind exchange agreement. The only remaining performance at the time of the debtors bankruptcy was for the debtor to convey the purchased real property to the client. On the client's complaint for specific performance, the court rules that the like kind exchange contract is no longer an executory contract, because the only remaining performance is the transfer of title and because the trustee held only bare legal title to the property. Accordingly, the court orders specific performance. *Manty v. Miller & Holmes, Inc. (In re Nationwide Exchange Services)*, 291 B.R. 131 (Bankr. D. Minn. 2003).

9.1.ddddd. Trustee may not assign exclusive distributorship agreement to counterparty manufacturer's direct competitor. The debtor was the exclusive distributor for a specialty steel. In its chapter 11 case, the debtor sold all of its assets to a direct competitor of the specialty steel manufacturer. The manufacturer objected. The court disallows the assignment, relying on U.C.C. section 2-210(2), which prohibits assignment of contracts in certain limited circumstances. The court rules that assignment of such an exclusive distributorship agreement to the manufacturer's direct competitor would violate U.C.C. section 2-210(2) and that section 365(c)(1)(A) of the Bankruptcy Code permits application of section 2-210(2), because it makes the contract non-assignable as a matter of state law. *In re Nedwick Steel Co., Inc.*, 289 B.R. 95 (Bankr. N.D. Ill. 2003).

9.1.eeeee. Section 365(d)(3) applies only when the debtor is the lessee. The debtor leased space to a sub-tenant. Because of the debtor's non-performance of its obligation as sub-lessor, the sub-tenant incurred substantial expense for which it sought payment as an administrative expense. In disallowing the claim, the court determines that section 365(d)(3), which requires the trustee to "perform all the obligations of the debtor … arising from and after the order for relief under any unexpired lease of non-residential real property," applies only where the debtor is the lessee. *Einstein/Noah Bagel Corp. v. Smith's (In re BCE West, L.P.)*, 319 F.3d 1166 (9th Cir. 2003).

9.1.fffff. Section 365(n) does not apply to trademarks. After reviewing the legislative history that specifically excludes trademarks from the definition of "intellectual property" in section 101(35A), the bankruptcy court concludes that the protection of section 365(n) for intellectual property licensees does not protect trademark licensees. Accordingly, the debtor's rejection of a trademark licensing agreement deprives the non-debtor licensee of the right to continue to use the trademark. The court reasons that by excluding trademarks from section 365(n) protection, Congress intended that the harsh *Lubrizol* rule (*In re Richmond Metal Finishers, Inc.*), 756 F.2d 1043 (4th Cir. 1985), apply, thereby depriving the licensee of

any right to use the trademark. The licensee retains only a claim for damages. *Raima U.K. Ltd. v. Centura Software Corp. (In re Centura Software Corp.)*, 281 B.R. 660 (Bankr. N.D. Cal. 2002).

9.1.ggggg. Partner's bankruptcy did not dissolve partnership. The Third Circuit notes the split in the case law on whether the bankruptcy of a general partner dissolves a partnership or whether section 365(e)(1) (invalidating *ipso facto* clauses) prevents the operation of the Uniform Partnership Act provision that causes dissolution of a partnership upon a bankruptcy filing. It does not reach the question, however, because it finds that in this case, neither the debtor not his partner treated the partnership as dissolved upon the filing and in fact took action after bankruptcy consistent with continuation of the partnership's business. Section 365(e)(2)(A) and section 365(c)(1)(A) permit assumption of an otherwise non-assumable personal services contract if the counter party consents. In this case, there was consent by conduct, so the court concluded that the partnership had not been dissolved. *Waskob v. Waskob (In re Waskob)*, 305 F.3d 177 (3d Cir. 2002).

9.1.hhhhh. "Support agreement" is not enforceable in bankruptcy. To provide credit support to the debtor's lenders, the debtor's parent agreed in a "Support Agreement" to invest funds in the debtor as needed to support the lender's loan and provide funds necessary to make payments on the loan. After the debtor filed bankruptcy, the lender sought to enforce the support agreement against the parent. The district court ruled for the parent, holding that the support agreement is "a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor." Such a contract may not be assumed under section 365(c)(2) and therefore could not be enforced either by the debtor or by the lenders for whose benefit the contract was made, once the debtor had filed bankruptcy. *Chase Manhattan Bank v. Iridium Africa Corp.*, 197 F. Supp. 2d 120 (D. Del. 2002).

9.1.iiiii. Assumption of contract validates preference. The debtor had entered into a merger agreement before bankruptcy. The merger agreement provided for deferred payment of a portion of the purchase price. The deferred portion was paid before bankruptcy within the preference period. The confirmed plan provided that all contracts not rejected were assumed. Under this provision, the court holds that the merger agreement was assumed and that as a result, the creditor did not receive a greater percentage than it would have received in a chapter 7 liquidation. The court ruled that the greater percentage test is applied taking into account the effect of assumption, even though in a chapter 7 case, the contract would not have been assumed. *Philip Servs. Corp. v. Luntz (In re Philip Servs. (Delaware), Inc.)*, 284 B.R. 541 (Bankr. D. Del. 2002).

9.1.jjjjj. Non-creditor competitor does not have standing to object to assumption of contract. The debtor moved to assign its rental car concession agreements to an affiliate. Two of its competitors, who were not creditors in the debtor's case objected. The court rules that non-creditors do not have standing to object to the assumption and assignment of a contract. *In re ANC Rental Corp., Inc.*, 277 B.R. 226 (Bankr. D. Del. 2002).

9.1.kkkkk. Section 365(f)(1) anti-assignment clause is narrowly construed. The debtor sought to assume and assign an airport rental car concession agreement. A local statute prohibited the undertaking of a concession at an airport without the written consent of the airport authority. The bankruptcy court rules that this provision does not prohibit assignment of the contract. It rules that the language in section 365(f)(1) that invalidates anti-assignment clauses states a broad rule, to which the anti-assumption language of section 365(c)(1) makes only a narrow exception. The (c)(1) exception applies only if "the applicable law specifically states that the contracting party is excused from accepting performance from a third party under circumstances where it is clear from the statute that the identity of the contracting party is crucial to the contract or public safety is at issue." *In re ANC Rental Corp., Inc.*, 277 B.R. 226 (Bankr. D. Del. 2002).

9.1.lllll. Purchaser of intellectual property does not receive royalties from rejected license agreements. The purchaser acquired all of the assets of the debtor, including its intellectual property. The debtor had granted an exclusive license outside the United States to a licensee. Because the debtor was unable to provide the service required under the license agreement, the debtor rejected the agreement. At

the same time, the purchase excluded the agreement and any assets or liabilities related to that licensee from its purchase. After rejection, the licensee elected to retain the license to the intellectual property under section 365(n)(2)(B) and make net license royalty payments. On a dispute between the debtor and the purchaser over the entitlement to the net license royalty payments, the court rules that the exclusion of the license agreement from the purchase entitled the debtor to the royalty payments, despite the purchaser's acquisition of all of the debtor's intellectual property. The court reasons that section 365(n)(2)(B) requires the licensee to "make all royalty payments due under the contract," which requires the payments to be made to the party to the contract (the debtor), not the owner of the intellectual property. What is more, rejection did not terminate the debtor's rights under the agreement. *Schlumberger Resource Mgmt. Servs, Inc. v. Cellnet Data Systems, Inc. (In re Cellnet Data Systems, Inc.)*, 277 B.R. 588 (D. Del. 2002).

9.1.mmmmm. Bankruptcy-related delay in option exercise permits price increase. The debtor had an option to purchase real property from the optionor. The option agreement specifically provided that if there was a delay in the exercise of the option beyond a specified date, the option price would increase by $5,000 per day. The debtor filed bankruptcy the day before the specified date and, relying on the 60 day extension under section 108(b), exercised the option 60 days later. The debtor moved to strike the daily price increase as being an invalid *ipso facto* clause under section 365(e)(1). The Eleventh Circuit overrules the debtor's objection. The court rules that the delay provision is not an invalid *ipso facto* clause because it is not conditioned solely on insolvency or bankruptcy, even though the parties agreed that the price increase provision was included in the option agreement expressly because of the possibility that the debtor might file bankruptcy and seek a delay in the exercise of the option. *Yates Development, Inc. v. Old Kings Interchange, Inc. (In re Yates Development, Inc.)*, 256 F.3d 1285 (11th Cir. 2001).

9.1.nnnnn. Boilerplate plan provision providing for contract assumption is ineffective. The reorganization plan contained the usual boilerplate provision that all contracts not previously rejected are assumed. The Fifth Circuit rules that such a plan provision is ineffective, because section 1123(b)(2) makes assumption of contracts under a plan "subject to section 365." Section 365(a) requires court approval of the assumption. Therefore, the general boilerplate is ineffective. The same is true with respect to rejection of contracts under a catch-all boilerplate provision in the plan. *McGee v. Stumpf (In re O'Connor)*, 258 F.3d 392 (5th Cir. 2001).

9.1.ooooo. A partnership agreement is not assumable. Under Louisiana law, a partner cannot make a third person a member of the partnership without his partner's consent. Therefore, a partnership agreement in Louisiana is unassumable under section 365(c)(1), which prohibits assumption of contracts that are not assignable as a matter of law. The Fifth Circuit rules in addition that the provision is not limited to personal service contracts. *McGee v. Stumpf (In re O'Connor)*, 258 F.3d 392 (5th Cir. 2001).

9.1.ppppp. An unassumed contract passes through bankruptcy after confirmation of a chapter 11 plan to the debtor. The plan did not provide for the assumption of a partnership agreement, and the trustee did not assert a right to the economic interest of the debtor/partner under the partnership agreement. The chapter 11 plan provided for a liquidating trust to collect the assets of the debtor and distribute them to creditors, but characterized the liquidating trust as the "reorganized debtor." Because the partnership agreement was not assumed (and was not assumable) under the plan, it passed through bankruptcy to the individual debtor, not to the liquidating trust. To hold otherwise would permit the partnership agreement to be assumed by the trustee in violation of section 365(c)(1). The court suggests that the result might be different if the debtor continued to operate after reorganization and was in fact the reorganized debtor. *McGee v. Stumpf (In re O'Connor)*, 258 F.3d 392 (5th Cir. 2001).

9.1.qqqqq. Court enjoins declaration of lease default to prevent letter of credit draw. The debtor had obtained a letter of credit in favor of the landlord to secure the debtor's obligations under the lease. The letter of credit required the lessor to certify as a condition to draw that the debtor had failed to pay or perform one or more of its obligations under the lease. At the date of the filing of the petition, the debtor was current on all rent. The only default the landlord asserted was the filing of the bankruptcy petition. Upon the debtor's motion for a temporary restraining order and preliminary injunction, the court enjoined the lessor from declaring a default, on the grounds that the *ipso facto* clause default was unenforceable in

bankruptcy. As a result, the lessor was effectively prohibited from drawing under the letter of credit. *In re Metrobility Optical Systems, Inc.*, 268 B.R. 326 (Bankr. D.N.H. 2001).

9.1.rrrrr. Section 365(d)(3) protects a note payable under a lease. The tenant/debtor borrowed $600,000 at the time of entering into the lease and agreed to repay it as "further rent" under the lease. The first payment became due after bankruptcy but before the debtor rejected the lease. The Ninth Circuit rules that the payment is entitled to administrative expense priority under section 365(d)(3), because that section requires performance of "all the obligation of the debtor ... arising from and after the order for relief." The obligation does not, however, include statutory interest, because that obligation was imposed by the state statute, not by the lease. *Cukierman v. Uecker (In re Cukierman)*, 265 F.3d 846 (9th Cir. 2001).

9.1.sssss. A merger agreement with a non-compete provision is an executory contract. A shareholder had sold his business to the debtor. Part of the sale consideration was deferred, and the shareholder agreed not to compete for several years. Although the debtor's only obligation was the payment of money, the contract was executory under the stricter Countryman Test, because breach by either side would have excused performance by the other side. *In re Teligent, Inc.*, 268 B.R. 723 (Bankr. S.D.N.Y. 2001).

9.1.ttttt. A contract for the sale of a business is not a contract "to issue a security of the debtor." The debtor agreed to buy a business in exchange for its own stock. A portion of the consideration was paid upon closing, with the balance deferred. Under the contract, the seller agreed not to compete with the debtor. The debtor filed bankruptcy before the expiration of the non-compete clause and the due date of the deferred purchase price. The bankruptcy court rules that the agreement is not a contract "to issue a security of the debtor," because the principal purpose of the contract was for the sale of the business to the debtor. The issuance of the debtor's stock was incidental, much in the way that a contract to sell the debtor goods or services on credit does not constitute a contract to extend debt financing to the debtor. The court rejects the debtor's argument that the prohibition in section 365(c)(2) is limited to newly issued stock, ruling that treasury stock previously re-acquired by the corporation would come within the prohibition. The court also concludes that the word "issue" applies to the debtor corporation, not to the third party, omitting the possibility that an underwriter might be considered an "issuer" of the debtor stock. *In re Teligent, Inc.*, 268 B.R. 723 (Bankr. S.D.N.Y. 2001).

9.1.uuuuu. Lease obligation arises when billed for purposes of section 365(d)(3). In a break with the Seventh Circuit's ruling in *In re Handy Andy*, 144 F.3d 1125 (7th Cir. 1998), the Third Circuit rules that the obligation of the debtor to reimburse the real property lessor for real property taxes "arises" for purposes of section 365(d)(3) when the lease says it arises, in this case, upon the lessor's presentation of a bill for the taxes to the debtor. Because the landlord presented the bill for pre-petition taxes after the date of the order for relief, the taxes were payable as an administrative expense. *Centerpoint Properties v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 206 (3d Cir. 2001).

9.1.vvvvv. Notice of contract assumption was deficient. In connection with a sale of its assets, the debtor served notice of its assumption and assignment of contracts to the other contracting party, without directing it to any particular officer (as required under Bankruptcy Rule 7004(b)(3)) or to the individual at the other contracting party with whom the debtors had previously dealt. The court finds the service inadequate. What is more, prior effective service of a notice of assumption and of assignment to an earlier bidder, who was not the ultimately successful bidder, was inadequate, because the other contracting party had specific and valid business reasons for objecting to the successful bidder, although it did not object to the initial, unsuccessful bidder. *In re Golden Books Family Entertainment, Inc.*, 269 B.R. 300 (D. Del. 2001).

9.1.wwwww. A covenant not to compete is enforceable after rejection. The debtor rejected a franchise agreement, which contained a covenant not to compete. Because the rejection constituted only a breach of the contract and not a termination, the covenant not to compete, which remained effective after the franchisee breached, continued to bind the debtor in possession. The court did not address

whether the obligation under the covenant not to compete was discharged. *Sir Speedy, Inc. v. Morse*, 256 B.R. 657 (D. Mass. 2000).

9.1.xxxxx. Prepetition waiver of right to reject contract is unenforceable. In its second chapter 11 case reorganization plan, TWA entered into a ticket agreement that proved to be a substantial financial drain on the airline. But the agreement, which was part of the chapter 11 plan, prohibited rejection in a subsequent bankruptcy case. Nevertheless, in its third chapter 11 case, TWA moved to approve the rejection. The court permitted the rejection, holding that a prepetition waiver of the right to reject an executory contract is not enforceable, even when that agreement is entered into in a prior chapter 11 case. In permitting the rejection, the court also rejected the other party's judicial estoppel and *res judicata* arguments, reaffirmed the business judgment rule for rejection, and rejected the claim that the court must consider the effect of rejection on the other contracting party. *In re TransWorld Airlines, Inc.*, 261 B.R. 103 (Bankr. D. Del. 2001).

9.1.yyyyy. Post-petition lease performance obligation applies only to lessees. Section 365(d)(3) requires the trustee to timely perform all of the debtor's post- petition obligations under an unexpired lease of non-residential real property. In a case of apparent first impression, the bankruptcy court rules that the section applies only to a debtor lessee, not a debtor lessor, based on the last sentence of the section, which provides that acceptance of performance does not constitute a waiver "of the lessor's rights" under the lease. *In re BCE West, L.P.*, 257 B.R. 304 (Bankr. D. Ariz. 2000); *aff'd*, 246 B.R. 578 (9th Cir. B.A.P. 2001).

9.1.zzzzz. An LLC Agreement is not an executory contract. Under applicable Virginia law, the bankruptcy of an LLC member disassociates the member from the LLC but does not affect his economic interest in the company. Because the LLC Agreement in this case imposed no obligations on the member and permitted the member to resign at any time, the LLC Agreement was not an executory contract, and the provisions of sections 365(c) and (e), which might have otherwise restricted the enforceability of the provision that disassociates the member upon the filing of bankruptcy, did not apply. *In re Garrison-Ashburn, L.C.*, 253 B.R. 700 (Bankr. E.D. Va. 2000).

9.1.aaaaaa. Contract rejection does not waive defenses to the contract. The trustee rejected one of the debtor's executory contracts. The creditor filed a proof of claim for rejection damage, to which the trustee objected. The court rejected the creditor's arguments that the trustee's rejection created a conclusive statutory breach of contract claim and permitted the trustee to object to the claim on the grounds of the invalidity of the underlying contract. *Durkin v. Benedor Corp. (In re G.I. Industries, Inc.)*, 204 F.3d 1276 (9th Cir. 2000).

9.1.bbbbbb. Estate owes full month's rent for lease rejected during the month. The debtor rejected the lease of non-residential real property and vacated the premises on the second day of the month. Because of the requirement of section 365(d)(3), which requires the trustee to "timely to perform all the obligations of the debtor . . . arising from and after the order for relief" the estate was liable for the full month's rent to the lessor, even though the premises were occupied for only two days of the month. *Koenig Sporting Goods, Inc. v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986 (6th Cir. 2000).

9.1.cccccc. Discharge does not affect executory contract assumption cure claims. The discharge granted under section 1141(d) does not include cure amounts owing under executory contracts assumed under the plan. *Century Indem. Co. v. NCG Settlement Trust (In re National Gypsum Co.)*, 208 F.3d 498 (5th Cir. 2000).

9.1.dddddd. Plan confirmation does not nullify executory contract cure requirement. The debtor's plan listed a contract cure amount at $0. The creditor had not previously filed a proof of claim. The debtor argued that the cure amount claim was discharged under section 1141 upon plan confirmation. The court holds otherwise, ruling that the non-debtor is not required to file a proof of claim until after rejection of the contract and that the failure to file did not subject the claim for a cure amount to discharge. *Century Indem. Co. v. NGC Settlement Trust (In re National Gypsum Co.)*, 208 F.3d 498 (5th Cir. 2000).

9.1.eeeeee. Contract to make a loan; termination; rejection; termination fee. Foothill Capital's revolving loan agreement contained an early termination premium and permitted Foothill to terminate under various circumstances, including the filing of a bankruptcy petition, without notice of election and without demand. The court rejected Foothill's argument that because its contract to make a loan was non-assumable under section 365(c)(2), rejection was inevitable and therefore the contract was terminated upon the filing of the bankruptcy. It also rejected Foothill's argument that Foothill's "silent" termination of the contract after bankruptcy entitled it to receive the early termination premium, ruling that had determination been automatic upon the filing or had Foothill given notice to the debtor of termination, it might have been able to collect its premium. Finally, the court rejects Foothill's arguments that the early termination premium was a contingent claim that became fixed after bankruptcy and that the early termination premium was an allowable charge under section 506(b). *Foothill Cap. Corp. v. Official Unsecured Creditors Committee of Midcom Communications, Inc.*, 245 B.R. 296 (E.D. Mich. 2000).

9.1.ffffff. Assignment of less than all of a contract prevents release of the debtor. In selling its business, the chapter 11 debtor assigned a collective bargaining agreement to the purchaser, except that the purchaser was not obligated to assume the debtor's obligation to pay retroactive wage increases. Because the assignment was of less than all of the obligations under the contract, section 365(k) did not apply, and the debtor was not absolved of liability. In addition, because the contract was a collective bargaining agreement and the elimination of the retroactive wage payment obligation did not comply with section 1113, the modification was ineffective, and the debtor remained liable. *American Flint Glass Workers Union v. Anchor Resolution Corp. (In re Anchor Resolution Corp.)*, 197 F.3d 76 (3d Cir. 1999).

9.1.gggggg. Prepetition agreement for sale of assets is not enforceable. The debtor entered into an agreement to sell all its assets in a chapter 11 case. The agreement was expressly made subject to the bankruptcy court's approval. The court ultimately ordered a sale to a different purchaser. Because of the court-approval contingency in the agreement, the agreement was not enforceable, and the purchaser's claim for damages for breach of contract was disallowed. *In re Big Rivers Electric Corp.*, 233 B.R. 726 (Bankr. W.D. Ky. 1998), *aff'd*, 223 B.R. 739 (W.D. Ky. 1998).

9.1.hhhhhh. Termination of a post-petition lease creates an administrative expense claim. The debtor-in-possession entered into a real property lease during the case. After conversion to chapter 7, the trustee terminated the lease and returned possession to the landlord. The landlord's claim for damages for breach of the lease was entitled to administrative expense priority, because the lease itself was an "actual and necessary expense" of preserving the estate, even though the future rent claim was not. The trustee could not, however, reject the lease under 365, which applies only to prepetition contracts, nor did the landlord damages cap of section 502(b)(6) apply, also because it applies only to prepetition leases. However, the claim is a chapter 11 administrative expense rather than the higher priority chapter 7 expense. *Devan v. Simon DeBartolo Group, L.P. (In re Merry-Go-Round Enterprises, Inc.)*, 180 F.3d 149 (4th Cir. 1999).

9.1.iiiiii. Debtor in possession may not assume nonassignable contract. As a matter of federal law, a patent license is personable and nondelegable. In a narrow reading of Section 365(c)(1), the Ninth Circuit joins the Third and Fourth Circuits in adopting the "hypothetical test" to govern assumption of executory contracts. Under that test, a debtor-in-possession may not assume an executory contract over the other party's objection if applicable law would bar assignment to a hypothetical third party, even if the debtor-in-possession has no intention of assigning the contract. The Ninth Circuit thus rejects the view of the First Circuit, which adopted the so-called "actual test." *Perlman v Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)*, 165 F.3d 747 (9th Cir. 1999).

9.1.jjjjjj. An agreement under section 1110 elevates lease obligations to administrative expense priority. If an airline makes an agreement under section 1110 to keep and pay for aircraft, then all rent accruing after the petition date is calculated at the rate set forth in the lease, even though fair rental value may be less, and is payable until return of the aircraft. In addition, an obligation to perform maintenance upon return is an administrative expense. *Interface Group-Nevada, Inc. v. Trans World Airlines, Inc. (In re Trans World Airlines, Inc.)*, 145 F.3d 124 (3d Cir. 1998).

9.1.kkkkkk. Real estate purchase option is not necessarily an executory contract. Reversing its prior decision in *Gill v. Easebe Enterprises (In re Easebe Enterprises)*, 900 F.2d 1417 (9th Cir. 1990), the Ninth Circuit *en banc* determines that whether a real estate option agreement is an executory contract is a question of fact to be determined as of the petition date. If the option has not yet been exercised, it is not an executory contract at the petition date. If the option has been exercised, then the obligations of both parties have come into play as under a normal real estate purchase contact, and the contract is an executory contract that is subject to section 365. *Unsecured Creditor's Committee v. Southmark Corporation (In re Robert L. Helms Construction & Development Co., Inc.)*, 139 F.3d 702 (9th Cir. 1998) (*en banc*).

9.1.llllll. Chapter 11 aircraft lessee may cure post-petition lease defaults. The debtor in possession complied with section 1110, curing pre- and postpetition defaults under its aircraft leases within 60 days after the date of the order for relief. Later, the debtor in possession defaulted on the leases. The aircraft lessors sought immediate relief from the stay and repossession. The district court holds that once the cure has been made within 60 days as required by section 1110, any subsequent default is governed by the general terms of the Bankruptcy Code governing the automatic stay and unexpired leases, not by section 1110. *Western Pacific Airlines, Inc. v. GATX (In re Western Pacific Airlines, Inc.)*, 219 B.R. 305 (D. Colo. 1998). On a motion for reconsideration, the court reaffirms its decision and takes the lessors and amici curiae to task for a "sky-is-falling" assault on the prior ruling. 221 B.R. 1 (D. Colo. 1998).

9.1.mmmmmm. Unrejected collective bargaining agreement is deemed assumed. The chapter 11 debtor in possession did not reject its collective bargaining agreement before the case was converted to chapter 7. Because section 1113 permits rejection "only in accordance with the provisions of this section," which were not followed in this case, the collective bargaining agreement " was assumed in bankruptcy as a result of the [debtor's] failure to reject it in accordance with section 1113." As a result, all pre-petition claims for contributions to pension plans became administrative expenses. *Adventure Resources, Inc. v. Holland*, 137 F.3d 786 (4th Cir. 1998).

9.1.nnnnnn. Section 1113 does not apply to a modification after a sale of the debtor's business. The buyer of the debtor's business negotiated a modification of the collective bargaining agreement with the Union, reducing certain payments. The modifications were made contingent upon closing of the sale of the debtor's business and assumption by the buyer of the collective bargaining agreement. The Union nevertheless sought to hold the debtor liable for the loss it suffered. The court rules that section 363(k) absolves the debtor of any liability and that this modification is not subject to section 1113, which speaks of modifications only by the trustee of debtor in possession and only before assumption of the contract. In addition, the listing of the contract in a notice of assumption, with a cure amount of zero dollars, binds the Union. *In re Anchor Resolution Corp.*, 218 B.R. 330 (Bankr. D. Del. 1998).

9.1.oooooo. Lease option may be exercised before assumption. Where a real property lease contains a renewal option that may be exercised only if the lessee/debtor is not in default, the debtor in possession may exercise the renewal option without assuming the lease and without curing any default, because to hold otherwise would effectively shorten the time within which the debtor in possession could decide to assume or reject the lease. *Coleman Oil Co., Inc. v. The Circle K Corporation (In re The Circle K Corporation)*, 127 F.3d 904 (9th Cir. 1997).

9.1.pppppp. Anti-assignment restriction does not affect debtor in possession. A patent license is normally not assignable. Where the debtor proposes a plan that provides for the acquisition of its stock by a unrelated entity and its continuance as a going concern, section 365(c) does not prevent assumption of the patent license, because the debtor in possession is not a legal entity that is materially distinct from the pre-petition debtor and because the acquisition of the debtor's stock by a third party does not constitute an assignment of an executory contract with the debtor. *Institut Pasteur v. Cambridge Biotech Corporation*, 104 F.3d 489 (1st Cir. 1997).

9.1.qqqqqq. Store closing is an uncurable default. The debtor's franchise agreement gave the franchisor authority to terminate if the debtor/franchisee failed to operate the business for seven consecutive business days. The Ninth Circuit held that such a default could not be cured (because the

store could not be reopened on the days it had been closed) and therefore the contract could not be assumed. *Worthington v. General Motors Corp. (In re Claremont Acquisition Corp., Inc.)*, 113 F.3d 1029 (9th Cir. 1997).

9.1.rrrrrr. Real estate option agreement is an executory contract. A panel of the Ninth Circuit explains in detail why *Gill v. Easebe Enterps. (In re Easebe Enterps.)*, 900 F.2d 1417 (9th Cir. 1990), was incorrect in holding that all options to purchase real estate are executory contracts governed by section 365 and compliments the B.A.P. on its extensive opinion criticizing *Easebe*. Nevertheless, the Ninth Circuit reverses, being bound by *Easebe*, and reaffirms the rule in the Ninth Circuit that all real estate purchase option agreements are executory contracts. *Unsecured Creditors' Committee v. Southmark Corp. (In re Robert L. Helms Constr. and Dev. Co., Inc.)*, 110 F.3d 1470 (9th Cir. 1997).

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.1.a. Debtor is entitled to car ownership cost deduction only if the debtor has actual expenses for a loan or lease. The chapter 13 debtor owned a car free and clear of any loan or lease and therefore had no actual loan or lease payments. Chapter 13 requires that a debtor devote his or her "disposable income" to plan payments. "Disposable income" is "current monthly income" minus "amounts reasonably necessary to be expended" for "maintenance and support". For an above-median income debtor, such amounts are "the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides". The Local Standards include a table for Car Ownership Costs, which the IRS guidelines say is based on average loan and lease costs and is disallowed if the taxpayer does not have loan or lease costs. The word "applicable" in the expense definition limits the expense deduction to those expenses that are applicable to the debtor, in part because the phrase defines the more general standard, "amounts reasonably necessary to be expended". The use of "actual" in the expense definition does not detract from this interpretation, because such expenses may be deducted only to the extent actually incurred, whereas the Car Ownership Cost may be deducted based on the Local Standards, whether or not that is the debtor's actual cost, as long as the debtor has some such cost. Finally, disallowing the expense deduction where the debtor does not incur any ownership cost comports with the statute's policy to require debtors to pay all of their disposable income under a plan. Therefore, the debtor is not entitled to the Car Ownership Cost deduction. *Ransom v. FIA Card Servs., N.A.*, 562 U.S. ___, 131 S. Ct. 716, 178 L. Ed. 2d 603 (2011).

10.1.b. "Projected disposable income" must take account of known or virtually certain changes in the debtor's circumstances. The debtor received a buy-out payment from her former employer within six months before her chapter 13 petition, inflating her "current monthly income" substantially above the income from her new job and placing her above the means test cutoff. She filed a plan that did not provide for full payment of her unsecured debts and proposed to pay only her disposable income calculated based on actual income and actual expenses, rather than the higher amount that would result from using "current monthly income" and section 707(b)(2)-allowed expenses. The debtor could not afford to make plan payments of the higher amount. The trustee objected to confirmation. Section 1325(b)(1) requires the court to deny confirmation of a plan that does not pay unsecured claims in full unless, as of the effective date, it provides for payment to creditors of all the debtor's "projected disposable income to be received in the applicable commitment period". Section 1325(b)(2) defines "disposable income" as "current monthly income" minus certain charitable contributions, business expenses and amounts reasonably necessary to be expended for maintenance or support of the debtor and dependents. Amount reasonably necessary for support is calculated as actual expenses, unless the debtor's current monthly income is above the means test. The statute does not, however, define "projected". Therefore, "projected" should be given its ordinary meaning, requiring the court to look into the future (whereas "current monthly income" is strictly a backward-looking concept). As such, in determining compliance with the "projected disposable income" test, the court must take account of known or virtually certain changes to the debtor's income or expenses as of confirmation. In this case, the lower amount calculated as of the confirmation hearing date that the plan proposed to pay, not the higher amount based on the petition date means test

calculation, was the debtor's projected disposable income, and the plan could be confirmed. *Hamilton v. Lanning*, 560 U.S. ___, 130 S. Ct. 2464, 177 L. Ed. 2d 23 (2010).

10.1.c. State-based median income test does not violate the Uniformity Clause. BAPCPA applies certain Bankruptcy Code provisions, including section 707(b)'s means test and section 1325(b)'s plan payment requirement and applicable commitment period, based on the debtor's state's median income. The Constitution authorizes Congress to enact "uniform Laws on the subject of Bankruptcies". The Uniformity Clause requires geographic uniformity, that is, uniform application of federal law to treatment of a debtor's obligations throughout the country, regardless of the state in which the debtor resides or the bankruptcy court sits, even though applicable state law may have differing effects on debtors from state to state. The difference in treatment based on federal statistics of median income does not differ from differences in treatment resulting from the application of different state exemption or other nonbankruptcy laws. The state median income test therefore does not violate the Uniformity Clause. *Schultz v. U.S.*, 529 F.3d 343 (6th Cir. 2008).

10.1.d. Section 1322(b) permits a debtor to cure a default over a reasonable time, despite section 108(b)(2)'s 60-day cure limit. Section 108(b)(2) permits a trustee to cure a default within 60 days after the order for relief if as of the petition date, the debtor could have cured the default. Section 1322(b)(3) permits a chapter 13 plan to cure a default, and section 1322(b)(5) permits a plan to cure a default "within a reasonable time … on any … claim on which the last payment is due after the date on which the final payment under the plan is due." Section 1322(c)(1) permits a plan to cure a default on a claim secured by a lien on the debtor's principal residence until the "residence is sold at a foreclosure sale". Here, the debtor was purchasing his Montana principal residence under a contract for deed. The seller had given notice of default within 30 days before the debtor filed chapter 13. Under Montana law, the debtor had 30 days to pay the entire remaining balance of the contract, failing which the seller would become the property owner again. Under this procedure, section 1322(c)(1) does not apply, because there is no "foreclosure". However, section 1322(b)(5) does apply, despite the 60-day limit in section 108(b)(2). Section 108(b) is a provision of general applicability, while section 1322(b) is directed specifically at chapter 13 plans and therefore controls the general provision. *Frazer v. Drummond (In re Frazer)*, 377 B.R. 621 (9th Cir. B.A.P. 2007).

10.1.e. Bad faith may forfeit debtor's right to convert to chapter 13. The debtor filed chapter 7. He failed to disclose assets. When the trustee discovered the assets and sought recovery, the debtor converted his case to chapter 13 under section 706(a) by filing a notice of conversion. Rule 1017(c)(2) treats the notice as a motion, which the bankruptcy court denied based on the debtor's bad faith in concealing assets. The Supreme Court affirms. Section 706(a) grants a debtor the right to convert, but section 706(d) limits the right to a debtor eligible to be a debtor under the target chapter. If a debtor files a chapter 13 case in bad faith, the court may dismiss under section 1307(c). The court's determination to dismiss for bad faith pre-petition (or pre-conversion) conduct "is tantamount to a ruling that the individual does not qualify as a debtor under Chapter 13" and therefore does not meet section 706(d)'s eligibility requirement. A bad faith determination should be limited, however, to "atypical" or "extraordinary" cases, so as not to affect the vast majority of filers who are "honest but unfortunate debtors." In addition, section 105(a) gives the court the power to issue any order to prevent an abuse of process and is adequate to authorize denial of a conversion motion. A dissent relies on the plain language of section 706(a) and questions whether bad faith is properly treated as an eligibility issue and whether section 105(a) should override the section 706(a)'s express conversion authorization. *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007).

10.1.f. Debtor's right to convert from chapter 7 to chapter 13 is not absolute. In his schedules, the chapter 7 debtor did not disclose assets and prepetition transfers. When the chapter 7 trustee questioned him about them at the 341 meeting, the debtor moved to convert to chapter 13 under section 706(a), which provides that "the debtor may convert" the case to chapter 13 "at any time" if the debtor is eligible for chapter 13 and the case has not previously been converted. The court denies the motion to convert because of the debtor's bad faith conduct. Section 105(a) authorizes the bankruptcy court to take action "necessary or appropriate to … prevent an abuse of [the bankruptcy] process," and the Code's policy is not to shelter those who would play fast and loose with the bankruptcy process. Therefore, the

word "may" in section 706(a) should be construed as being used in the conditional sense (that is, "might"), not as an authorization, making the right to convert not absolute. *Marrama v. Citizens Bank of Mass. (In re Marrama)*, 430 F.3d 474 (1st Cir. 2005).

10.1.g. A chapter 13 debtor does not have avoiding powers. The debtor sued a creditor under section 544(a) seeking to avoid the creditor's unperfected lien. The debtor does not have standing to do so, however. Section 544(a) grants the avoiding power to the trustee. Section 1303 gives a debtor rights and powers in a chapter 13 case, but the avoiding powers are not among them. The Code authorizes a debtor to pursue avoiding power actions in certain circumstances, such as under section 522(g). The omission of a comparable provision in chapter 13 suggests the debtor does not have this power. The absence of a direct grant in section 1302 of avoiding powers to the trustee does not imply that they are vested in the debtor. Therefore, the court dismisses adversary proceeding. *Hansen v. Green Tree Servicing, LLC (In re Hansen)*, 332 B.R. 8 (10th Cir. B.A.P. 2005).

10.1.h. Rents are real property collateral for purposes of the section 1322(b)(2) anti-modification clause. Section 1322(b)(2) prohibits modification under a chapter 13 plan of a mortgage that is secured solely by real property that is the debtor's principal residence. In this case, the lender took a second mortgage on the debtor's principal residence and on rents. Under applicable New Jersey law, rents are real property. They therefore do not disqualify the mortgage from the anti-modification provision of section 1322(b)(2). In addition, an escrow that the lender maintains for taxes and insurance does not disqualify the mortgage from protection, because the debtor retains no interest in the escrowed property, and it is therefore not collateral for the loan. *In re Ferandos*, 402 F.3d 147 (3d Cir. 2005).

10.1.i. Postpetition, preconversion tax claim is entitled to administrative expense priority in chapter 13. The debtors operated their business in chapter 11 for over a year, but did not pay FICA and FUTA taxes during the case. They discontinued their business, found employment, and converted their cases to chapter 13. The tax claims were entitled to administrative expense priority in the chapter 13 cases. Section 348(d) provides that a claim that arises during a chapter 11 case is treated as a prepetition claim after conversion, except for administrative expense claims. This section takes precedence over section 1305, which requires that tax claims filed under section 1305 be determined and allowed under section 502 as if they had arisen prepetition. Section 1305 does not, however, address priority, only allowability. Section 348(d) preserves the tax claims' priority status. *United States v. Fowler (In re Fowler)*, 394 F.3d 1208 (9th Cir. 2005).

10.1.j. Right to convert from chapter 7 to chapter 13 is not absolute. The well-educated and well-paid debtor had engaged in protracted efforts, including six prior bankruptcy petitions, for nine years to prevent paying his ex-wife alimony or support and to prevent her from receiving property awarded in their divorce proceeding. When he moved to convert his current chapter 7 case to chapter 13, the court balked, finding that he had lied his way through the trial on the motion, was completely untrustworthy, and sought conversion only to avoid discharge and dischargeability litigation. A chapter 13 case therefore could not be filed or pursued in good faith. Acknowledging the split in the case law on the issue, the court rules that under the circumstances, the right to convert is not absolute, and the motion is properly denied. *Copper v. Copper (In re Copper)*, 314 B.R. 628 (6th Cir. B.A.P. 2004).

10.1.k. Debtor's absolute right to dismiss chapter 13 case does not prevent court from imposing conditions. The debtors filed a face-sheet only chapter 13 case and failed to file the schedules within 15 days or to appear at the 341 meeting. The U.S. Trustee moved to dismiss; a secured creditor moved to dismiss "with prejudice," that is, with a bar to the debtor's refiling for 180 days. The debtors then filed their own motion to dismiss under section 1307(b). The court acknowledges that the debtors' motion takes precedence over the other motions, because section 1307(b) gives the debtors an absolute right to dismiss a chapter 13 case at any time. But the court may make the dismissal with prejudice, as the creditor requests. In this case, the creditor fails to establish that the dismissal should be with prejudice, but the court notes that the creditor's filing of a stay relief motion would have required the dismissal to be with prejudice, under section 109(g). *In re Wyatt*, 317 B.R. 159 (Bankr. D. Idaho 2004).

10.1.l. Prepetition chapter 13 attorney's fees may be paid under section 330(a). Section 330(a)(4)(B) authorizes the court to award attorney's fees in a chapter 13 case "for representing the interests of the debtor in connection with the bankruptcy case." This language is not limited to postpetition services and therefore encompasses prepetition services that are rendered "in connection with the bankruptcy case." Those services include counseling the debtor about the filing and preparation of necessary papers, such as the petition, the schedules, and the chapter 13 plan. Section 507(a)(1) grants first priority to claims allowed under section 503(b), which includes compensation allowed under section 330, and section 1322(a)(2) requires payment of priority claims in full under the plan. Therefore, the allowed compensation for prepetition services in connection with the case must be paid in full under the plan. *In re Busetta-Silvia*, 314 B.R. 218 (10th Cir. B.A.P. 2004).

10.1.m. Right to convert from chapter 7 to chapter 13 is absolute. The debtor filed his chapter 7 case in bad faith and had filed and dismissed a chapter 13 case while his chapter 7 case was pending. The trustee had filed an action to recover $60,000 that the debtor had fraudulently transferred. The debtor then filed a motion under section 706(a) to convert his case to chapter 13. The right to convert under section 706(a) is absolute, as long as the debtor meets the eligibility standards for chapter 13 and the requirements of that section that the case not previously have been converted. The debtor's prior conduct does not provide a basis to deny the motion to convert. If the debtor is unable to propose or confirm a chapter 13 plan or if the facts "are sufficiently egregious to support an argument that the § 706(a) conversion right should be overridden," then the court may reconvert to chapter 7, even on its own motion, because there is no right to remain in chapter 13 once the case has been converted. The purpose of the motion requirement in Bankruptcy Rule 1017(f)(2) is to determine eligibility, not to create discretion in the court to deny the conversion on grounds other than those stated in section 706(a). *Croston v. Davis (In re Croston)*, 313 B.R. 447 (9th Cir. B.A.P. 2004).

10.1.n. Right to convert from chapter 7 to chapter 13 is not absolute. In extreme circumstances, such as where the debtor is guilty of misconduct, such as inadequate asset disclosure, and seeks conversion from chapter 7 to chapter 13 after the trustee threatens or takes action against the debtor, the court may deny conversion. The bankruptcy court should consider the totality of the circumstances in determining whether extreme circumstances exist that warrant denial of conversion. *Marrama v. Citizens Bank (In re Marrama)*, 313 B.R. 525 (B.A.P. 1st Cir. 2004).

10.1.o. Supreme Court adopts "prime plus" calculation for secured creditor cram down. The bankruptcy court proposed a cram down chapter 13 plan to restructure a 21% secured auto loan at a 9.5% interest rate, calculated as the bank prime rate of 8% plus a risk factor increase of 1.5%. The Supreme Court affirms. Four Justices endorse the prime-plus approach the bankruptcy court used. They reason that any other approach does not adequately reflect Congress's intentions, focuses too much on the lender, and is administratively difficult to implement. They adopt an objective standard, based on the present value of the payment stream, rather than a subjective standard, based on the lender's identity, preferences, costs, or other individual circumstances. And they place the burden on the lender to show the bankruptcy court any required upward risk adjustment to the prime rate, in part because they believe the lender is better able to sustain it. Mr. Justice Thomas concludes, based on a narrow reading of the statute, that the court may use a risk-free rate. Because the 9.5% plan rate here exceeds the risk-free rate, he would also affirm. The dissent would adopt the presumptive rate approach, where the original contract interest rate is presumed correct, subject to a showing why the bankruptcy court should depart in either direction from the presumptive rate. Eight Justices (the plurality and the dissent) conclude that the interest rate must be adjusted upward for the nonpayment risk. All nine Justices reject a rate based on the lender's cost of funds and the coerced loan approach, under which the court determines the interest rate the lender would receive if it forecloses on its collateral and reinvests the proceeds in a new loan. Therefore, the prime-plus approach should apply. *Till v. SCS Credit Corp.,* 541 U.S. 465 (2004).

10.1.p. Chapter 13 plan may not strip down a lien unless payments on the secured claim are to be completed during the plan. Section 1322(b)(2) permits a plan to modify a secured claim, except one secured solely by the debtor's principal residence. Section 1322(b)(5) permits a plan to cure defaults and maintain payments on a long-term secured claim beyond the plan payment period. But a plan may not modify a secured claim under section 1322(b)(2) and then extend payments under section 1322(b)(5). In

this case, the debtors owned commercial real estate that was worth less than the secured claim. They bifurcated the claim under section 506(a) and proposed payment of the secured claim according to its terms under section 1322(b)(5) at the full monthly payment amount for a period extending beyond the plan payment period. Such a plan is impermissible, because the strip down constitutes a modification that brings the claim under section 1322(b)(2). *Enewally v. Washington Mut. Bank (In re Enewally)*, 368 F.3d 1165 (9th Cir. 2004).

10.1.q. 180-day deadline to revoke confirmation is absolute, but might not bar dismissal. The debtor lied on her bankruptcy schedules about her income and assets, but in a way that would have put a creditor on notice of the lie. 180 days after confirmation of the debtor's chapter 13 plan, creditors moved to revoke confirmation on the ground that it was obtained by fraud. Later, the creditors moved to revoke confirmation on the ground that the debtor lied about her debts and was ineligible for chapter 13 under its debt limits. The 180-day deadline to seek revocation of confirmation is absolute, despite the debtor's fraud, and fraud is the only ground to obtain revocation. In this case, although the debtor obtained confirmation by fraud about her assets and income, those issues could have been litigated at the confirmation hearing, because the creditors, had they been diligent in investigating, would have uncovered the lie. Nor can they evade the 180-day limit by seeking revocation under section 105(a) or under Rule 9024 (incorporating Fed. R. Civ. P. 60), which expressly bars its use to revoke confirmation. They could, however, seek dismissal or conversion under section 1307 more than 180 days after confirmation based on the lie about debts and eligibility, because dismissal is not time-limited, and there was nothing that would have put the creditor on notice of the lie. Therefore, *res judicata* did not apply. Chapter 11's dismissal provision is the same as chapter 13's for these purposes. *Duplessis v. Valenti (In re Valenti)*, 310 B.R. 138 (9th Cir. B.A.P. 2004).

10.1.r. Chapter 13 debtor has standing to pursue avoiding powers. The debtors had granted a security interest in the proceeds of a personal injury action. After the debtors filed a chapter 13 case, they collected the proceeds of the action. Their chapter 13 plan provided for them to avoid the security interest so that they could use the proceeds to fund the plan. The creditor objected to the subsequent avoidance action on the ground that only the trustee may pursue avoiding power claims in chapter 13. The Ninth Circuit B.A.P. rejects the plan provision in the chapter 13 plan as a basis for the debtor's standing to pursue the claim and similarly rejects the trustee's assignment, without court approval, of the avoiding power claim to the debtors as a basis for standing. It then rejects a narrow construction of chapter 13 in favor of a holistic approach. Reviewing the extensive case law surrounding this and related issues in chapter 13, the B.A.P. concludes that the debtor retains avoiding powers concurrently with the trustee and that the bankruptcy court can regulate any mischief that may result from any disagreement between the debtor and the trustee over whether an action should be pursued. Tellingly, the B.A.P. notes the potential anomaly of a case in which a debtor has limited future income with which to fund a plan and a potentially large avoiding power cause of action. Because of the best interest test and the avoidability of the transfer in a chapter 7 case, the debtor could not confirm a plan without avoiding the transfer, suggesting that the debtor should have the power to avoid it. *Houston v. Eiler (In re Cohen)*, 305 B.R. 886 (9th Cir. B.A.P. 2004).

10.1.s. Chapter 13 plan may modify wholly undersecured claim. Joining all the other courts of appeal that have addressed the issue, the Ninth Circuit rules that the provision of section 1322(b)(2) that prohibits modification under a chapter 13 plan of a secured claim that is secured only by the debtor's residence does not prohibit modification of a claim that is wholly undersecured. The Ninth Circuit reasons that, under section 506(a), "secured claim" is a term of art and that a creditor whose claim is wholly undersecured does not hold a secured claim. (In the course of its opinion, the Ninth Circuit expresses concern about the failure of the bankruptcy court to follow B.A.P. decisions and recommends the Judicial Council consider an order clarifying whether the bankruptcy courts must follow the decisions of the B.A.P.) *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220 (9th Cir. 2002).

10.1.t. Chapter 13 plan may modify short term mortgage. Section 1325(a)(5) permits a chapter 13 plan to bifurcate a secured claim, as provided under section 506(a), and pay the unsecured portion only the percentage being paid to general unsecured claims. However, section 1322(b)(2) prohibits modification of a claim "secured only by a security interest in real property that is the debtor's principal

residence." As construed in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), section 1322(b)(2) prohibits bifurcation or modification of a mortgage claim. However, section 1322(c)(2) permits a plan to "provide for payment of the claim as modified pursuant to section 1325(a)(5)" notwithstanding section 1322(b)(2), if the claim is secured by a security interest in the debtor's principal residence but "is due before the date on which final payment under the plan is due." The Eleventh Circuit rules that section 1322(c)(2) permits bifurcation and modification of a short term mortgage, disagreeing with the Fourth Circuit's decision in *In re Witt*, 113 F.3d 508 (4th Cir. 1997). *American General Finance, Inc. v. Paschen (In re Paschen)*, 296 F.3d 1203 (11th Cir. 2002).

10.1.u. Bankruptcy court may not augment confirmation requirements. The debtors' chapter 13 plan met all six of the statutory confirmation requirements of section 1325(a). Nevertheless, the bankruptcy court imposed an additional requirement, that the debtors furnish periodic financial reports to the trustee, to permit the trustee to monitor whether the debtors had additional disposable income. The Seventh Circuit reverses the bankruptcy court's order, holding that the confirmation requirements set forth in section 1325(a) are exclusive and may not be expanded. *Petro v. Mishler*, 276 F.3d 375 (7th Cir. 2002).

10.1.v. Creditor may apply chapter 13 payments to post-petition interest on non-dischargeable debts. The Code of Federal Regulations provides for application of payment on student loans first to costs, then to accrued interest, and finally to principal. Student loans are non-dischargeable in chapter 13. When a debtor's plan provides for payment on a student loan, the agency may file a claim only for principal and pre-petition interest, but may apply the payments received to post-petition interest, thus not reducing principal at all. In reaching this conclusion, the court reasons that other creditors are not disadvantaged, because the agency's claim is not greater than it would otherwise be under section 502(b)(2), that the debtor should not obtain any better treatment with respect to a non-dischargeable claim by filing a chapter 13 than if he did not, and, in dictum, that the scope of the defined term "claim" differs in scope from "debt." *Kielish v. Educational Credit Management Corp (In re Kielish)*, 258 F.3d 316 (4th Cir. 2001).

10.1.w. Chapter 13 estate continues past confirmation. After confirmation, the debtor moved for authority to sell property that had revested in the debtor under the plan and under section 1327(b) free and clear of claims of creditors. On a motion to determine the disposition of the proceeds of the property that were in excess of the secured claim, the First Circuit holds that property of the estate revests at the time of confirmation, but the estate "continues to be funded by the debtor's regular income and post-petition assets as specified in section 1306(a)." As a result, the proceeds were estate property and available to pay the debtor's unsecured claims under the plan. *Barbosa v. Soloman*, 235 F.3d 31 (1st Cir. 2000).

10.1.x. "Estate transformation" rule applies upon confirmation of Chapter 13 plan. Chapter 13 contains conflicting provisions on whether post-confirmation earnings remain property of the estate or revest in the debtor upon confirmation of the chapter 13 plan. Following the "estate transformation" approach previously adopted by the Seventh Circuit, the Eleventh Circuit rules that the debtor's post-confirmation earnings revest in the debtor except to the extent necessary to fulfill the terms of the confirmed chapter 13 plan. *Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333 (11th Cir. 2000).

10.1.y. Rights of a chapter 20 debtor limited. The debtor filed chapter 7 and discharged the unsecured liability on an undersecured mortgage. The debtor then filed chapter 13 and sought to sell the property, turning over the proceeds to the mortgagee. Because such a plan deprived the mortgagee of its right to foreclose under state law, even though that right arguably had no greater economic value than what was proposed under the plan, the plan impermissively modified the rights of a secured creditor in the debtor's principal mortgage, contrary to *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993). *In re Kirschner*, 216 B.R. 417 (Bankr. W.D. Wisc. 1997).

10.1.z. Chapter 13 plan may not bifurcate short-term home mortgage. *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993), prohibited bifurcation of a claim secured by the debtor's principal residence. Congress then amended section 1332(c)(2) to permit modification of secured claims where the last payment is due during the term of the plan. Nevertheless, the Fourth circuit holds that a short-term home mortgage may still not be bifurcated, based on a narrow textual reading of the amendment. *Witt v. United Companies Lending Corp. (In re Witt)*, 113 F.3d 508 (4th Cir. 1997).

10.1.aa. Chapter 13 plan may be modified to cure post-petition arrearages. The Supreme Court's decision in, does not preclude a bankruptcy court from approving a modification of a chapter 13 plan where the debtor has missed postpetition interest payments to a creditor secured by a home mortgage. In this case, the debtor proposed to cure the arrearages over six months. The court also approves the inclusion of a "drop dead" clause in the order, over the debtor's objection, if the debtor misses any further payments. *Mendoza v. Temple-Inland Mortgage Corp. (In re Mendoza)*, 111 F.3d 1264 (5th Cir. 1997).

10.1.bb. A chapter 13 debtor may not exercise the avoiding powers. *LaBarge v. Benda (In re Merrilfield)*, 214 B.R. 363 (8th Cir. B.A.P. 1997).

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).

10.2.b. Defalcation requires a known breach of a known fiduciary duty. The debtor was a trustee of a trust. He borrowed from the trust for his own benefit and repaid all the loans. When the beneficiaries learned of the loans, they sued and received a judgment against the debtor for damages arising from his self-dealing. Under section 523(a)(4), a debt for fraud or defalcation while acting in a fiduciary capacity is nondischargeable. Defalcation does not require fraud, embezzlement or misappropriation. However, it requires more than an innocent mistake or mere negligence. It requires a known breach of a known fiduciary duty, such that the conduct can be objectively described as reckless. The debtor's conduct here met that standard, so the debt is nondischargeable. *Bullock v. Bankchampaign (In re Bullock)*, 670 F.3d 1160 (11th Cir. 2012).

10.2.c. Section 523(a)(19) nondischargeability for securities fraud applies only to a culpable debtor. The SEC pursued securities fraud charges against an individual and obtained appointment of s receiver and a disgorgement order. The individual had paid an attorney for work that the attorney had not yet performed, so the disgorgement order required the attorney to return the excess payments, even though the attorney had not violated any securities laws. Before the attorney did so, however, he filed bankruptcy. Section 523(a)(19) excepts from discharge "a debt for the violation of any of the Federal securities laws". In this context, "for" is ambiguous, because the provision does not specify whether the conduct giving rise to nondischargeability must have been the debtor's conduct, as some (but not all) other exceptions to discharge do. The debt here for disgorgement of the proceeds of a securities law violation by another was not "for" the violation of the securities laws. In addition, to promote the Code's fresh start principle, exceptions to discharge should be narrowly construed. The Code discharges an "honest but unfortunate debtor". To apply the exception here would violate that principle, because the debtor was innocent of any violation. Therefore, the debt is discharged. *Sherman v. S.E.C. (In re Sherman)*, 658 F.3d 1009 (9th Cir. 2011).

10.2.d. Nonpayment of taxes alone is insufficient evidence to show a willful attempt to evade or defeat. The debtor filed complete and accurate income tax returns for four prepetition years that were more than three years before her bankruptcy, but she did not pay any of the tax shown as owing on the returns. After her bankruptcy, the United States sought to collect the taxes, but produced no evidence, other than the nonpayment, to support nondischargeability. Section 523(a)(1)(C) renders nondischargeable any tax "with respect to which the debtor … willfully attempted to evade or defeat such tax". The provision requires proof of two elements: conduct and mental state. Failure to file a return or pay taxes satisfies the conduct element of evading or defeating the tax. The mental element requires a

showing of willfulness, that is, that the nonpayment was knowing and deliberate. Evidence of nonpayment alone is not sufficient to show willfulness. The government must show that the debtor had the ability to pay and chose to spend the money for other purposes. In this case, the absence of evidence of willfulness rendered the taxes dischargeable. *United States v. Storey*, 640 F.3d 739 (6th Cir. 2011).

10.2.e. Knowing and intentional nonpayment of taxes constitutes a willful attempt to evade or defeat. The debtor was a real estate salesman. The debtor did not file tax returns for tax years 1998 through 2002, because he could not afford to pay both the taxes due and obligations arising from his divorce. He filed the returns in 2003 and then made several attempts with the IRS to address the taxes, first by an offer in compromise that was rejected and later, after the IRS attempted to levy, by an installment payment plan. His attorney threatened bankruptcy in correspondence relating to the offer in compromise. The debtor was employed consistently during all relevant years and earned over $100,000 each year (except for one). Between 2003 and his bankruptcy in 2006, he bought a house, but titled it in his new wife's name, sold the house and used the proceeds, including a significant profit, to buy another, also in his wife's name, and formed a corporation to receive his sales commissions after the IRS levied. Section 523(a)(1)(C) renders nondischargeable any tax "with respect to which the debtor … willfully attempted to evade or defeat such tax". The provision requires proof of two elements: conduct and mental state. Nonpayment alone is insufficient to satisfy the conduct requirement, but nonpayment coupled with failure to file a return does. The mental state condition requires a showing that the debtor had a duty, knew of the duty and voluntarily and intentionally violated the duty. Inadvertent mistakes do not satisfy the condition. Here, the debtor's failure to file returns because he knew he could not afford to pay, the titling of the houses in his wife's name and the creation of a corporation to receive his sales commissions all showed that the debtor knew of the duty and voluntarily and intentionally violated it. The taxes are therefore nondischargeable. *U.S. v. Mitchell*, 633 F.3d 1320 (11th Cir. 2011).

10.2.f. Corporate insider's debt to corporate creditor is not excepted from discharge for defalcation while acting in a fiduciary capacity. The debtor was the sole shareholder and president of an advertising agency. The agency received payments from a customer for ad placements but did not pay for the ads, which the customer then paid. The customer sought to hold its claim against the president nondischargeable under section 523(a)(4) as a claim for defalcation while acting in a fiduciary capacity, on the theory that as an officer of an insolvent corporation, the president owed a fiduciary duty to creditors. The state law standard for determining whether an individual is a fiduciary does not govern whether the individual is a fiduciary for purposes of section 523(a)(4), which is a matter of federal law. Section 523(a)(4) should be construed narrowly. The fiduciary relationship must have existed before the debt was incurred, not as a result of the debt's incurrence. In addition, the fiduciary relationship must be express, not implied at law, unless the debtor held ultimate power over the creditor sufficient to create a fiduciary relationship. A mere debtor-creditor relationship at arms' length does not suffice. Therefore, the debt is discharged. *Follett Higher Educ. Group, Inc. v. Berman (In re Berman)*, 629 F.3d 761 (7th Cir. 2011).

10.2.g. Ponzi scheme's net winner's disgorgement obligation is nondischargeable. The debtor invested in a Ponzi scheme and received fictitious profits from the operator. The Oklahoma Department of Securities brought an action against him under the Oklahoma Uniform Securities Act for unjust enrichment to recover the fictitious profits and obtained a disgorgement judgment. The debtor then filed a chapter 7 case. Section 523(a)(19) makes nondischargeable any debt "that is for the violation of any … of the State securities laws … and results … from any judgment". The discharge exception does not specify that it applies only to a violation by the debtor. The Ponzi scheme operator violated the Securities Act. The Act authorizes disgorgement from an investor who directly benefited from a securities law violation, even if the violation was by a third party. Although exceptions to discharge are generally narrowly construed, this exception should be broadly construed to carry out its express purpose to protect investors. Therefore, it applies to the disgorgement judgment against the debtor, which is nondischargeable. *Okla. Dep't of Sec. v. Mathews*, 423 B.R. 684 (W.D. Okla. 2010).

10.2.h. A claim against the debtor retains its nondischargeable character when it is revived after a preference recovery. Within 90 days before his bankruptcy, the debtor repaid his employer funds that the debtor had embezzled. The trustee avoided and recovered the payment as a preference. The employer timely filed a dischargeability complaint. Section 502(h) provides that a claim arising from the trustee's

recovery of an avoided transfer "shall be determined, and shall be allowed under … this section or disallowed under … this section, the same as if such claim had arisen" before the petition date. Although the references in section 502(h) to "allowed" and "disallowed" refer to the revival of the claim against the estate, the reference to "determine" expands section 502(h)'s reach to include revival of the claim against the debtor for dischargeability purposes, because section 523 refers twice to "determination of dischargeability". Therefore, when the employer repaid the preference to the estate, its claim against the debtor, including its nondischargeability, was revived. *Busseto Foods, Inc. v. Laizure (In re Laizure)*, 548 F.3d 693 (9th Cir. 2008).

10.2.i. Nondischargeability for willful and malicious conduct requires an intentional tort. The debtor breached a settlement agreement with a creditor, which resulted in injury to the creditor. A debt for "willful and malicious injury" is nondischargeable. "Willful and malicious injury" requires an intentional tort. The Bankruptcy Code contemplates intentional breaches of contracts, either by the bankruptcy filing itself or by contract rejection. In addition, contract law permits a party to breach if it concludes the damages for which it will be liable are preferable to performance. Thus, an intentional breach of contract, no matter how willful and malicious, does not render the resulting liability nondischargeable unless the conduct also constitutes a tort under applicable nonbankruptcy law. *Lockerby v. Sierra*, 535 F.3d 1038 (9th Cir. 2008).

10.2.j. A horse & buggy is not a vessel. In the early morning hours after New Year's Eve, Mr. Schmucker was driving his horse and buggy while intoxicated on the roads of Indiana when he failed to stop at a through way. A car traveling on the through way struck Mr. Schmucker's buggy, seriously injuring the car's passenger. The passenger sought to have Mr. Schmucker's debt to her held nondischargeable under section 523(a)(9), which makes nondischargeable any debt arising from "the debtor's operation of a motor vehicle, vessel, or aircraft" while intoxicated. "Vessel" does not include a horse and buggy. Although "vessel" might be defined to include any container, such a definition could include "coffee cups, flower pots, and grocery carts, all of which could cause injury and, quite conceivably, be operated while under the influence." Therefore, given the context in which the term is used, and given the "vessel" definition in 1 U.S.C. § 3, its meaning is limited to boats and similar watercraft. *Young v. Schmucker (In re Schmucker)*, 376 B.R. 256 (Bankr. N.D. Ind. 2007); *aff'd* 409 B.R. 477 (N.D. Ind. 2009).

10.2.k. Some misconduct is required to qualify as "defalcation". The debtor was a 50% shareholder with another individual in an insurance agency, which was deeply indebted. The other shareholder died. The debtor continued to collect premiums in the agency to pay off the agency's debt but also formed a new agency for new business. After the other shareholder's estate's lengthy but unsuccessful negotiations with the debtor to sell its 50% interest in the old agency to the debtor, the estate sued the debtor for misappropriation of the old agency's funds and goodwill. The state court ruled that the debtor had breached his fiduciary duty by co-opting the old agency for his own and the new agency's enrichment and awarded the estate a substantial judgment against the debtor. The estate sought to hold the claim nondischargeable in the debtor's subsequent bankruptcy. The court notes the split among the circuits on the meaning of "defalcation while acting in a fiduciary capacity" under section 523(a)(4) (innocent or negligent misappropriation in the Fourth, Eighth, and Ninth Circuits; some level of wrongful conduct in the Fifth, Sixth, Seventh, and Tenth Circuits; and scienter in the First Circuit) and follows the First Circuit's standard. The state court's findings against the debtor therefore do not rise to a defalcation. Defalcation requires "some portion of misconduct, akin to the level of recklessness required for scienter" in the securities laws. This standard is consistent with the requirement that the Supreme Court has imposed of narrowly interpreting nondischargeability grounds in section 523(a). *Denton v. Hyman (In re Hyman)*, 2007 U.S. App. LEXIS 21249 (2d Cir. Sept. 6, 2007).

10.2.l. Tenth circuit construes "statement of financial condition" in section 523(a)(2)(B) narrowly. Section 523(a)(2)(B) makes nondischargeable a debt for money obtained by use of a "statement … respecting the debtor's financial condition," but only if the statement is in writing. Section 523(a)(2)(A), by contrast, makes a debt incurred by false pretenses, false representation, or actual fraud nondischargeable, whether or not in writing, but only if the representation is not a "statement respecting the debtor's financial condition." In this case, the debtor orally represented to her lender that she owned specified real and personal property and that she would soon receive a new loan from her brother from which to repay the loan. Both representations were false. When the lender found a different

name on the real property title records, the debtor explained that the name was hers. In fact, it was really her sister-in-law's. The lender sought nondischargeability under (A). The debtor defended on the ground that the statements were respecting her financial condition. The Tenth Circuit adopts a narrow interpretation of "statement respecting the debtor's financial condition" as a statement "going to the debtor's overall financial net worth or financial condition." The debtor's statements here concerning property ownership and the expectation of a new loan do not meet that definition, so the debt is nondischargeable. *Caldwell v. Joelson (In re Joelson)*, 427 F.3d 700 (10th Cir. 2005).

10.2.m. Judgment solely for emotional distress is dischargeable. The creditor had obtained a judgment in state court against the debtor for emotional distress arising from the debtor's fraud. The debtor had not obtained any money, property, services, or an extension or renewal of credit from the creditor. Accordingly, the debt is dischargeable, because section 523(a)(2) applies only when the debtor has acquired one or more of such things from the fraud. *Nunnery v. Rountree (In re Rountree)*, 330 B.R. 166 (E.D. Va. 2004).

10.2.n. Post-discharge attorney's fees for continuing prepetition litigation are not discharged. The debtor had sued her employer before bankruptcy. She claimed the action as exempt and pursued it unsuccessfully after the order for relief. Under state law and her employment agreement, her former employer obtained an award of attorney's fees against her. The postpetition portion of the fees—the portion incurred after the order for relief—was not discharged. Although postpetition fees arising out of prepetition claims may be discharged, where the debtor "returns to the fray" after the order for relief to pursue litigation against the adverse party, the debtor converts any relationship of the fees to the pre-bankruptcy period to a postpetition relationship. The fees therefore "arise" after the order for relief. The standard for determining that the fees relate to postpetition and therefore post-discharge activities differs from the standard for determining whether the fees would be entitled to administrative expense priority if asserted against the estate, because the policies underlying the discharge and the priority provisions differ, the one relating to the debtor's personal liability for the debtor's postpetition acts, the other affecting benefit to the estate and the effect on recoveries of other creditors. *Boeing North American, Inc. v. Ybarra (In re Ybarra)*, 424 F.3d 1018 (9th Cir. 2005).

10.2.o. Bail bondsman's bail debts are nondischargeable. The debtor was a commercial bail bondsman, who filed a bankruptcy case with unpaid bail debts to the Superior Court. Disagreeing with the Fourth and Fifth Circuits, the Third Circuit holds the debts nondischargeable under section 523(a)(7). They are payable to a governmental unit and are not in compensation for actual pecuniary loss. They are also a "forfeiture," because they constitute a loss payable by reason of failure to perform an obligation. *Dobrek v. Phelan*, 419 F.3d 259 (3d Cir. 2005).

10.2.p. Eighth Circuit expands "undue hardship" requirement for student loan discharge. The debtor suffered depression, made significantly worse by the pressure and stress of $142,000 in student loans. Although she earned a regular income and had some disposable income with which to pay a portion of the loans, the court discharged them as an undue hardship. The Eighth Circuit has previously rejected the *Brunner* three-factor test (*Brunner v. N.Y. State Higher Educ. Serv. Corp.*, 831 F.2d 395 (2d Cir. 1987)) and adopted instead a "totality of the circumstances" test in determining whether repayment of a student loan constitutes an undue hardship. Here, the court expands the concept of undue hardship to include non-financial hardship. Even if the debtor could afford to repay a portion of the loans, the bankruptcy court may consider the medical hardship repayment would pose. *Reynolds v. Pennsylvania Higher Educ. Assist. Agency (In re Reynolds)*, 425 F.3d 526 (8th Cir. 2005).

10.2.q. Section 523(a)(19) applies to cases pending at the date of enactment. Congress added section 523(a)(19) in the Sarbanes-Oxley Act of 2002 to make judgments, orders, or decrees for violation of the securities laws nondischargeable. Here, the debtor had filed bankruptcy before enactment of Sarbanes-Oxley, but the court' held the hearing on nondischargeability after enactment. The general rule is that the court must apply the law in effect at the time it rules. However, the court considers whether application of this provision to a pending case would be an improper retroactive application. It concludes that a debtor does not become entitled to a discharge just by filing a bankruptcy petition, so the debtor had no vested rights as of the petition date, and the additional nondischargeability ground did not increase

the debtor's liability. Therefore, it was proper to apply the provision to the pending case. *Harvey v. Lewandowski (In re Lewandowski)*, 325 B.R. 700 (Bankr. D.N.J. 2005).

10.2.r. BAPCPA's amendment of section 523(a)(19) applies to cases in which the court has already made a prior determination of dischargeability. In a case filed in 2004, a creditor sued to have the debtor's securities fraud debt excepted from discharge. The court denied the motion on December 29, 2004, because the claim was not yet reduced to judgment, as section 523(a)(19) then required. Congress amended the provision on April 20, 2005 to apply to claims whether reduced to judgment before or after the date of the filing of the petition. The creditor moved for reconsideration even though the claim had not yet been reduced to judgment in state court, so the discharge injunction would not apply and he could continue to pursue the action in state court. The court holds the debt nondischargeable, because Congress specifically provided for the amendment to become effective immediately. Accordingly, it applied to this pending case, despite the court's prior contrary determination. *In re Weilein*, 328 B.R. 553 (Bankr. N.D. Iowa 2005).

10.2.s. Sanctions under Rule 11 and 28 U.S.C. § 1927 are nondischargeable. The attorney brought an action on behalf of his client against the creditor. The court found that it was unreasonable for the attorney to do so, because there was no colorable claim that the action was not time barred. The court awarded sanctions under Rule 11 and 28 U.S.C. § 1927. When the attorney later filed bankruptcy, the sanctions were nondischargeable as a claim arising from a willful and malicious injury under section 523(a)(6). The trial court had found a "clear violation" of Rule 11 and that the action "was unwarranted." Although the trial court did not make a finding that the action was willful and malicious, its findings that the litigation was unreasonable and vexatious satisfied the willful and malicious standard of section 5256(a)(6) and would be binding on the bankruptcy court. *Ball v. A.O. Smith Corp.*, 321 B.R. 100 (S.D.N.Y. 2005).

10.2.t. Sixth Circuit adopts straight *Brunner* test, rejects modified version. Previously, the Sixth Circuit had adopted a modified *Brunner* test in determining whether to permit discharge of a student loan. The court considered additional factors, such as amount, interest rate, expenses and standard of living, income and ability, and attempts to maximize repayment ability. The court recognizes, however, that the additional factors are all easily subsumed within the three *Brunner* factors of ability to maintain a minimal standard of living, likelihood that the adverse circumstances will persist for a significant portion of the repayment period, and a prior good faith effort to repay, and so concludes that it will henceforth apply the *Brunner* test in an unmodified form. Applying it here, the court rules the debtor's debt nondischargeable. The debtor had a master's degree, but he served only as the pastor of a start-up church, earning $10,000 per year. Under the circumstances, he could not show that his current circumstances will persist throughout the repayment period, nor that the circumstances were beyond his control. "Choosing a low paying job cannot merit undue hardship relief." *Oyler v. Educational Credit Mgmt. Corp.*, 397 F.3d 382 (6th Cir. 2005).

10.2.u. IRS living standards do not apply to student loan dischargeability hardship determination. A student loan may be discharged only if repayment would impose an undue hardship on the debtor. Under the *Brunner* test, repayment imposes an undue hardship only if, among other things, the debtor cannot maintain a minimal standard of living if required to repay. In determining what constitutes a minimal standard of living, the IRS Collection Financial Standards, which the IRS uses to evaluate the ability of taxpayers to repay past due taxes, do not provide the proper test. First, the IRS Standards do not focus on a "minimal" standard of living, but rather on adequate means to provide basic living expenses, and do not include such expenses as healthcare. Second, the IRS Standards are variable based on the taxpayer's family size and income, permitting higher expenses for higher income individuals. Such variability is inconsistent with the minimal standard of living test. Third, the IRS Standards do not provide for other expenses that the courts have permitted under the minimal standard test. The court rejects the creditor's argument that the IRS Standards provide a ceiling on allowable expenses, holding that the court must make an independent evaluation of the debtor's needs and expenses. *Educational Credit Mgmt. Corp. v. Howe (In re Howe)*, 319 B.R. 886 (B.A.P. 9th Cir. 2005).

10.2.v. Court may not declare nondischargeability of civil contempt sanction in advance. The bankruptcy court imposed a civil contempt sanction on the corporate debtor's principal for failing to turn over the corporation's property to the trustee and declared that the sanction would be nondischargeable in the principal's subsequent personal bankruptcy, if the principal later filed. The Ninth Circuit vacates the nondischargeability order, ruling that a bankruptcy court may determine nondischargeability only in the obligor's own personal bankruptcy, not in a case of a related entity, such as here. It notes, however, that a civil contempt sanction is generally nondischargeable under section 523(a)(7) where it is imposed to uphold the dignity and authority of the court (a conclusion of uncertain validity) and that the bankruptcy court may so note in its order so as to make a future bankruptcy court aware of the issue. *Hansbrough v. Birdsell (In re Hercules Enters., Inc.)*, 387 F.3d 1024 (9th Cir. 2004).

10.2.w. Creditor may recover nondischargeable attorney's fees under sections 523(a)(2) and (a)(6) if state law permits. The Supreme Court's decision in *Cohen v. de la Cruz*, 523 U.S. 213 (1998), permits attorney's fees in nondischargeability proceedings under section 523(a)(2) if the fees would have been recoverable in a nonbankruptcy court on the underlying claim. The same rule should apply to nondischargeability proceedings under section 523(a)(6). *Bertola v. Northern Wisconsin Produce Co., Inc. (In re Bertola)*, 317 B.R. 95 (B.A.P. 9th Cir. 2004).

10.2.x. Transferee liability for taxes is nondischargeable to the same extent as the underlying taxes. Some years after the debtor dissolved his corporation and succeeded to its assets and liabilities, he filed a chapter 7 petition. Upon a later audit, the IRS determined that the corporation had not filed an income tax return for one year and assessed the debtor for the taxes owing under the Internal Revenue Code's transferee liability provision, section 6901(a). The resulting liability was nondischargeable as a debt for a tax, because section 6901(a) provides only a mechanism for collecting a tax, not a new liability or obligation. *McKeowen v. Internal Revenue Serv.*, 370 F.3d 1023 (10th Cir. 2004).

10.2.y. False statement about an insider does not necessarily amount to a false financial statement for nondischargeability purposes. The debtor was a general partner in a partnership; the creditor was a limited partner. The debtor purchased the creditor's partnership interest with a note, but defrauded the creditor by concealing the nature and amount of assets the partnership owned at the time of sale. Although the fraud was related to an insider, it did not relate to the insider's financial condition, so the debt was nondischargeable under section 523(a)(2)(A). The creditor did not need to show a written misrepresentation, as required by section 523(a)(2)(B). Section 523(a)(2)(B) was primarily designed to limit the rights of creditors who routinely require submission of financial statements, and this was not that kind of case. *Rose v. Lauer (In re Lauer)*, 371 F.3d 406 (8th Cir. 2004).

10.2.z. Debtor's revocation of assignment of military retirement pay is not embezzlement or larceny. The debtor had retired from the military and was receiving a pension. He "sold" the pension to Structured Investments Co. for a lump sum. Because the relevant federal statute prohibits assignment of the benefits, the debtor agreed to direct to the government to deposit the monthly payments into his account, which Structured swept each month, remitting a portion back to the debtor. Just before bankruptcy, the debtor revoked the deposit instructions. Structured sought nondischargeability on the ground that the debtor had embezzled Structured's property. The bankruptcy court determines that the purported assignment of the benefits was void under the federal statute, so the payments the debtor received were not Structured's property. *Structured Invs. Co., LLC v. Price (In re Price)*, 313 B.R. 805 (Bankr. E.D. Ark. 2004).

10.2.aa. Secured taxes (including postpetition interest) are nondischargeable. Section 523(a)(1) excepts from discharge "any debt … for a tax … of the kind and for the periods specified in … section . . . 507(a)(8), whether or not a claim for such tax was filed or allowed." Section 507(a)(8) grants priority to "allowed unsecured claims of governmental units" for certain taxes. Joining with the Eleventh Circuit and splitting with the Tenth, the Ninth Circuit concludes that secured taxes are excepted from discharge. It concludes that the cross-reference in section 507(a)(8) is to the type of tax, not to the type of claim. It reasons that unsecured taxes are excepted from discharge whether or not allowed and that the taxes should similarly be nondischargeable, whether or not unsecured. As a result, postpetition, pre-confirmation

interest on a secured tax claim was not discharged under the chapter 11 plan. *Miller v. United States*, 363 F.3d 999 (9th Cir. 2004).

10.2.bb. Hiding money from the IRS results in nondischargeable taxes. A debt for a tax "with respect which the debtor willfully attempted in any manner to evade or defeat such tax" is nondischargeable under section 523(a)(1)(C). In this case, the debtor had reported the taxes owing on his tax returns but failed to pay them. In negotiations with the IRS, he failed to disclose the existence of nominee bank accounts, where he had hidden the bulk of his cash. Though he had promised payment of the taxes from certain settlements he was about to receive, he also hid the settlement payments and did not pay the taxes. In addition to proving that the debtor engaged in affirmative acts to avoid payment, the government had to prove that "the debtor voluntarily, consciously, and knowingly" evaded payment. These standards apply not only to an attempt to defeat assessment of the tax, but also an attempt to defeat payment of a tax already assessed. The taxes were therefore nondischargeable. *Stamper v. United States (In re Gardner)*, 369 F.3d 551 (6th Cir. 2004).

10.2.cc. B.A.P. interprets "statement of financial condition" in section 523(a)(2)(B) narrowly. Section 523(a)(2)(B) makes nondischargeable a debt for money obtained by use of a "statement . . . respecting the debtor's financial condition," but only if the statement is in writing. Section 523(a)(2)(A), by contrast, makes a debt incurred by false pretenses, false representation, or actual fraud nondischargeable, whether or not in writing, but only if the representation is not a "statement respecting the debtor's financial condition." In this case, the debtor orally represented to her lender that she owned specified real and personal property and that she would soon receive a new loan from her brother from which to repay the loan. Both representations were false. When the lender found a different name on the real property title records, the debtor explained that the name was hers. In fact, it was really her sister-in-law's. The lender sought nondischargeability under (A). The debtor defended on the ground that the statements were respecting her financial condition. The Tenth Circuit B.A.P. adopts a narrow interpretation of "statement respecting the debtor's financial condition" as a statement "of a debtor's net worth, overall financial health, or ability to generate income." It finds the statements concerning property ownership and the expectation of a new loan do not meet that definition and rules the debt nondischargeable. *Cadwell v. Joelson (In re Joelson)*, 307 B.R. 689 (10th Cir. B.A.P. 2004).

10.2.dd. A debt for fraud is not dischargeable as a willful and malicious injury. Generally, a ground for exception to discharge is nonexclusive of other grounds, and a creditor may plead one or more than one ground in seeking to hold a particular debt nondischargeable. In this case, the creditor contended that the debtor's oral representation about his financial condition, which would not render the debt nondischargeable under section 523(a)(2), nevertheless should be nondischargeable under section 523(a)(6) as a debt for willful and malicious injury. The creditor argued that fraud is an intentional tort, which section 523(a)(6) is intended to cover. The court rejects the contention, holding that permitting a creditor to seek nondischargeability under the willful and malicious injury provision when the injury is a loss caused by a fraudulent oral statement concerning the debtor's financial condition would permit a creditor to circumvent the strict requirement of section 523(a)(2)(B) that any misstatement regarding financial condition be in writing as a condition to nondischargeability. *Berkson v. Gulevsky (In re Gulevsky)*, 362 F.3d 961 (7th Cir. 2004).

10.2.ee. Brunner's "additional circumstances" need not be exceptional. The debtor was 51 years old, earned a moderate living for her community, expected to retire in 13 years (which would result in a reduction in her income), and had maximized her earnings potential in her community. She had no physical or mental disabilities, and there were no exceptional circumstances that interfered with her ability to repay her student loans. However, she had taken a deferral for 12 years, during which interest charges grew so that the loan was beyond her ability to repay. The *Brunner* test permits discharge only if the debtor cannot afford to repay and maintain a minimal standard of living, "additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans," and the debtor made a good faith effort to repay. The second prong does not require exceptional circumstances, such as physical or mental disability, only a showing that the circumstances are "tenacious and demonstrate insurmountable barriers to the debtor's financial recovery and ability to pay for a significant portion of the repayment period." In this case, the facts that the debtor's income had

topped out and that she was facing retirement during the repayment period met this test. *Nys v. Educational Credit Mgmt. Corp. (In re Nys)*, 308 B.R. 436 (9th Cir. B.A.P. 2004).

10.2.ff. Unpaid chapter 11 attorney's fees are discharged in subsequent chapter 7 case. The individual debtor incurred attorney's fees during his chapter 11 case, which the attorney sought to collect from the debtor after his chapter 7 discharge. The chapter 7 discharge applies to all debts incurred before the date of the chapter 7 order for relief, which is the conversion date in a case converted from another chapter. Section 348(d) requires that claims against the debtor or the estate incurred during the chapter 11 case, except administrative expense claims, be treated for all purposes as though they were incurred prepetition. Though this provision exempts administrative expenses from this requirement, it does not prohibit treatment of administrative expenses the same as prepetition claim. If it did, it would unnecessarily conflict with the chapter 7 discharge provision. Therefore, the fees were discharged. *Fickling v. Flower, Medalie & Markowitz (In re Fickling)*, 361 F.3d 172 (2d Cir. 2004).

10.2.gg. Postpetition, non-administrative chapter 11 claims are not discharged. A chapter 11 plan for an individual debtor must except from discharge any postpetition claims that are for the personal benefit of the debtor, rather than the debtor in possession or estate. They are not allowable as administrative expenses under section 503, because they are not incurred on behalf of the estate and do not provide any benefit to the estate. They are not allowable under section 502, which applies only to prepetition claims. Chapter 11 does not contain any provisions that allow a plan to deal with postpetition, non-administrative claims, and, because the claims cannot be allowed claims, their holders do not have any means of voting or objecting to the plan. Therefore, even though section 1141(d)(1)(A) contemplates discharge of all claims that arose before plan confirmation, a plan that does not except such claims from discharge is not filed in good faith, as required by section 1129(a)(3), and should not be confirmed. The court's opinion applies similar reasoning to postpetition, non-administrative tax claims and the application of section 505(a) (determination of estate's tax liability) and section 523(a)(1) (nondischargeability of tax claims). *In re Shin*, 306 B.R. 397 (Bankr. D.D.C. 2004).

10.2.hh. Debtor's fee agreement does not limit recovery under section 523(d). The debtor paid her attorney a flat fee of $595 for the bankruptcy case, $200 of which was allocated to the defense of possible nondischargeability actions. A creditor brought a nondischargeability action that was not substantially justified, entitling the debtor to an award of fees under section 523(d). The language of section 523(d) is modeled on similar language in the Equal Access to Justice Act. As such, the debtor is entitled to an award of attorney's fees regardless of the fee arrangements between the debtor and her attorney. What's more, the debtor is entitled to receive attorney's fees for making the motion to receive fees. *Sears Roebuck & Co. v. Dayton (In re Dayton)*, 306 B.R. 322 (Bankr. N.D. Cal. 2004).

10.2.ii. Tenth Circuit adopts softer Brunner test. The Tenth Circuit adopts the Second Circuit's *Brunner* test in determining dischargeability of student loans, rather than the Eighth Circuit's "totality of the circumstances" test. In doing so, however, the court criticizes lower courts that have applied the *Brunner* test too harshly. The court rules that permanent disability is not required as a condition to discharge, that "good faith attempt to repay" does not require a certain percentage or minimum amount of prior repayment, and that "a certainty of hopelessness" is not required as part of the determination that the hardship is likely to persist for a significant period of the repayment period. The court also permits consideration of other factors beyond the three stated and encourages lower courts to apply the test to carry out Congress's policy that student loans be discharged in hardship cases. *Educational Credit Management Corp. v. Polleys*, 356 F.3d 1302 (10th Cir. 2004).

10.2.jj. Unpaid tuition and fees are dischargeable. The student attended college but did not timely pay various fees and tuition. After the college obtained a judgment against the student, she filed bankruptcy and sought to have debt declared dischargeable. The Seventh Circuit concludes that the debt was not a "loan" as that term is used in section 523(a)(8). In order for it to be a loan, there must be a contract whereby one party transfers money, goods, or services to the other and intends an extension of credit to be repaid at a later time. This was not such a case. *In re Chambers*, 348 F.3d 650 (7th Cir. 2003).

10.2.kk. Tax penalties on nondischargeable taxes are dischargeable. The debtor had agreed with the IRS to an open extension of time to assess taxes for tax years that ended more than three years before the petition date. Accordingly, the taxes were nondischargeable under section 523(a)(1)(A). The tax penalties on those taxes, however, were dischargeable. The exception to discharge in section 523(a)(7) permits discharge of tax penalties for dischargeable taxes or for taxes "imposed with respect to a transaction or event that occurred before three years before the date of the filing of the petition." The court construes the latter phrase to include the filing of the income tax return for the tax year in question as the "transaction or event" and permits discharge of the related tax penalties. *Miller v. Internal Revenue Service (In re Miller)*, 300 B.R. 422 (Bankr. N.D. Ohio 2003).

10.2.ll. Corporate officer is not a fiduciary under section 523(a)(4). Section 523(a)(4) renders nondischargeable a debt for defalcation while acting in a fiduciary capacity. A corporate officer that misuses corporate funds is a fiduciary based on a relationship arising from an express or technical trust that is required to come within the terms of section 523(a)(4). *Cal-Micro, Inc. v. Cantrell (In re Cantrell)*, 329 F.3d 1120 (9th Cir. 2003).

10.2.mm. Contempt citation excepted from discharge as willful and malicious injury. The individual debtor breached a union contract by hiring non-union employees. The district court ordered restitution for the breach and ordered future compliance with the contract. The debtor later hired non-union employees again. The district court imposed sanctions for violation of the prior order. The first award was dischargeable, because an intentional breach of contract is not by itself "willful and malicious injury," and the union did not show that the debtor intended to injury the union by the conduct. However, knowing violation of a court order resulting in contempt sanctions constituted willful and malicious injury, because the violation was knowing and was substantially certain to inflict injury on the union. *Williams v. International Brotherhood of Electrical Workers (In re Williams)*, 337 F.3d 504 (5th Cir. 2003).

10.2.nn. Post petition attorney's fees are discharged. Before bankruptcy, the debtor had brought an action against her former employer. After bankruptcy, and after some preliminary litigation about whether she could exempt the action, she exempted it and continued to pursue it. She ultimately lost, and the state court awarded attorney's fees against her. In a sharply divided opinion, the Ninth Circuit B.A.P. attempts to construe confusing Ninth Circuit precedent on the dischargeability of the post petition attorney's fees that the state court awarded against the debtor. It concludes that because the action was based on prepetition conduct and was commenced prepetition, the attorney's fees should be discharged. It concludes, however, that the discharge injunction did not apply to the grant of attorney's fees, because the grant occurred in a creditor's post petition defensive action in a prepetition suit brought by the debtor. *Ybarra v. Boeing North American, Inc. (In re Ybarra)*, 295 B.R. 609 (9th Cir. B.A.P. 2003).

10.2.oo. Nevada law applied to enforceability of gambling debt. The debtor incurred gambling debt in Nevada and later filed bankruptcy in California. The casino sought to have the debt held non-dischargeable. The bankruptcy court dismissed the complaint on the ground that the debt was not enforceable in California. The B.A.P. reverses, holding that Nevada law applies to a gambling debt incurred in Nevada. Therefore, the casino may try the non-dischargeability claim in the California bankruptcy court. *Mandalay Resort Group v. Miller (In re Miller)*, 292 B.R. 409 (9th Cir. B.A.P. 2003).

10.2.pp. Debtor must meet Brunner hardship test for partial disallowance of student loan. In *Brunner v. New York*, 831 F.2d 395 (2d Cir. 1987), the Second Circuit set out the widely accepted test for determining whether a debtor meets the "undue hardship" requirement for discharge of a student loan. In this case, the Eleventh Circuit adopts the *Brunner* test, as have the Third, Fourth, Seventh, and Ninth (differing from the Sixth and Eighth Circuits). The bankruptcy judge granted the debtor a partial discharge without specifically making the *Brunner* findings. In a case of apparent first impression, the Eleventh Circuit rules that the Debtor must meet the *Brunner* undue hardship test even for a partial discharge. *Hemar Ins. Corp. v. Cox (In re Cox)*, 338 F.3d 1238 (11th Cir. 2003).

10.2.qq. Debt novation agreement does not preclude non-dischargeability. The creditor sued the debtor in state court for fraud but settled for a lesser amount, including a cash payment and a promissory note, and released all underlying claims. The debtor defaulted on the note and filed bankruptcy. The

creditor sought to have the note declared non-dischargeable on the grounds that it was for a debt incurred by fraud. The Supreme Court, relying on its prior decision in *Brown v. Felsen*, 442 U.S. 127 (1979), concludes that despite the release, the underlying debt may have been incurred by fraud and the settlement does not preclude the creditor from pursuing non-dischargeability on that ground as a matter of bankruptcy law, although the court leaves to the lower courts the question of whether state court principles of claim preclusion would prevent such a claim of fraud. *Archer v. Warner*, 123 S. Ct. 1462 (2003).

10.2.rr. State statute may not declare certain debts non-dischargeable. A Colorado statute provides that any liability for certain automobile accidents are for "willful and malicious injuries," which would make them non-dischargeable under section 523(a)(6). Such a state legislative determination would preempt the exclusive jurisdiction of the bankruptcy courts to determine whether the grounds for non-dischargeability have been met in a particular case, and the statute may not be enforced to render debts non-dischargeable. *Farmers Ins. Exchange v. Mills (In re Mills)*, 290 B.R. 822 (Bankr. D. Colo. 2003).

10.2.ss. An agent's fraud may render a debt non-dischargeable. The debtor's husband defrauded the creditor, who obtained a state court judgment against the debtor and her husband. After the debtor filed bankruptcy, the creditor sought to have the debt declared non-dischargeable as a debt incurred by actual fraud. The Ninth Circuit B.A.P. rules that the marital relationship alone does not give rise to such a principal/agent relationship that fraud of the agent may be imputed to the principal (here, the debtor). However, the bankruptcy court found, and the B.A.P. affirms, that the debtor and her husband were actually partners in a business partnership. Because each partner is the agent of the other, the fraud could be imputed, and the debt was non-dischargeable. *Tsurukawa v. Nikon Precision, Inc. (In re Tsurukawa)*, 287 B.R. 515 (9th Cir. B.A.P. 2002).

10.2.tt. First Circuit sets high standard for defalcation. A debt is non-dischargeable under section 523(a)(4) if the debt is "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." In a case of first impression on an issue that has split other circuits, the First Circuit construes "defalcation" narrowly to require more than innocent mistake, negligence, or civil recklessness, requiring instead "some degree of fault, closer to fraud, without the necessity of meeting a strict specific intent requirement." Accordingly, a debtor who served as trustee of an express trust and breached a duty of loyalty to the trust, causing payment of his own expenses out of the trust for his own personal benefit, was guilty of defalcation while acting in a fiduciary capacity, and the resulting debt was non-dischargeable. By contrast, the loss that the trust and its beneficiaries suffered by the debtors flawed and negligent judgments in administering the trust were not reckless and therefore did not constitute a defalcation. *Rutanen v. Baylis (In re Baylis)*, 313 F.3d 9 (1st Cir. 2002).

10.2.uu. ERISA contribution obligations were non-dischargeable in the bankruptcy of the employer's president. The employer was owned and controlled by two individuals. In the months before bankruptcy, the employer did not make required pension and welfare plan contributions, although it made numerous payments to or for the personal benefit of the two individual shareholders, directors, and officers. One of the individuals subsequently filed bankruptcy. The pension plan sought to hold the individual liable for the plan contributions and to hold the obligation non-dischargeable under section 523(a)(4) (fraud or defalcation while acting in a fiduciary capacity). The court rules that the individual was a plan fiduciary, that the debt owing from the employer corporation to the plans were plan assets, that the failure to pay the plan constituted a defalcation (which the court rules is broadly defined to include ordinary negligence or mistake), that the individual was therefore personally liable to the funds for breach of his fiduciary duty, and that the obligation was non-dischargeable because it arose from defalcation. *Hunter v. Philpott (In re Philpott)*, 281 B.R. 271 (Bankr. W.D. Ark. 2002).

10.2.vv. Corporate officer's guarantee debt is non-dischargeable under section 523(a)(4). The individual debtor was the shareholder, director, and officer of a travel agency, which had entered into an Agent Reporting Agreement with Airlines Reporting Corporation. The Agreement provided that the travel agent would hold ticket proceeds in trust for ARC. The individual guaranteed the agency's obligations to ARC. When the agency did not hold the funds in trust for ARC and, with its individual shareholder, filed bankruptcy petitions, ARC sought to hold the individual's debt non-dischargeable for defalcation while acting in a fiduciary capacity under section 523(a)(4). Over a vigorous (and well reasoned) dissent, the

Fourth Circuit rules that the individual did not owe a fiduciary duty to ARC but that he did owe a duty to his travel agency, which owed a fiduciary duty to the creditor, which the individual caused the travel agency to breach. Those facts, combined with the personal guaranty, made the debt one for defalcation while acting in a fiduciary capacity even though the fiduciary capacity was not to the creditor. *Airlines Reporting Corporation v. Ellison (In re Ellison)*, 296 F.3d 266 (4th Cir. 2002).

10.2.ww. Once non-dischargeable, always non-dischargeable. Section 523(b) provides that a debt that was excepted from discharge in a prior case under section 523(a)(1) (taxes) (a)(3) (unscheduled), or (a)(8) (educational loans) may be discharged in a subsequent case. The Ninth Circuit B.A.P. reads this section as an exception to the general rule that a debt excepted from discharge in a prior case is always non-dischargeable under principles of *res judicata*. In this case, the debtor failed to schedule the creditor in the prior case. The discharge was granted. Later, the bankruptcy court concluded that the creditor's debt should be excepted from discharge under due process principles. The debtor did not appeal that judgment, but several years later filed another bankruptcy, seeking to discharge the creditor's debt. Because the debt was excepted from discharge in the prior case, it is excepted from discharge in the current case. *Paine v. Griffin (In re Paine)*, 283 B.R. 33 (9th Cir. B.A.P. 2002).

10.2.xx. A non-dischargeability complaint under section 523(a)(3) may be barred by laches. Section 523(a)(3)(B) excepts from the deadline of section 523(c) certain complaints to determine non-dischargeability by a creditor whose claim has not been listed or scheduled and who does not receive notice or knowledge of the bankruptcy case to permit timely filing of a non-dischargeability complaint. Bankruptcy Rule 4007(b) permits such a complaint to be filed "at any time." The Ninth Circuit rules that despite the "at any time" language, a creditor may be barred by laches from bringing a non-dischargeability complaint under section 523(a)(3)(B). However, the debtor must make a heightened showing of the unreasonableness of the creditor's delay and the prejudice to the debtor, because it was the debtor's omission of the creditor's claim on the schedules in the first place that permitted the creditor the longer time to file the non-dischargeability complaint. *Beaty v. Selinger (In re Beaty)*, 306 F.3d 914 (9th Cir. 2002).

10.2.yy. Pre-bankruptcy waivers are against public policy. In settlement of an action for repayment of a loan and for fraud, the debtor agreed that she would not file a bankruptcy petition and that if she did, the debt arising from the settlement agreement would be non-dischargeable and the bank would have immediate relief from the automatic stay to enforce the settlement agreement and a security interest granted to secure payment. Fourteen months later, the debtor filed bankruptcy. The bank argued non-dischargeability on the ground of fraud and collateral estoppel based on the settlement in the pre-bankruptcy lawsuit. The Ninth Circuit rules that it is against public policy for a debtor to waive pre-petition protection of the Bankruptcy Code, including all three waivers contained in the settlement agreement. The Ninth Circuit also rules that because the fraud was not admitted in the settlement agreement, nor was it necessary to the debtor's liability in the pre-petition action, collateral estoppel did not apply. *Bank of China v. Huang*, 275 F.3d 1174 (9th Cir. 2002).

10.2.zz. Chapter 13 filing tolls three-year look-back for income tax dischargeability. The debtor had filed a chapter 13 within three years after an income tax return was due, entitling the tax claim to priority and non-dischargeability. The debtor later dismissed the chapter 13 case and filed a chapter 7 case more than three years after the tax return was due. The Supreme Court holds that the pendency of the chapter 13 case, which prevented the IRS from enforcing the tax claim against the debtor, tolled the three-year period of section 507(a)(8)(A). The Supreme Court characterizes the three year period as a statute of limitations and applies the doctrine of equitable tolling to conclude that it would be inequitable to permit the statute to run while the IRS was prohibited from taking collection action. *Young v. United States*, 535 U.S. 43 (2002).

10.2.aaa. Laches does not apply to a non-dischargeability complaint for an unscheduled debt. Bankruptcy Rule 4007(a) permits a complaint to determine dischargeability under section 523(a)(3)(B) (unscheduled claims) to be filed "at any time." Because of this Rule, the debtor may not assert laches as a defense to a non-dischargeability complaint for an unscheduled claim even where, as in this case, the

complaint was brought only after the creditor lost on his complaint to deny discharge under section 727. *Selinger v. Beaty (In re Beaty)*, 268 B.R. 839 (9th Cir. B.A.P. 2001).

10.2.bbb. Covenant not to compete is not discharged. Under Iowa law, a breach of a covenant not to compete may give rise to a claim for money damages for past violations, but the plaintiff may obtain an injunction for future violations only if money damages are inadequate. The Sixth Circuit concludes, therefore, that equitable relief is not an alternative to a right to payment for future injuries. Accordingly, the right to an equitable remedy does not give rise to a right to payment (as required for it to be included in the definition of claim under section 101(5)(B)), and the covenant not to compete is not discharged. *Kennedy v. Medicap Pharmacies, Inc.*, 267 F.3d 493 (6th Cir. 2001).

10.2.ccc. Due process for dischargeability requires more than mere knowledge of bankruptcy case. The debtor terminated its pension plan during its chapter 11 case, giving notice to all individual pension claimants that the termination would not affect their rights. Years later, a retired employee sued the debtor for reduction in pension benefits by reason of the termination. The debtor defended on discharge grounds. Holding that *Mullane v. Central Hanover Bank*, 339 U.S. 306 (1950), requires an analysis of the particular facts of each case to determine whether notice of the bankruptcy was adequate, the Fifth Circuit rejects a rule that mere knowledge of the bankruptcy case is adequate to bar unfiled claims. The Fifth Circuit rules that due process requires the debtor to refrain from assuring potential claimants that their rights will not be adversely affected during bankruptcy proceedings, lest the claimant be falsely lulled into not filing a proof of claim. *Christopher v. Kendavis Holding Co. (In re Kendavis Holding Co.)*, 249 F.3d 383 (5th Cir. 2001).

10.2.ddd. Vicarious fraudulent liability is non-dischargeable. One of three partners in an accounting firm defrauded a client by diverting the client's cash to his own use. The two innocent partners received no benefit from the money. In the bankruptcy of the two innocent partners, the client sought to have the claim declared non-dischargeable. Holding that the receipt of a benefit is not a requirement of the non-dischargeability statute, the Fifth Circuit holds the debts non-dischargeable. *Deodati v. M.N. Winkler & Assocs. (In re M.N. Winkler & Assocs.)*, 239 F.3d 746 (5th Cir. 2001).

10.2.eee. Rooker-Feldman doctrine does not permit review of state court dischargeability determination. The creditors, who were not listed on the debtor's list of creditors, sued the debtors in state court two years after the debtor's discharge. The state court concluded that the debt was not discharged under section 523(a)(3). The bankruptcy court refused to rule otherwise, based on the *Rooker-Feldman* doctrine, relying to a degree on the Ninth Circuit panel decision in *In re Gruntz*, 166 F.3d 1020 (9th Cir. 1999), before it was withdrawn and overruled *en banc*. The court also did not credit section 524(a), which voids non-bankruptcy court judgments as part of the discharge injunction. *In re Toussaint*, 259 B.R. 96 (Bankr. E.D.N.C. 2000).

10.2.fff. Fraud exception to discharge is broader than a fraudulent misrepresentation. The debtor was a participant in her brother's actual fraudulent transfer to her of assets subject to the brother's creditors' security interests. When she filed bankruptcy, the creditors sought to have the claim against her for receiving the fraudulent transfer declared nondischargeable under section 523(a)(2) as a "debt for money, property, or services obtained by actual fraud." The court rules that her participation in a fraudulent transfer, even though it did not involve a false representation or a material omission, constituted actual fraud for purposes of section 523(a)(2). *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000).

10.2.ggg. Willful attempt to evade or defeat payment of taxes creates a nondischargeable claim. Reversing its prior panel ruling, 174 F.3d 1222 (11th Cir. 1999) and its prior decision in *In re Haas*, 48 F.3d 1153 (11th Cir. 1995), the Eleventh Circuit joins four other circuits in ruling that a willful attempt to evade or defeat payment of taxes is non-dischargeable under section 523(a)(1)(C), not just a willful attempt to evade or defeat a tax. In this case, because the debtor had made fraudulent transfers into trust to evade payment of the taxes, the court concluded that the outstanding tax debt was non-dischargeable, acknowledging that something more than mere non-payment is required for non-dischargeability. *Griffith v. United States (In re Griffith)*, 206 F.3d 1389 (11th Cir. 2000).

10.2.hhh. Court awards debtor attorney's fees under section 523(d). Finding a pervasive pattern of creditors bringing dischargeability complaints under section 523(a)(2) alleging fraud based on the debtor's inability to repay credit card charges and advances to obtain unwarranted settlements, the bankruptcy court reiterates its previously announced high burden of proof for such complaints and holds the creditor liable for attorney's fees under section 523(d) on the ground that the creditor should have known not to bring such a complaint solely to obtain settlement leverage. *Universal Bank N.A. v. Rocco (In re Rocco)*, 239 B.R. 297 (Bankr. E.D. Pa. 1999).

10.2.iii. SEC disgorgement claim is non-dischargeable. In an expansive reading of section 523(a)(2)(A), the Eleventh Circuit rules that the amount owing to the SEC in a civil disgorgement action for securities fraud falls within the fraud exception to discharge. The court substitutes the concept of materiality under the securities laws for the concept of reliance under general fraud principles in applying the discharge exception. *Securities and Exchange Commission v. Bilzerian (In re Bilzerian)*, 153 F.3d 1298 (11th Cir. 1998).

10.2.jjj. Chapter 11 does not discharge ERISA withdrawal liability for a post-confirmation withdrawal. Reading "contingent" in the definition of "claim" in section 101(4) narrowly, the Sixth Circuit rules that the possibility that a chapter 11 debtor might withdraw from a multi-employer pension plan after confirmation is not enough to render the potential withdrawal liability "contingent" before confirmation so as to make the potential liability a dischargeable claim. *CPT Holdings, Inc. v. Industrial and Allied Employees Union Pension Plan*, Local 73, 162 F.3d 405 (6th Cir. 1998).

10.2.kkk. Punitive damages for fraud are not dischargeable. The debtor fraudulently obtained money from the creditor, who obtained treble damages against the debtor under state law. The treble damages as well as the actual compensatory damages were nondischargeable under section 523(a)(2)(A) as a "debt ... for money ... to the extent obtained by ... fraud." Parsing the language of the statute, reviewing prior practice under the Bankruptcy Act, and discerning Congress's policy in excepting debts for fraud from discharge, the Supreme Court concludes that the "debt" for "money to the extent obtained by fraud" is for the full amount of compensatory and punitive damages. *Cohen v. De La Cruz*, 118 S. Ct. 1212 (1998).

10.2.lll. "Willful and malicious injury" means intentional tort. The creditor had a judgment against the doctor/debtor for gross negligence and reckless medical malpractice. The debt was not non-dischargeable as "willful and malicious injury" under section 523(a)(6). The phrase does not cover acts done intentionally that cause injury, only acts done with actual intent to cause injury, that is, intentional torts. *Kawaauhau v. Geiger*, 118 S. Ct. 974 (1998).

10.2.mmm. Oral statements transcribed by creditor are not a "written financial statement." The credit card company took the debtor's application and financial information over the phone and input the information into the company's computer. Such information is not a "statement in writing … respecting the debtor's … financial condition," as required by the section 523(a)(2)(B) false financial statement exception to discharge. The Tenth Circuit holds forth on the duty of a creditor to be prudent in investigating the risk of extension of credit. *Bellco First Federal Credit Union v. Kaspar (In re Kaspar)*, 125 F.3d 1358 (10th Cir. 1997).

10.2.nnn. Medical malpractice is not "willful and malicious injury." A doctor's negligence, even reckless, does not rise to the level of a "willful" injury for purposes of the section 523(a)(6) ground of nondischargeability. Willfulness requires an intentional tort, that is, and intention to commit harm, not merely an intentional act that results in harm. *Geiger v. Kawaauhau (In re Geiger)*, 113 F.3d 848 (8th Cir. 1997), cert. granted.

10.2.ooo. Medical malpractice is not "willful and malicious injury" or fraud in a fiduciary relation. The doctor misperformed amniocentesis. The doctor-patient relationship does not create a fiduciary relationship for purposes of nondischargeability under section 523(a)(4)."Willful and malicious" for purposes of section 523(a)(6) requires a wrongful act which necessarily produced harm. Thus, neither ground prevents discharge of the malpractice judgment. However, the doctor's representation of the need

for amniocentesis to the mother of the injured creditor could give rise to fraud under section 523(a)(2), even though the debt was not for "money obtained" and the allegedly representation was not made "to the creditor." *Lee-Benner v. Gergely (In re Gergely)*, 110 F.3d 1448 (9th Cir. 1997).

10.2.ppp. Creditors have only one chance to litigate dischargeability in a conv€erted case. The creditor filed a dischargeability complaint after the deadline in the chapter 11 case, and the complain was dismissed. The case was converted, and a new deadline was set as part of the notice to creditors of the 341 meeting. The creditor filed another dischargeability complaint in the chapter 7 case. The B.A.P. holds that the first dismissal constituted an adjudication on the merits, barring the creditor from bringing the dischargeability action in the chapter 7 case. The B.A.P. distinguishes the situation in which a creditor does not file a complaint in the chapter 11 case, as there is then no adjudication on the merits preceding the chapter 7 case filing. *Marino v. Classic Auto Refinishing, Inc. (In re Marino)*, 213 B.R. 846 (9th Cir. B.A.P. 1997).

10.3 Exemptions

10.3.a. Michigan's bankruptcy-specific exemption scheme is constitutional. Michigan permits a debtor in a bankruptcy case to elect the federal exemptions under section 522(d), the general state exemptions or more generous, bankruptcy-specific state exemptions. In general, states retain the power to act in bankruptcy-related matters where Congress has declined to act or where it has permitted the states to act. Section 522(b) permits a state to make the federal exemption scheme of section 522(d) unavailable to debtors in that state. It neither permits nor prohibits any other state-based exemption schemes and thus shows that Congress has not restricted the states' authority to prescribe bankruptcy-specific exemptions. Second, the Uniformity Clause provides a substantive limit on bankruptcy laws. It requires geographic, not personal, uniformity. It does not require uniformity between bankruptcy debtors and non-bankruptcy debtors, only among bankruptcy debtors within the same state. Therefore, a federal bankruptcy law may incorporate applicable state law without violating uniformity. Third, federal law may preempt state law if preemption is explicit, if Congress occupies the field or if it is impossible for a party to comply with both federal and state law simultaneously. Section 522(b) does not explicitly preempt a bankruptcy-specific exemption statute. States' authority to opt out shows that Congress did not occupy the field. And it is not impossible for a debtor to comply with Michigan's three-option exemption scheme. Therefore, there is no preemption. Michigan's bankruptcy-specific exemption scheme is constitutional. *Richardson v. Schafer (In re Schafer)*, 689 F.3d 601 (6th Cir. 2012).

10.3.b. Michigan bankruptcy-only exemption statute violates the Bankruptcy Clause. Michigan did not opt out of federal exemptions under section 522(d) but enacted separate state exemptions for debtors in bankruptcy. The Constitution's Bankruptcy Clause permits Congress to enact uniform laws on the subject of bankruptcies. The Constitution imposed the uniformity requirement to prevent disparate state laws and "replace a hodgepodge of bankruptcy relief with one national system". It therefore restricts the states' power to legislate. Uniformity is geographic, not personal. Within a state, bankruptcy and non-bankruptcy debtors and their creditors must receive the same treatment. Therefore, the different treatment for those who file bankruptcy is unconstitutional. *Richardson v. Schafer (In re Schafer)*, 2011 Bankr. LEXIS 564 (6th Cir. B.A.P. Feb. 17, 2011).

10.3.c. The trustee is entitled to postpetition appreciation in exempt assets. The debtor's equity interest in his encumbered home was less than the applicable homestead exemption. He claimed the interest as exempt. Three years later, the real property had appreciated to a value that exceeded his exemption and the mortgage. The bankruptcy case was still open, so the trustee moved to sell the house to realize the value over the lien and exemption amounts. Section 522(b)(1) permits a debtor to exempt an interest in property, not the property itself, up to the amount of the allowable exemption. Thus, where the total fair market value of the property exceeds the allowable exemption, the excess remains property of the estate, whether the excess existed at the petition date or resulted from postpetition appreciation. The debtor may petition under section 554(b) for abandonment of the asset, but absent abandonment, the asset remains property of the estate that the trustee may sell. *Gebhart v. Gaughan (In re Gebhart)*, 621 F.3d 1206 (9th Cir. 2010).

10.3.d. Trustee need not object to debtor's valuation of exempt property. The debtor claimed property as exempt. The debtor valued the property at less than the maximum allowed exemption and listed her valuation in the exemption claim. The trustee did not object within the 30-day period permitted under Bankruptcy Rule 4003(b) but later moved to sell the property for more than the debtor's valuation and more than the permitted exemption amount. Section 522(*l*) provides that "unless a party in interest objects, the property claimed as exempt [on the Schedules] is exempt". Section 522(d) provides that the debtor's exemption is the debtor's interest, not to exceed a specified dollar amount, not an unlimited interest in the property. Where the debtor claims an exemption of a value of property that is less than the limit, the exemption claim is proper, up to that value, so the trustee need not object to the exemption claim to preserve his right to object to the valuation. To preserve her right to claim the full property in kind as exempt and still require the trustee to raise any valuation objection within the 30-day period, the debtor must value the property either as "unknown", as "100% of fair market value" or at a dollar value above the exemption limits. *Schwab v. Reilly*, 560 U.S. ___, 130 S. Ct. 2652 (2010).

10.3.e. Bankruptcy Code does not preempt bankruptcy-only state exemption scheme. West Virginia opted out under section 522(b) of the Bankruptcy Code's federal exemption scheme and enacted, in addition to its general exemption scheme for judgment debtors, a bankruptcy-only exemption scheme that is similar but not identical to the Bankruptcy Code's federal exemptions. A federal law preempts a state law if Congress expressly declares an intention to preempt, if Congress "occupies the field" by the breadth of the federal legislation or if the state law actually conflicts with federal law. However, federal law does not preempt where Congress expressly authorizes state law on the subject. Here, section 522(b) expressly authorizes the states to opt out of the federal exemption scheme, which is "an express delegation to the states of the power to create state exemptions in lieu of the federal bankruptcy exemption scheme" without restriction. *Sheehan v. Pevich*, 574 F.3d 248 (4th Cir. 2009).

10.3.f. Bankruptcy court may not surcharge exempt property as remedy for noncompliance with turnover order. The bankruptcy court ordered the debtors to turnover nonexempt funds to the estate. The debtors refused. The trustee sought to surcharge the debtors' exempt retirement funds in the amount of the withheld funds. Section 105(a) authorizes a bankruptcy court to enforce its orders but does not authorize an order that is inconsistent with the Code. The Bankruptcy Code authorizes a debtor to exempt certain assets from property of the estate but contains limited exceptions, in sections 522(c) and (k), that permit otherwise exempt assets to be used to satisfy prepetition claims. A surcharge order is inconsistent with the Code's exemption scheme, because it would engraft an additional non-statutory exception. Therefore, the court may not surcharge the debtors' exemption for failure to comply with the turnover order. *Scrivner v. Mashburn (In re Scrivner)*, 535 F.3d 1258 (10th Cir. 2008).

10.3.g. Applying debtor's prior domicile state's exemptions does not violate the Uniformity Clause. Section 522(b)(3) requires a debtor who has moved within 730 days before filing a bankruptcy petition to use the exemption laws of his or her prior state or, if that requirement renders the debtor ineligible for any state's exemptions, then to use the federal exemptions under section 522(d). Here, the debtor moved from California to Montana within that 730-day period and claimed California exemptions. Section 522(b)(3) does not violate the Uniformity Clause. The Uniformity Clause requires either geographic uniformity (that is, that the statute apply equally to all similarly situated persons throughout the United States) or class uniformity (that is, that the statute apply equally to all members of a defined class, even though its application may vary from state to state due to the incorporation of state law). Here, the statute applies equally to all debtors who move within 730 days before bankruptcy and thus satisfies the uniformity requirement. *Drummond v. Urban (In re Urban)*, 375 B.R. 882 (9th Cir. B.A.P. 2007).

10.3.h. $125,000 homestead cap does not apply to homestead acquired through regular mortgage payments. The debtors bought their home more than five years before bankruptcy. They continued to make regular monthly mortgage payments, thereby increasing the equity in their home. They claimed the home equity as exempt under Texas's generous homestead exemption law. A creditor objected to the claim under section 522(p), which limits to $125,000 "any interest that was acquired by the debtor during the 1215-day period" before bankruptcy. The provision does not apply to ordinary increase in equity resulting from mortgage payments, because the increase in equity is not an "interest" that a debtor "acquires." *In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005).

10.3.i. Limitation on recently acquired homestead applies only in non-opt-out states. Section 522(p), added by BAPCPA 2005, limits a homestead claim "as a result of electing under subsection (b)(3)(A) to exempt property under State or local law" to $125,000 if the homestead was acquired within 1215 days before the date of the filing of the petition. The court reasons that a debtor claims a homestead "as a result of electing under subsection (b)(3)(A)" only in those states that have not opted out from the federal election scheme under section 522(b)(2), because in opt-out states, the debtor claims a homestead only under state law and does not make an election. *In re McNabb*, 326 B.R. 785 (Bankr. D. Ariz. 2005).

10.3.j. An IRA is exempt. The debtors had interests in IRAs, which they attempted to exempt under section 522(b)(10)(D), which exempts "a right to receive a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age or length of service." The trustee argued that the debtors could withdraw funds from their IRAs at any time, subject only to a 10% tax penalty, so withdrawals from an IRA are not based on age. The Supreme Court rules that the tax penalty is a substantial restriction on early withdrawal, so that the right to receive payment under the plan is on account of age. An IRA is "similar" to a pension plan for the same reason. It is intended as income replacement after retirement. Therefore, the IRAs are exempt. *Rousey v. Jacoway*, 125 S. Ct. 1561 (2005).

10.3.k. Florida homestead withstands attack from creditor asserting sanctions claim under section 303(i); judicial lien may be avoided. The debtor had filed an involuntary petition in bad faith against JRH in Michigan. The Michigan bankruptcy court dismissed the petition and awarded over $4 million in sanctions against the debtor under section 303(i). The debtor promptly bought a homestead in Florida for $2.8 million. The Michigan bankruptcy court found that the Florida property did not qualify as a homestead, because the sanctions order under section 303(i) preempted Florida homestead law, and ordered the debtor to sell the property to satisfy the sanctions award. When the debtor could not obtain a stay pending appeal of the Michigan order, he filed a chapter 11 case in Florida. The Florida bankruptcy court upholds the exemption claim despite the Michigan court's prior ruling, because the sanctions order is no different from an ordinary money judgment, which would not preempt the homestead law. *In re Adell*, 321 B.R. 562 (Bankr. M.D. Fla. 2005). In addition, JRH had obtained a judgment lien against the real property under Florida law. The debtor sought to avoid it under section 522(f)(1). The debtor may avoid the lien, no matter what its source or the nature of the underlying claim, for example, even if the claim were nondischargeable. Therefore, the lien may be avoided under section 522(f)(1). *In re Adell*, 321 B.R. 573 (Bankr. M.D. Fla. 2005).

10.3.l. Debtor may avoid a judicial lien that impairs an exemption that is senior to a consensual lien. The creditor obtained and perfected a judicial lien on the debtor's homestead, which the debtor refinanced without payoff of the senior judicial lien. After bankruptcy, the debtor could avoid the judicial lien on the ground that it impaired her exemption, even though it was the subsequent grant of a consensual lien that over-encumbered the property and impaired the exemption. The arithmetic formula in section 522(f)(2)(A) dictates the results, despite any policy arguments to the contrary. When applied to this situation, the judicial lien impairs the exemption, because the sum of the liens and the debtor's exemption exceeds the value of the property. *Moldo v. Charnock (In re Charnock)*, 318 B.R. 720 (B.A.P. 9th Cir. 2004).

10.3.m. Michigan tenancy by the entirety law "preserved." The filing of a bankruptcy petition in Michigan does not sever a tenancy by the entireties, and the former practice in Michigan will prevail. *In re Spears*, 313 B.R. 212 (W.D. Mich. 2004), *rev'g* 308 B.R. 793 (Bankr. W.D. Mich. 2004).

10.3.n. IRA is not exempt. The debtors had rolled over a 401(k) account from their prior employers into IRAs. A pension or similar plan is exempt under section 522(d)(10)(E) only if, among other things, payments under the plan are "on account of illness, disability, death, age, or length of service." Because an IRA holder can withdraw the funds at any time, albeit with serious adverse tax consequences, an IRA does not qualify as exempt under this provision. *Rousey v. Jacoway (In re Rousey)*, 347 F.3d 689 (8th Cir. 2003).

10.3.o. Bankruptcy filing terminates tenancy by the entirety. Following a close textual analysis of the Bankruptcy Code and the Michigan law of tenancy by the entireties, the court concludes that the filing of a bankruptcy petition by only one spouse terminates the tenancy by the entirety, because the filing of the petition effects the transfer of the debtor's interest in the property to the estate, thus severing the tenancy and converting it into a tenancy in common. The court rejects the application of the state law property rule despite *Butner v. United States*, 440 U.S. 48 (1979), because that case excepted the application of state law where a compelling federal interest required otherwise. The court concludes that the Bankruptcy Code's language evidences just such a compelling federal interest and a Congressional determination to sever the tenancy upon the creation of the estate. As a result, the debtor may not rely on the *Trickett* procedure (*In re Trickett*, 14 B.R. 85 (Bankr. W.D. Mich. 1981)), which permitted joint creditors to file joint proofs of claims against the estate, which were to be paid from the proceeds of the entireties property, sold under section 363(h), with any surplus returned to the debtor as an exemption. Instead, the debtor may claim an exemption only in the estate's undivided equity (net after secured and joint claims) in the former entireties property, which the trustee may sell under section 363(h), returning to the nondebtor spouse one-half of the proceeds. Joint and separate creditors would both share in the aggregate estate on the same basis. That is, joint creditors would not have a special claim to the former entireties property proceeds. The court notes the result would be different under New York entireties law, because New York treats the unilateral transfer of an entireties interest differently from Michigan. *In re Spears*, 308 B.R. 793 (Bankr. W.D. Mich. 2004).

10.3.p. Court permits surcharge of exemptions as remedy for asset concealment. Days before bankruptcy, the debtors sold a car and a boat for $8,500. They did not report the sales, reported and exempted only $1,500 of the cash proceeds on their schedules, and did not explain the loss of the remaining proceeds. When the trustee found out, he successfully sought to deny the debtors' discharge. The trustee subsequently sought to surcharge the debtors' exemptions by $7,000. The surcharge was not barred by *res judicata*, because the issues on an objection to discharge are different from those on an exemption surcharge motion and, because of the Rule 4004(a) deadline for objecting to discharge, must be brought much earlier than an exemption surcharge motion. Despite the absence of statutory authorization, the exemption surcharge was within the bankruptcy court's equitable powers when reasonably necessary to protect the integrity of the bankruptcy process and prevent excess exemption claims, because it allowed the bankruptcy court to prevent the debtors from effectively gaining additional exemptions (the ones claimed plus the hidden funds) by concealing their assets. *Latman v. Burdette*, 366 F.3d 774 (9th Cir. 2004).

10.3.q. Conversion of non-exempt assets to exempt assets before bankruptcy is not *__per se__* fraudulent. On the eve of bankruptcy, the debtor transferred non-exempt IRA funds into an exempt pension plan. The trustee attacked the transfer as a fraudulent transfer. The Ninth Circuit, reaffirming its 1971 Bankruptcy Act ruling in *Wudrick v. Clements*, 451 F.2d 988 (9th Cir. 1971), holds that deliberate conversion of non-exempt assets to exempt assets just before bankruptcy will not, by itself, support a finding of fraud or support avoidance as a fraudulent transfer. *Gill v. Stern (In re Stern)*, 317 F.3d 1111 (9th Cir. 2003).

10.3.r. Entireties property is exempt in a consolidated joint case. The husband and wife debtors filed a joint case. They owned their home in tenancy by the entirety. They each had separate unsecured creditors and no joint creditors other than the mortgage lender. The bankruptcy court ordered substantive consolidation of their cases. Nevertheless, because the entireties property was exempt from process under applicable non-bankruptcy [Virginia] law, even the substantive consolidation of the estates, which is strictly a bankruptcy remedy, did not defeat the debtors' exemption claim. *Bunker v. Peyton (In re Bunker)*, 312 F.3d 146 (4th Cir. 2002).

10.3.s. Debtor may avoid judicial lien on former homestead. The creditor obtained a judicial lien on the debtor's residence, which the debtor claimed as exempt in its subsequent chapter 7 case. After the trustee sold the residence, the debtor sought to avoid the fixing of the judicial lien so that it could receive the benefit of the proceeds of sale and the debtor's exemption. The Ninth Circuit rules that because the debtor avoids "the fixing" of the lien rather than the lien itself, neither the debtor nor the estate need own the property at the time the debtor brings the action to avoid the fixing of the lien. It is sufficient if the

estate owns the property at the time of the filing of the petition or at the time of the commencement of the action. *Culver, LLC. v. Chiu (In re Chiu)*, 304 F.3d 905 (9th Cir. 2002).

10.3.t. State law increase in exemptions may be constitutionally applied to existing debt. Colorado increased the dollar amount of its exemptions after the creditor extended credit. The debtors sought to avoid a lien on their exempt property under section 522(f). After first ruling that the debtors were entitled to exemptions in effect on the date of the filing of the petition (rather than on the date the loan was made), the court upholds against constitutional challenge the application of the increased exemptions in the case. *In re Larson*, 260 B.R. 174 (Bankr. D. Colo. 2001).

10.3.u. Chapter 13 debtor may exercise avoiding powers to recover exemption. In a case of apparent first impression at the Court of Appeals level, the Fifth Circuit holds that a chapter 13 debtor may exercise the trustee's avoiding powers under section 522(h) when the requirements of that section are met, even though a chapter 13 debtor may not normally exercise the avoiding powers of a trustee. *Realty Portfolio, Inc. v. Hamilton (In re Hamilton)*, 125 F.3d 292 (5th Cir. 1997).

10.4 Reaffirmation and Redemption

10.4.a. Debtor may use liquidation value to redeem collateral. In *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), the Supreme Court required use of "replacement value" to value collateral for purposes of a cram down under section 1325(a)(5)(B), basing its decision on the second sentence of section 506(a) that value must be "determined in light of the purpose of the valuation and of the proposed disposition or use of such property." It reasoned that the chapter 13 debtor was keeping the car—a replacement-type use—and that the creditor was subject to a double risk, that of collateral deterioration and of debtor nonperformance under the plan, justifying the higher replacement value. In redemption, however, the creditor does not have either risk, as redemption requires a lump sum payment and terminates any continuing creditor interest in the asset. Redemption effectively works as a foreclosure, with the creditor receiving the auction value of the collateral without attendant processing and storage costs. Therefore, liquidation value is the appropriate measure of value. *Weber v. Wells Fargo Auto Fin., Inc. (In re Weber)*, 332 B.R. 432 (BA.P. 10th Cir. 2005).

10.4.b. Third Circuit permits "ride through." Breaking the tie in the circuit split on this issue (Second, Fourth, Ninth and Tenth *vs*. First, Fifth, Seventh and Eleventh), the Third Circuit sides with the former group in holding that section 521(2)(A) does not limit a consumer debtor to the three options of exemption, reaffirmation, or surrender but permits a debtor to maintain payments on a secured installment contract and retain the collateral. The court concludes that section 521(2)(C), which provides that section 521(2) is not intended to affect substantive rights, requires that section 521(2)(A) not be read so as to preclude options that the debtor had available before its enactment in 1984. *Price v. Delaware State Police FCU (In re Price)*, 370 F.3d 362 (3d Cir. 2004).

10.4.c. Creditor may "link" reaffirmation of secured and unsecured claims. The debtor owed a credit union on his home mortgage and on two unsecured claims. The credit union agreed to reaffirmation of the mortgage only if the debtor also reaffirmed the unsecured claims. The bankruptcy court found the credit union's conduct inherently coercive and in violation of the automatic stay and imposed sanctions as well as an order effectively requiring the credit union to accept reaffirmation of the mortgage claim alone. The B.A.P. affirmed. The First Circuit reverses. It rejects a *per se* rule that linkage of reaffirmation of a secured and unsecured claim is inherently impermissible. It also concludes that the credit union's conduct was not impermissibly coercive, because it did not violate the automatic stay to require the debtor to choose an all or nothing approach. *Jamo v. Katahdin F.C.U.*, 283 F.3d 382 (1st Cir. 2002).

10.4.d. "Tying" of reaffirmation agreements violates the stay. The credit union held the debtor's mortgage as well as several unsecured loans. As a condition to permitting reaffirmation of the mortgage, the credit union demanded reaffirmation of the unsecured loans as well and threatened to foreclose on the mortgage if the debtor did not reaffirm all loans. The First Circuit B.A.P. holds that this conduct violates the automatic stay. Although it is permissible to solicit a reaffirmation agreement, and the creditor is under

no obligation to agree to reaffirmation, it is impermissible to tie reaffirmation of the two loans together. *Katahdin Federal Credit Union v. Jamo (In re Jamo)*, 262 B.R. 159 (1st Cir. B.A.P. 2001).

10.4.e. Ninth Circuit approves "ride through" of secured debt. Joining the Second, Fourth, and Tenth Circuits and parting company with the Fifth, Seventh, and Eleventh Circuits, the Ninth Circuit interprets section 521(2) of the Bankruptcy Code as procedural and non-exclusive, thus preventing a secured creditor from foreclosing on collateral where the debtor keeps all payment current and the only default is the filing of the bankruptcy. On that basis, the court affirms the bankruptcy court's refusal to approve the debtor's reaffirmation agreement. *McClellan Federal Credit Union v. Parker (In re Parker)*, 139 F.3d 668 (9th Cir. 1998).

10.4.f. Disclosure required for reaffirmation agreements. In yet another installment of Sears' is ongoing problems with reaffirmation agreements, Judge Bernstein in the Eastern District of New York reopens a case, strikes counsel's verification of a reaffirmation agreement as inadequate and inaccurate, voids the reaffirmation agreement and orders detailed disclosure (akin to Regulation Z) for all future reaffirmation agreements. *In re Bruzzese*, 214 B.R. 444 (Bankr. E.D. N.Y. 1997).

10.4.g. Second Circuit approves "ride through." The Second Circuit affirmed the bankruptcy judge's decision denying relief from the stay to a creditor where the debtor has agreed to continue making payments on his car loan. *Capital Communications Federal Credit Union v. Boodrow (In re Boodrow)*, 126 F.3d 43 (2d Cir. 1997).

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a. Court enforces a prebankruptcy forum selection clause. The Nevada bankruptcy trustee sued the debtor's contract counterparty in the Nevada bankruptcy court for breach of contract. The contract provided for exclusive jurisdiction in New York for any disputes that "arises out of or in connection with" the contract. A trustee may bring any action that the debtor could have brought on the petition date, but the trustee remains subject to all defenses that might have been asserted against the debtor, including a forum selection clause. Therefore, the court enforces the clause and transfers the action to New York. *Cory v. eBet Ltd. (In re Sona Mobile Holdings Corp.)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 94206 (D. Nev. July 5, 2013).

11.1.b. Court has subject matter jurisdiction to grant third-party release where debtor's indemnification of released claims was automatic. The debtor's bond indenture trustee re-perfected a lapsed security interest within 90 days before bankruptcy. The debtor in possession sued to avoid the re-perfection as a preference. The debtor in possession and the indenture trustee settled the litigation by allowance of the bonds as a secured claim in a substantially reduced amount. The settlement provided for the indenture trustee's release of its contractual indemnification claims for all claims, losses, damages or liabilities against the debtor and for a third-party release of the bondholders' claims against the indenture trustee. Before the settlement was approved, a bondholder brought a claim against the indenture trustee in a nonbankruptcy court. The bankruptcy court has subject matter jurisdiction to approve a third-party release if it would have jurisdiction over a proceeding asserting against the third party the claims that would be released. A bankruptcy court has jurisdiction over a proceeding that is related to a bankruptcy case, that is, if its outcome could conceivably effect the estate. An indemnification agreement between the third party and the debtor does not automatically create related to jurisdiction, as a mere potential effect on the estate is insufficient to create related to jurisdiction. Rather, the debtor's liability must be triggered automatically upon the filing of the claim against the third party, and the indemnification must not depend on the intervention of another lawsuit against the debtor. Here, the bondholder's action against the indenture trustee automatically triggered the debtor's indemnification obligation for defense costs, whether or not the bondholder prevailed, so the obligation would not depend on the intervention of another lawsuit. Therefore, the court had subject matter jurisdiction to grant the release. *Bank of N.Y. Mellon Trust Co. v. Becker (In re Lower Bucks Hosp.)*, 488 B.R. 303 (E.D. Pa. 2013).

11.1.c. Bankruptcy court clerk may enter final default judgment in noncore proceeding. The trustee sued a defendant who had not filed a proof of claim to recover a preference in a certain amount. The summons, conforming to official form B 250, stated in bold, all-capital type that a failure to respond "will be deemed to be your consent to entry of a judgment by the bankruptcy court … for the relief demanded in the complaint". The defendant defaulted. Generally, a bankruptcy judge may not constitutionally issue a final judgment against a defendant in a noncore proceeding. Courts are divided on whether consent provides the necessary authority. Article III implements both individual rights and structural protections, which prevent Congress from "withdraw[ing] from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law". A defendant may waive individual rights, but not the structural protections. Congress vested decision-making authority in bankruptcy cases in the district courts and permitted litigants the right in noncore proceedings to an Article III tribunal, thereby not withdrawing noncore proceedings from judicial cognizance. As a result, only individual rights are implicated in evaluating whether a litigant may waive Article III protections. A waiver may be express or implied, as long as the implied consent is sufficiently clear. Failure to object in the face of a summons that states clearly the effect of failing to respond is sufficiently clear to constitute a waiver. If failure to respond were not sufficient implied consent, then, ironically, only express consent or an inadequate objection could suffice as a waiver. Therefore, the clerk may enter a default judgment. In addition, Fed. R. Civ. Proc. 55 requires the clerk (not the judge) to enter a default judgment if the claim is for a sum certain. Rule 55 applies in adversary proceedings. If the Article III district court's clerk may enter a final, enforceable judgment upon a default, then the bankruptcy judge and the bankruptcy court clerk may do so as well. *Exec. Sounding Board Assocs. Inc. v. Advanced Machine & Eng'g Co. (In re Oldco M Corp.)*, 484 B.R. 598 (Bankr. S.D.N.Y. 2012).

11.1.d. Probate and domestic relations exceptions to jurisdiction apply to approval of a settlement agreement. The debtor signed a prenuptial agreement with her husband, preserving their property as separate during and after the marriage. After he became disabled, she had him execute in her favor a durable power of attorney for his financial affairs and prepared and had him execute a new will, also in her favor. She transferred substantial assets from her husband to herself. His brother and another sought and obtained conservatorship and guardianship orders for the husband in state court. The conservator and guardian sought return of the property the debtor had obtained and sued for divorce on the husband's behalf. The debtor filed a chapter 11 case and sued the conservator and the guardian for a declaration that the prenuptial agreement was invalid, the new will was valid, and the property transfers to her were valid and the property was property of the estate. After conversion of the case to chapter 7, the trustee settled with the conservator and guardian. The settlement provided for a declaration that the prenuptial agreement was valid and the new will was invalid ab initio. The federal jurisdiction probate exception deprives a federal court of jurisdiction to probate or annul a will or to administer a decedent's estate. A finding that the new will was invalid ab initio amounts to the annulment of the will. Therefore, the court does not have jurisdiction to issue an order under the settlement agreement declaring the new will invalid. The domestic relations exception deprives a federal court of jurisdiction to grant a divorce, alimony or child custody decree. A finding that the prenuptial agreement is valid directly affects the determination of what property is property of the estate and is merely a basic contract interpretation action. Therefore, the court may find that the prenuptial agreement was valid. *In re Brown*, 484 B.R. 322 (Bankr. E.D. Ky. 2012).

11.1.e. Jurisdiction extends to any dispute that implicates property of the estate. The debtor operated a Ponzi scheme. Investors in the scheme included various investment funds. The state attorney general sued an investment manager of one of those funds on behalf of fund investors, for violation of state laws, and ultimately agreed to a settlement with the manager under which the manager would make a substantial payment to the attorney general. The trustee sued to enjoin the settlement on the ground that the manager's funds derived from property of the debtor, that the manager's funds were therefore property of the estate and that the settlement therefore violated the automatic stay as an attempt to exercise control over property of the estate. Section 1334(b) of title 28 grants jurisdiction to the district courts over "all civil proceedings arising under title 11, or arising in or related to a case under title 11". Related-to jurisdiction encompasses any proceeding whose outcome might have any conceivable effect on the estate. The trustee's claim here asserts that the settlement would dissipate property of the estate. Even if the court ultimately concludes that the property is not property of the estate or that it should not issue an injunction (as the court here later concludes), it has jurisdiction to determine the dispute. *Secs.*

Investor Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC, ___ B.R. ___, 2013 U.S. Dist. LEXIS 55670 (S.D.N.Y. Apr. 15, 2013).

11.1.f. Nevada LLC interests are located in Nevada for involuntary bankruptcy venue purposes. The debtor resided and was domiciled in Washington. He transferred substantially all of his assets, which comprised real property located in several states, to a Nevada limited liability company in exchange for the membership interests in the LLC. Three creditors filed an involuntary petition against him in Nevada. Bankruptcy case venue is proper at the location of the debtor's domicile, residence, principal place of business or principal assets for the 180 days (or for the greater portion of that period) before the petition date. LLC membership interests are intangible property, which does not have a location, except as a legal fiction. Under the common law, intangible property is located where the owner is. Under the Nevada LLC statute, Nevada LLC interests are located in Nevada for purposes of an unsecured creditor's obtaining a charging order against the interests, and only a Nevada court may issue such an order. Under Ninth Circuit precedent, determination of intangible property location is based on the context in which the question arises. Here, the context is unsecured creditors' collection efforts through an involuntary petition. Because Nevada law provides that the LLC interests are located in Nevada for purposes of creditors' collection efforts, the context here requires a determination that they are located in Nevada for involuntary bankruptcy venue purposes as well. *Montana Dept. of Rev. v. Blixseth (In re Blixseth)*, 484 B.R. 360 (9th Cir. B.A.P. 2012).

11.1.g. 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.)*, 702 F.3d 553 (9th Cir. 2012).

11.1.h. 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.i. 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).

11.1.j. Bankruptcy court lacks post-confirmation jurisdiction over a removed action to enforce a prepetition claim. The debtor maintained a defined benefit pension plan, which it had frozen 8 years before the petition date and which was underfunded. The debtor's chapter 9 plan provided that it would not affect the pension plan participants' rights against the retirement plan but that any claims against the debtor arising out of the administration of the retirement plan would be discharged. After confirmation and the discharge, plan participants filed a petition in state court against the debtor, its officers and the retirement plan administrator alleging violation of state statutory and constitutional law in administering the plan, seeking a writ of mandamus requiring the debtor to fund the retirement plan. The debtor removed the action to the bankruptcy court. An action may be removed to the bankruptcy court only if the bankruptcy court has jurisdiction over it. A bankruptcy court has jurisdiction over a proceeding that arises

under title 11 (depends on a substantive right that title 11 grants), arises in a case under title 11 (is unique to the bankruptcy process) or is related to a case under title 11. After confirmation, a proceeding is related to a case under title 11 only if the proceeding has a close nexus to the plan. A bankruptcy court's jurisdiction, even in a removed action, is determined by the facts alleged in the complaint, not by defenses that may be asserted. The petition here did not seek recovery on a right granted by title 11 nor relate to anything that was unique to the bankruptcy process. It did not have a close nexus to the plan. Only the debtor's potential chapter 9 discharge defense could meet those requirements, and those defenses were not apparent on the face of the petition. As such, the bankruptcy court did not have jurisdiction over the removed action. The state court is fully capable of considering the debtor's discharge affirmative defense, and while a bankruptcy court may interpret its own orders, it may not dictate to another court in which an action is brought the preclusive effects of the bankruptcy court's orders. In a cautionary note, however, the court warns, "If … the state court misinterprets the plan, the confirmation order or any of the bankruptcy court's other orders, [the debtor] *might* be able to seek relief from the bankruptcy court, provided the state court's ruling implicates substantive bankruptcy rights law issues or impacts [the debtor] or its plan." *Kirton v. Valley Health Sys. (In re Valley Health Sys.)*, 471 B.R. 555 (9th Cir. B.A.P. 2012).

11.1.k. For venue purposes, "residence" applies only to an individual. The debtor's principal place of business is in Boston, though it has an office in New York City. The parent holding company leased space in New York City but subleased the entire space, at a loss, to an unaffiliated sublessee. The debtor reached agreement with its creditors for a prepackaged chapter 11 plan. The plan provided for conversion of secured debt to equity and not to impair any classes of unsecured claims. The agreement required the case to be filed in New York. All voting creditors accepted the plan. The debtor and its affiliates filed the cases in the Southern District of New York, and the court set a hearing on confirmation about 32 days after the petition date. Eight days after the petition date, the U.S. trustee filed an objection to venue and a motion to transfer the cases. Section 1408 places venue for a case in the district where the debtor has its "domicile, residence, principal place of business …, or principal assets" for the greater portion of the preceding 180 days. Case law interpreting section 1406 requires a court to dismiss or transfer to a proper venue a title 11 case that lays venue in the wrong district or division. Unlike section 1412, which permits transfer of venue "in the interest of justice or for the convenience of the parties", section 1406 is mandatory. Section 1408 authorizes corporate venue in the debtor's principal place of business or principal assets. Treating the location of any place of business or assets as a "residence" would devour the principal place of business or principal assets test for a corporate debtor. Therefore, the "residence" venue test applies only to individual debtors, and the court must transfer the case. However, section 1406 does not require immediate transfer, nor is improper venue jurisdictional. Because all impaired creditors supported the plan and New York venue, the court delays enforcement of its order until the earlier of the effective date of the plan, which the court confirmed on the same day as it heard oral argument on the venue motion, or 21 days after its order. *In re Houghton Mifflin Harcourt Publishing Co.*, 474 B.R. 122 (Bankr. S.D.N.Y. 2012).

11.1.l. Potential defendant has standing to object to a trustee's assignment of a claim against him. The trustee attempted to assign to a creditor claims the estate had against the corporate principal arising out of the debtor's failure. The claims were insured in part by directors' and officers' insurance, and some of the claims might be nondischargeable in the principal's own bankruptcy case. The principal objected. Only a person with a pecuniary interest in the outcome has standing to object in a bankruptcy proceeding. Because the claims might not be fully insured and might not be subject to the principal's discharge, the principal has standing to object to the trustee's assignment of the claim. The court does not address why a potential defendant has standing to object to who sues him. *In re Knight-Celotex, LLC*, 695 F.3d 714 (7th Cir. 2012).

11.1.m. Bankruptcy court may enjoin extraterritorial automatic stay violation. The trustee sued a Cayman fund to recover a preference and a fraudulent transfer. The fund appeared and obtained an extension of time to respond to the complaint. On the same day that the fund answered, it brought an action against the trustee in the Cayman court for a declaration that it was not liable to the trustee. The automatic stay prohibits any action to obtain or exercise control over property of the estate. Property of the estate includes the debtor's property, "wherever located". The bankruptcy court has *in rem* jurisdiction over all estate property, regardless of its location. The automatic stay applies "to all entities", to protect

the debtor's property and the court's jurisdiction. Still, the bankruptcy court's ability to enforce the automatic stay against an entity depends on the court's *in personam* jurisdiction over the entity. Here, the defendant had appeared in the bankruptcy court, so the court had jurisdiction over it. It therefore could enjoin the defendant's action, wherever it occurred, to recover property of the estate, wherever located. *Picard v. Maxam Absolute Return Fund, L.P. (In re Bernard L. Madoff Inv. Secs. LLC)*, 474 B.R. 76 (S.D.N.Y. 2012).

11.1.n. Court has subject matter jurisdiction to grant third party release in plan, even after confirmation. The debtor's bond indenture trustee re-perfected a lapsed security interest within 90 days before bankruptcy. The debtor in possession sued to avoid the re-perfection as a preference. The debtor in possession and the indenture trustee settled the litigation by allowance of the bonds as a secured claim in a substantially reduced amount. The settlement provided for the indenture trustee's release of its contractual indemnification claims against the debtor and for a third party release of the bondholders' claims against the indenture trustee. However, the settlement was contingent upon confirmation of a plan that incorporated its terms. The court approved the settlement and later approved a disclosure statement that did not clearly describe the third party release. The bondholders overwhelmingly accepted the plan, but one bondholder objected to confirmation based on the third party release. To permit confirmation, all parties stipulated to address the third party release objection after confirmation, as a stand-alone issue, that would rise or fall independently of confirmation, and to allow confirmation to proceed. A bankruptcy court has jurisdiction over core proceedings (arising under title 11 or arising in the case) and over non-core proceedings (related to the case). A proceeding is related to a case if its outcome could have any conceivable effect on the estate. A creditor's contractual indemnification claim can make the proceeding on a nondebtor's claim against the creditor related to the case, so the court has jurisdiction to grant a third party release of a contractually indemnified claim. However, after confirmation, the claim will not have an effect on the estate. But once a court acquires jurisdiction, it may retain it even if later events eliminate the basis for jurisdiction. Here, the court exercises its discretion to retain jurisdiction because the parties agreed to defer litigation until after confirmation. *In re Lower Bucks Hosp.*, 471 B.R. 419 (Bankr. E.D. Pa. 2012).

11.1.o. Bankruptcy judge may constitutionally enjoin litigation to protect the estate. The bankruptcy court preliminarily enjoined asbestos claimants from pursuing certain claims against the debtor's parent corporation and related insurance policies and proceeds that were allocated to fund the debtor's chapter 11 plan. A claimant asserted a claim against the parent based on an independent legal right against the parent. The parent was entitled to coverage from the insurance policies for defending the action and for any liability, so that the pursuit of the action would deplete the assets available to fund the plan. Under *Stern v. Marshall*, 131 S. Ct. 2594 (2011), a bankruptcy judge does not have authority to issue a final order against a non-estate party in a traditional common law action. *Stern*'s holding was narrow. Whatever its contours, it does not prevent a bankruptcy judge from enjoining litigation to protect a bankruptcy estate during a bankruptcy case. Therefore, the bankruptcy judge's injunction against the claimant did not exceed its constitutional authority. *Quigley Co., Inc. v. Law Offices of Peter G. Angelos (In re Quigley Co., Inc.)*, 676 F.3d 45 (2d Cir. 2012).

11.1.p. Bankruptcy court jurisdiction depends on whether the proceeding affects the estate, not on whether it is derivative. The bankruptcy court preliminarily enjoined asbestos claimants from pursuing certain claims against the debtor's non-debtor parent corporation and against related insurance policies and proceeds that were allocated to fund the debtor's chapter 11 plan. A claimant asserted a claim against the parent based on an independent legal right against the parent. The parent was entitled to coverage from the insurance policies for defending the action and for any liability, so that the pursuit of the action would deplete the assets available to fund the plan. Section 1334(b) confers bankruptcy jurisdiction over a proceeding that directly affects property of the estate. A proceeding involving liability that is derivative of the debtor's liability or that relates in some way to the debtor's conduct or legal rights may affect property of the estate, while a proceeding that asserts a legal claim against a third party that is independent of any of the debtor's rights does not. Bankruptcy jurisdiction does not require both that the proceeding directly affect the estate and that it be derivative. The latter is just a means to determine the effect on the estate, but it is the effect on the estate that determines jurisdiction. Thus, even a non-derivative proceeding that has a direct effect on the estate is subject to bankruptcy jurisdiction. Because

the proceeding would deplete assets available to fund the plan, section 1334(b) provides jurisdiction to enjoin the action. *Quigley Co., Inc. v. Law Offices of Peter G. Angelos (In re Quigley Co., Inc.)*, 676 F.3d 45 (2d Cir. 2012).

11.1.q. Bankruptcy court has discretion to require arbitration of claims. Before bankruptcy, the debtor entered into a settlement agreement with its general liability insurer relating to asbestos claims. The debtor warranted that it had not assigned and would not assign any claims against the insurer and that it would not assist others in pursuing claims against the insurer. The agreement required arbitration of disputes. As its asbestos woes mounted, the debtor began negotiations with its other insurers and with asbestos claimants over a possible bankruptcy plan, which would provide for assigning contribution claims that other insurers might have against the settling insurer to the debtor, who would assign them under a plan to an asbestos trust under section 524(g). The debtor then filed a chapter 11 case and negotiated a plan consistent with the prepetition discussions. The insurer filed a proof of claim for breach of the settlement agreement, alleging that the negotiations for the debtor's receipt of claims against the insurer and their assignment to the asbestos trust violated the settlement agreement's anti-assignment provision. The Federal Arbitration Act requires a federal court to enforce an arbitration clause unless another statute provides otherwise. Although the Code does not expressly override the Arbitration Act, enforcement of an arbitration clause can interfere with the conduct of a bankruptcy case. Where it does, a bankruptcy court has discretion not to order arbitration, but only if it would conflict with the Code's underlying purpose. Arbitration of a non-core proceeding generally will not interfere with the bankruptcy case's conduct. Arbitration of a core proceeding presents a greater danger, as the core proceeding may be more central to the case's progress. The Code's purposes include the centralization of disputes and preventing piecemeal litigation, the more so in an asbestos case that attempts to use section 524(g) to address numerous asbestos claims. Here, the claim challenged the debtor's efforts to seek bankruptcy relief and confirm a plan using section 524(g). Therefore, the bankruptcy court properly denied arbitration. *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011 (9th Cir. 2012).

11.1.r. Bankruptcy court may not determine fraudulent transfer action but may propose findings and conclusions. The reorganized debtor sued defendants who had not filed proofs of claim to avoid and recover fraudulent transfers. *Stern v. Marshall*, 131 S. Ct. 2594 (2011), held it unconstitutional for a bankruptcy judge to hear and determine, as a core proceeding, a state-law counterclaim that the court did not need to resolve to rule on a proof of claim's allowability. Although the Court emphasized the holding's narrowness, the Court based its decision largely on *Granfinanciera S.A. v. Nordberg*, 492 U.S. 33 (1989), which ruled that a fraudulent transfer defendant had a Seventh Amendment jury trial right because a fraudulent transfer action implicated private rights that could constitutionally be resolved only by an exercise of the judicial power. Therefore, *Stern* applies to a fraudulent transfer action against a defendant who did not file a proof of claim. Section 157(c) expressly authorizes a bankruptcy judge to hear a noncore proceeding and propose findings of fact and conclusions of law to the district court for decision but does not prohibit a bankruptcy judge from doing so in a proceeding that the statute designates as core. Sections 157(a) and (b) give the district court broad discretion to allocate judicial proceedings between the district court and the bankruptcy judges. Therefore, the bankruptcy judge may hear and propose findings and conclusions in a fraudulent transfer action, and the district court so orders. Finally, the district court may withdraw the reference based on efficiency, delay, costs and uniformity of bankruptcy administration. Allowing the bankruptcy judge to hear the action and propose findings and conclusions promotes efficiency and reduces delay and costs because of the bankruptcy judge's familiarity with the underlying facts and legal issues and promotes uniform administration because of the bankruptcy judge's prior handling of similar matters in the case. *Heller Ehrmann LLP v. Arnold & Porter, LLP (In re Heller Ehrmann LLP)*, 464 B.R. 348 (N.D. Cal. 2011).

11.1.s. Proceeding for equitable subordination is a constitutionally core proceeding. The chapter 7 trustee brought an action to subordinate a claim on equitable grounds under section 510(c). The bankruptcy judge has authority to issue a final decision on a proceeding only if the proceeding is both statutorily and constitutionally a core proceeding. Section 157(b) defines core proceeding as one arising under title 11 or arising under a case under title 11. Section 157(b)(2) lists examples of core proceedings. Sections 157(b)(2)(B) and (O) list proceedings for "allowance or disallowance of claims against the estate" or "affecting … the adjustment of the debtor-creditor … relationship" as core proceedings. An

equitable subordination proceeding does not seek allowance or disallowance, only priority, and it involves the adjustment of the creditor-creditor, not the debtor-creditor, relationship. However, a proceeding that is not listed in section 157(b)(2) is core if it invokes a substantive right that title 11 provides or, by its nature, could arise only in a bankruptcy case. An equitable subordination claim invokes a right that section 510(c) provides and can arise only in a bankruptcy case. *Stern v. Marshall*, 131 S. Ct. 2594 (2011), prohibits a bankruptcy judge from determining a core proceeding if doing so requires an exercise of the judicial power of the United States. Despite broad language in parts of the opinion (which the bankruptcy court here catalogs), the Supreme Court's ultimate conclusion was that Congress had violated Article III "in one isolated respect" and its decision did "not change all that much" or meaningfully change the division of labor in the statute. Therefore, *Stern* must be read narrowly. An equitable subordination claim does not invoke a state law claim and therefore does not implicate *Stern*, narrowly read. It implicates only the Bankruptcy Code, so the bankruptcy judge may constitutionally determine the claim. *Burtch v. Huston (In re USDigital, Inc.)*, 461 B.R. 276 (Bankr. D. Del. 2011).

11.1.t. A foreign representative's claims to recover pre-foreign proceeding transfers under common law theories are not core proceedings. Foreign representatives sued foreign defendants in state court to recover transfers of property that the foreign debtor had made before its liquidation proceeding commenced under common law theories of mistake, money had and received and unjust enrichment and under the foreign avoiding power statutes. After the bankruptcy court granted recognition, the foreign representatives removed the state court cases to the bankruptcy court. On timely motion of a party in interest, the bankruptcy court must abstain from a noncore proceeding based on a state law claim over which federal jurisdiction exists only in bankruptcy if the action is commenced and can be timely adjudicated in the state court. A core proceeding is one that arises under title 11 or arises in a case under title 11, which the court must determine based on the proceeding's form and substance. A proceeding arises under title 11 if the Code creates the substantive right. Chapter 15's authorization of the foreign representative's action, without more, is insufficient to meet that standard. A proceeding arises in a title 11 case if there is a statutory basis for subject matter jurisdiction. Section 1521(a)(5) authorizes the bankruptcy court to entrust the administration or realization of the debtor's assets within the territorial jurisdiction of the United States to the foreign representative; section 1521(a)(7) authorizes the court to grant additional relief available to a trustee, except for the Code's avoiding powers. Section 1521(a)(5) contains a specific territorial limitation and so is not a basis for core jurisdiction over a proceeding to recover foreign assets or avoid foreign transfers. Chapter 15 cases are ancillary and assert jurisdiction only over assets within the United States, to assist the foreign court, not to become the principal case. Therefore, section 1521(a)(7)'s catch-all provision allowing additional relief does not authorize a foreign representative to pursue non-U.S. assets, especially under avoiding power-like claims, which are specifically excluded. A proceeding may also arise in a title 11 case if it would have no existence outside of bankruptcy. These common law claims that all arose before the foreign liquidation proceeding began do not meet that standard. Finally, the claims are traditional state law claims that do not implicate private rights and are beyond the bankruptcy court's authority to hear and decide. Therefore, these proceedings do not arise under title 11 or arise in a case under title 11 and are not core proceedings. If the other grounds for abstention are met, the court must abstain. *In re Fairfield Sentry Ltd.*, 455 B.R. 665 (S.D.N.Y. 2011).

11.1.u. Bankruptcy court has postconfirmation jurisdiction over subsequent transferee action under section 550 but not one under the UFTA. The plan established a litigation trust, which the plan vested with fraudulent transfer actions that the debtor in possession filed before confirmation. After the trustee got judgment in the actions, he filed subsequent transferee actions in the bankruptcy court against others, who were not defendants in the original actions, under section 550 and the comparable provision of the Texas UFTA. A bankruptcy court's jurisdiction narrows after confirmation. It extends only to related proceedings that involve disputes that are integral to the plan, that involve preconfirmation activities and were asserted before confirmation or that are determined under bankruptcy law, but not related proceedings that involve postconfirmation relations between the parties or do not depend on the plan for resolution, whether or not the outcome may affect distribution to creditors. It also extends to core proceedings. A core proceeding is one that arises under title 11 or arises in a case under title 11. The action under section 550 arises under title 11 and is core because it invokes a right created by the Bankruptcy Code. The UFTA claim, however, does not invoke a Bankruptcy Code right or provision and therefore is not a core proceeding. It involves strangers to the bankruptcy case and facts beyond those

proferred during the fraudulent transfer action and is therefore not a related proceeding. Section 1367 of title 28 grants the district courts supplemental jurisdiction (previously divided into "ancillary jurisdiction" and "pendent jurisdiction"). Supplemental jurisdiction includes jurisdiction to permit a single court to dispose of factually interdependent claims, whether or not involving additional parties or claims that might not otherwise be within the court's subject matter jurisdiction, and jurisdiction to enforce a court's order or judgment or to vindicate its authority. The UFTA subsequent transferee action here is a new, independent action that does not meet either of the tests for supplemental jurisdiction. Moreover, section 1367 grants jurisdiction only to the district courts, and supplemental jurisdiction is not within the district court's power to refer under section 157 of title 28. *Faulkner v. Eagle View Cap. Mgmt. (In re The Heritage Org. L.L.C.)*, 454 B.R. 353 (Bankr. N.D. Tex. 2011).

11.1.v. Bankruptcy court does not have postconfirmation jurisdiction to characterize partnership's plan transaction for tax purposes. The debtor partnership confirmed a plan that restructured the partnership into a limited liability company and discharged a portion of the claims against the partnership property. The confirmation order (but not the plan) provided that the plan transactions "do not provide for … and will not constitute, the liquidation of all or substantially all of the property of the Debtor's Estate". The state taxing agency later attempted to tax the general partners for capital gains, characterizing the restructuring as resulting in a taxable sale, rather than nontaxable cancellation of debt income. The bankruptcy court issued an order to show cause why the agency should not be held in contempt for attacking and refusing to comply with the confirmation order. The bankruptcy court has jurisdiction over a matter arising under title 11 (based on a right that title 11 grants) or arising in a case under title 11 (a matter that would not exist outside a bankruptcy case). The dispute here does not implicate arising under or arising in jurisdiction, because it is not based on any provision of the Code and is not unique to the bankruptcy case. A bankruptcy court also has jurisdiction over a proceeding related to a title 11 case, but its postconfirmation related to jurisdiction is narrower than its preconfirmation jurisdiction. After confirmation, the dispute must have a close nexus to the bankruptcy case, which requires that the dispute's resolution affects the reorganized debtor, the estate or the plan's implementation. Here, the plan had been fully implemented and the bankruptcy case closed. The dispute's resolution could affect only the partners' tax liability, not the reorganized debtor, the estate or the plan's implementation. Therefore, the bankruptcy court does not have jurisdiction to resolve the dispute. *In re Wilshire Courtyard*, 459 B.R. 416 (9th Cir. B.A.P. 2011).

11.1.w. Section 1334(e) ousts a state court receiver from possession of the debtor's assets. The municipal debtor had issued revenue bonds, secured by a pledge of the net revenues of the debtor's sewer system. The debtor defaulted in payments. The indenture trustee sought and obtained the appointment of a state court receiver, as provided in the indenture, to take possession of and operate the system, collect revenues, set rates and pay net revenues to the indenture trustee for distribution to bondholders. Upon the debtor's filing its chapter 9 case, the receiver moved for the bankruptcy court to abstain from taking any action to interfere with the receivership. Upon the filing of a petition, 28 U.S.C. § 1334(e) gives the bankruptcy court exclusive in rem jurisdiction over all property of the debtor as of the commencement of the case. Section 362's automatic stay and the turnover provisions of sections 542 and 543 only protect the court's in rem jurisdiction. Their inapplicability (as in chapter 9) does not limit the scope of the court's exclusive jurisdiction over property. Therefore, property of the debtor is subject to the court's in rem jurisdiction whether or not the turnover provisions apply. Under *Butner v. U.S.*, 440 U.S. 48 (1979), state law determines whether property is property of the debtor. Under Alabama law, a receivership order and the appointment of a receiver does not affect title to the receivership property. The property is in the custody of the receivership court, and the receiver takes possession only as an officer of the appointing court, not for the creditors seeking the appointment. The bankruptcy court's exclusive jurisdiction places the property in the custody of the bankruptcy court, ousting the receivership court of control and the receiver (who is an officer of the receivership court) of possession. Neither section 542 (turnover) nor 543 (prepetition custodian) defines what is property of the debtor, and neither is needed to oust the receiver of possession. Section 1334(e) accomplishes that result as a matter of statute. The result makes the race to the courthouse irrelevant: the bankruptcy court's exclusive in rem jurisdiction is always paramount. *In re Jefferson County, Ala.*, ___ B.R. ___, 2012 Bankr. LEXIS 40 (Bankr. N.D. Ala. Jan. 19, 2012).

11.1.x. The section 1409(b) exception to home court venue does not apply to a preference action. The trustee sued the defendant to avoid an $11,215 payment as a preference. Section 1409(a) of title 28 authorizes venue in the home court for "a proceeding arising under title 11 or arising in or related to a case under title 11". Section 1409(b) denies home court venue for "a proceeding arising in or related to such case to recover a money judgment … against a noninsider of less the $11,725". A preference action is a proceeding arising under title 11, which is covered by the plain language of section 1409(a) but is not covered by the plain language of the exception in section 1409(b). In addition, section 104(a) adjusted the dollar amount in section 1409(b) to $11,725 from $10,950 between the commencement of the case and the commencement of the adversary proceeding. Section 104(c) provides that adjustment in dollar amounts made under section 104(a) "shall not apply with respect to cases commenced before the date of such adjustments". Therefore, the adjustment does not apply to the adversary proceeding, which is a subaction within the case. The trustee may proceed in the home court. *Straffi v. Gilco World Wide Markets (In re Bamboo Abbott, Inc.)*, 458 B.R. 701 (Bankr. D.N.J. 2011); *see also Schwab v. Peddinghaus Corp. (In re Excel Storage Prods., L.P.)*, 458 B.R. 175 (Bankr. M.D. Pa. 2011).

11.1.y. Bankruptcy court may constitutionally approve a settlement of claims that it may not hear and determine. The debtor in possession proposed a settlement under Rule 9019 of claims against third parties. Under *Stern v. Marshall*, 131 S. Ct. 2594 (2011), the bankruptcy court may not hear and determine and issue final judgment in a matter if doing so would require exercise of the judicial power of the United States, which is reserved to courts created under Article III of the Constitution. Determining a claim that seeks to augment the estate rather than adjust creditor rights is an exercise of judicial power. A bankruptcy court may hear and determine and issue final judgment on a claim if it derives from the bankruptcy itself or would necessarily be resolved in the claims allowance process or if there is a well established historical practice permitting it. Rule 9019, which requires bankruptcy court approval of a settlement, is derived from section 27 of the Bankruptcy Act, enacted in 1898. A court need not have authority to issue judgment on a claim to determine whether its fiduciary (the debtor in possession or trustee) may settle it. Finally, approving the settlement here determines what constitutes property of the estate, which is clearly within the bankruptcy court's core authority. Therefore, the court may rule on approval of the settlement. *In re Wash. Mut., Inc.*, 461 B.R. 200 (Bankr. D. Del. 2011).

11.1.z. *Stern v. Marshall* does not prevent a bankruptcy judge from hearing and determining a fraudulent transfer action. The debtor in possession brought fraudulent transfer actions against defendants who had not filed proofs of claim in the case. The defendants moved to withdraw the reference. *Stern v. Marshall*, 131 S. Ct. 2594 (2011), held that a bankruptcy judge may not constitutionally hear and determine an estate's tort counterclaim against a creditor who filed a proof of claim in the case, despite section 157(b)(2)(C)'s designation of such a proceeding as "core" and its grant of authority to the bankruptcy court to hear and determine the counterclaim. Although *Stern's* reasoning was broad, it said only, "Congress, in one isolated respect, exceeded Article III". Therefore, *Stern*'s statement that *Granfinanciera, SA v. Nordberg*, 492 U.S. 33 (1989), concluded that "Congress could not constitutionally assign resolution of [a] fraudulent conveyance action to a non-Article III court" was dictum that did not expand *Stern*'s holding to fraudulent transfer actions. Whether a matter is core depends on whether it stems from the bankruptcy itself. A fraudulent transfer action stems from a bankruptcy, as it has no life outside of the insolvency context, which generally results in bankruptcy. Section 157(b)(2)(H) designates a fraudulent transfer action as a core proceeding and authorizes the bankruptcy judge to hear and determine it. Therefore, the bankruptcy judge may hear and determine the proceeding. If a proceeding is unconstitutionally designated as core, it may be treated as a related proceeding to which section 157(c) applies, because the absence of statutory authorization for a bankruptcy judge to make proposed findings and conclusions in a core matter that it may not constitutionally hear and determine does not prohibit the judge from doing so. The district court may determine the constitutional issue on appeal or review after the bankruptcy judge issues a final judgment in the proceeding. Therefore, the bankruptcy judge recommends that the district court deny the motion to withdraw the reference and provides that any final determination that is beyond constitutional competence must be treated as proposed findings and conclusions. *Heller Ehrman LLP v. Arnold & Porter, LLP (In re Heller Ehrman LLP)*, 2011 Bankr. LEXIS 3777 (Bankr. N.D. Cal. Sept. 28, 2011).

11.1.aa. Bankruptcy court may not issue final judgment in fraudulent transfer action. The trustee sued to recover a fraudulent transfer from a defendant who had not filed a proof of claim and who did not consent to the bankruptcy court's exercise of authority to hear and determine the proceeding and issue a final judgment. *Murray's Lessee v. Hoboken Land & Imp. Co.*, 59 U.S. 272 (1856), concluded that the Fifth Amendment Due Process clause requires judicial process for matters that were the stuff of the courts at Westminster in 1789 and that Article III requires a judge enjoying the protections of Article III of the Constitution to conduct any such required judicial process. Congress may assign matters that do not require judicial action, such as selling property or otherwise administering property of the estate, granting relief from the automatic stay and resolving claims against the estate, to a non-judicial officer. But a proceeding that seeks the government's assistance in depriving a person involuntarily of property must be a judicial proceeding in a court established under Article III, unless the parties consent to the determination by a non-Article III judge such as a bankruptcy judge. In such a proceeding, the bankruptcy judge may hear the evidence and legal argument and make a report and recommendation to the district court, including a recommendation that the district court not re-hear the evidence. The district court may then determine how to proceed. The court cautions, however, focusing again on *Murray's Lessee*, that there may be matters arising in bankruptcy cases that are not susceptible to judicial cognizance and therefore that may not be heard by an Article III court or its adjunct, but leaves exploration of the scope of that issue for another day. *Teleservices Group, Inc. v. Huntington Nat'l Bank*, 456 B.R. 318 (Bankr. W.D. Mich. 2011).

11.1.bb. State court replevin action against the debtor and his non-debtor company are not core proceedings. The bank filed a replevin action in state court against the debtor and his company to enforce a security interest in the company's assets. The security interest secured a loan to the company that the debtor had guaranteed. Before the state court heard the bank's replevin motion, the debtor filed a chapter 11 case for himself, but not his company, and removed the action to the bankruptcy court. The bankruptcy court must abstain from hearing a proceeding that is not a core proceeding if federal jurisdiction lies only under section 1334, a party timely seeks abstention and the action is commenced and can be timely adjudicated in a state court. A core proceeding is one that arises under title 11 or arises in a case under title 11, that is, a proceeding that involves a right created by the Bankruptcy Code or can arise only in a bankruptcy case. The replevin actions do not arise under title 11, because they are based on state law claims, and they can and did arise outside of the bankruptcy case. Section 157(b)(2)(O) of title 28 includes a proceeding "affecting … the adjustment of the debtor-creditor … relationship" as core, but such a proceeding is core only if it arises under title 11 or in the case. The replevin actions—both the one against the company and the one against the debtor—are not core proceedings, even though the bank's success in the actions against the company could prevent a successful reorganization in the individual's case and thereby affect the adjustment of the debtor-creditor relationship. If the other elements for mandatory abstention are met, the bankruptcy court must remand the actions to the state court. The automatic stay applies to the action against the debtor but not to the action against the company. *Schmidt v. Klein Bank (In re Schmidt)*, 453 B.R. 346 (8th Cir. B.A.P. 2011).

11.1.cc. Bankruptcy court lacks authority to hear and make proposed finding and conclusions in fraudulent transfer action against non-creditor. The trustee brought a fraudulent transfer action against a defendant who had not filed a proof of claim. Under *Stern v. Marshall*, the action is a core proceeding, which section 157(b)(2)(H) authorizes a bankruptcy court to hear and determine, but a bankruptcy court may not constitutionally determine the action. Section 157(c) authorizes a bankruptcy court to hear and propose findings and conclusions in a related proceeding, but not in a core proceeding. Therefore, the bankruptcy court does not have any authority to hear the action. The court gives the parties 14 days to seek a withdrawal of the reference, or the action will be dismissed. *Samson v. Blixseth (In re Blixseth)*, 2011 Bankr. LEXIS 2953 (Bankr. D. Mont. Aug. 1, 2011).

11.1.dd. Bankruptcy court must give full faith and credit to a state court judgment interpreting a bankruptcy sale order. The debtor operated a golf course on land that was subject to a restrictive covenant that required it to be operated as a golf course. During the chapter 11 case, the debtor in possession sold the land free and clear of all encumbrances and interests of any kind. The buyer operated the golf course for a while, but then began changing the property's use. Homeowners sued in state court to enforce the restrictive covenant, which determined that the sale order did not extinguish the covenant.

The buyer reopened the bankruptcy case to enforce the sale order. A federal court must give full faith and credit to a state court judgment under 28 U.S.C. § 1738. An exception exists where Congress has granted the federal court exclusive jurisdiction over the subject matter of the state court action. In that case, the state court judgment is void and subject to collateral attack. A bankruptcy court has exclusive jurisdiction over property of the estate under 28 U.S.C. § 1334(e), which ceases when the property is no longer property of the estate. Its jurisdiction over the sale proceeding under 28 U.S.C. § 1334(b) is non-exclusive. Therefore, after the sale, the bankruptcy court had concurrent jurisdiction with the state court, whose judgment was therefore entitled to full faith and credit. Section 363(m), which prohibits an appeal from affecting the validity of a sale order to a good faith purchaser, does not expand the bankruptcy court's exclusive jurisdiction. The proceeding here was not an appeal. Therefore, the state court judgment was effective and binding. *Mid-City Bank v. Skyline Woods Homeowners Assoc (In re Skyline Woods Country Club)*, 636 F.3d 467 (8th Cir. 2011).

11.1.ee. Section 1409(b)'s small claim venue limitation does not apply to a proceeding to recover a preference. The trustee sued an out-of-state defendant in the home court to avoid and recover a $7,800 preference. Section 1409(b) of title 28 permits a trustee in a title 11 case to "commence a proceeding arising in or related to such case to recover a money judgment … less than $1,000 or … a debt (excluding a consumer debt) against a non-insider of less than $11,725, only in the district court for the district in which the defendant resides." "Arising in" and "related to" are well defined terms of art in bankruptcy jurisdictional jurisprudence. A proceeding arises in a bankruptcy case if it could not exist outside of a bankruptcy case but is not a cause of action created by the Code. A proceeding is related to a bankruptcy case if its outcome could conceivably have an effect on the estate. By contrast, a proceeding to recover on a cause of action created by the Code is on that "arises under title 11". The preference action here arises under title 11 but does not arise in the case and is not related to the case. Therefore, section 1409(b)'s venue limitation does not apply to this proceeding. *Redmond v. Gulf City Body & Trailer Works, Inc. (In re Sunbridge Cap., Inc.)*, 454 B.R. 166 (Bankr. D. Kan. 2011).

11.1.ff. Section 547(c)(9) provides a threshold, not a deductible. Within 90 days before bankruptcy, the creditor obtained a lien against the debtor's property to secure a claim of $5,845.74. The trustee objected to the creditor's claim on the ground that the creditor had obtained and not returned a preference. Section 547(c)(9) provides that the trustee may not avoid a transfer in a nonconsumer case if "the aggregate value of all property that constitutes or is affected by such transfer is less than $5,475." Section 547(c)(9) provides a monetary threshold, not an exemption or deductible, because the paragraph does not contain the "to the extent that" language present in other preference exceptions. Therefore, the lien is entirely avoidable. *Western States Glass Corp. of N. Calif. v. Barris (In re Bay Area Glass, Inc.)*, 454 B.R. 86 (9th Cir. B.A.P. 2011).

11.1.gg. Core jurisdiction defined, but is unconstitutional as applied to an estate's counterclaim. The debtor's husband had promised her a substantial trust account, but he never amended his will to reflect his intentions. After he died, his son and sole heir probated the will in Texas probate court. The debtor filed bankruptcy. The son filed a nondischargeability complaint against her, alleging defamation on account of her allegations about the son's conduct in connection with the will, and a proof of claim. The debtor counterclaimed in the bankruptcy court for tortious interference with an expected gift from her late husband. The bankruptcy court granted her judgment on her counterclaim. The son appealed to the district court. In the meantime, the son sought and obtained a ruling from the Texas probate court that the will was valid and that the debtor was not entitled to any recovery. After the probate court ruled, the district court determined that the counterclaim was not a core proceeding, held a trial and entered judgment for the debtor. Section 157(b)(1) permits bankruptcy judges to "hear and determine … all core proceedings arising under title 11, or arising in a case under title 11". The "arising" phrases do not limit the scope of which core proceedings the bankruptcy judges may hear and determine; they describe what constitutes a core proceeding. Section 157(b)(2) provides a ready list of examples, but ultimately, a core proceeding is one that arises under title 11 or arises in a case under title 11. Section 157(b)(2)(C) defines core proceeding to include "counterclaims by the estate against persons filing claims against the estate". Thus, the statute authorizes the bankruptcy court to hear and determine such counterclaims. However, such authority violates Article III of the Constitution. Article III vests the judicial power in courts staffed by life tenured, salary protected judges. Non-Article III judges may hear and determine only matters

that are public rights, including those arising between the government and others, matters arising under a specialized federal statute or under a federal regulatory scheme, and matters that are central to the adjustment of the debtor-creditor relationship, but not matters arising under state common law. Bankruptcy courts exercise the full power that Article III courts exercise to hear and determine matters within their jurisdiction. As such, they are not adjuncts of the district court in matters in which they may enter final orders, any more than the district courts are adjuncts of the courts of appeals. The scope of matters in which they exercise such power is not limited to public rights, specialized federal statutes or regulatory matters or matters central to the adjustment of the debtor-creditor relationship. When applied to an estate's counterclaim based on state common law, such an exercise of power by a non-Article III judge violates Article III. The creditor's filing of a proof of claim does not save the bankruptcy court's power. The creditor does not truly consent to jurisdiction to resolve counterclaims whose determination are not essential to the court's determination of the creditor's claim (such as resolution of a section 502(d) claim objection), because the creditor has no choice but to file a claim if he wishes to share in the estate. Here, the tortious interference counterclaim arose in part out of the same facts underlying the defamation claim, but determining it was not necessary to determining the defamation nondischargeability claim. The counterclaim required rulings on the additional issues of whether Texas recognizes the tort claim and what its elements are, as well as proof of the additional facts to support the claim. Thus, the bankruptcy court's exercise of core jurisdiction to determine the tortious interference counterclaim went beyond what was necessary to determine the bankruptcy issues (claim allowance and dischargeability) and the adjustment of the debtor-creditor relationship and was therefore unconstitutional. Because the Texas probate court determined the tortious interference claim before the district court did, the Texas judgment bound the district court under the Full Faith and Credit Clause. *Stern v. Marshall (In re Marshall)*, 564 U.S. ___, 131 S. Ct. 2594 (2011).

11.1.hh. Section 157(b)(5) is not jurisdictional and may be waived. The debtor's husband had promised her a substantial trust account, but he never amended his will to reflect his intentions. After he died, his son and sole heir probated the will in Texas probate court. The debtor filed bankruptcy, and the son filed a nondischargeability complaint against her, alleging defamation on account of her allegations about the son's conduct in connection with the will, and a proof of claim. The debtor counterclaimed in the bankruptcy court for tortious interference with an expected gift from her late husband. The bankruptcy court granted her judgment on her counterclaim. The son appealed to the district court. In the meantime, the son sought and obtained a ruling from the Texas probate court that the will was valid and the debtor was not entitled to any recovery. After the probate court ruled, the district court determined that the counterclaim was not a core proceeding, held a trial and entered judgment for the debtor. Section 157(b)(1) permits bankruptcy judges to "hear and determine … all core proceedings arising under title 11, or arising in a case under title 11". But section 157(b)(5) requires the district court to order that "a personal injury tort or wrongful death claim be tried in the district court". The courts should not interpret a statute as jurisdictional unless Congress so indicates. Section 157(b)(5) does not speak in jurisdictional terms but addresses only where the matter may be tried. The statutory context suggests the provision is not jurisdictional, because it appears in the section that allocates the authority to enter a final judgment between the district court and the bankruptcy court. Therefore, section 157(b)(5) is not jurisdictional, and the parties may consent to trial and issuance of a final judgment by the bankruptcy court. Here, the counterclaim defendant consented to trial in the bankruptcy court and objected only years later, after the bankruptcy court had ruled against him. Accordingly, he waived the right to a trial before the district court. *Stern v. Marshall (In re Marshall)*, 564 U.S. ___, 131 S. Ct. 2594 (2011).

11.1.ii. Court lacks subject matter jurisdiction over postconfirmation action for breach of prepetition contract. During the chapter 11 case, an employee of the debtor joined a competitor in breach of the employee's non-compete agreement. After confirmation, the reorganized debtor sued the employee in the bankruptcy court to enjoin the employee from competing. The plan included a general provision granting the bankruptcy court post-confirmation jurisdiction to determine proceedings pending on the plan's effective date. Confirmation narrows the bankruptcy court's subject matter jurisdiction, even if the plan provides for retention of jurisdiction. Postconfirmation jurisdiction requires both a plan postconfirmation jurisdiction provision and the proceeding's close nexus to the plan or its interpretation or implementation. The claim against the former employee did not have a close nexus to the plan's implementation or interpretation, because it was for the sole benefit of the reorganized debtor.

Additionally, the plan's jurisdiction retention provision by its terms was too narrow to encompass this proceeding. Therefore, the court lacked subject matter jurisdiction to hear the complaint. *In re Park Ave. Radiologists, P.C.*, 450 B.R. 461 (Bankr. S.D.N.Y. 2011).

11.1.jj. Estate's debtor's debtor is not a party in interest in proceeding to approve settlement between estate and its debtor. Shortly before bankruptcy, the debtor dismissed its CEO and forgave a large loan that the CEO's employment contract required the debtor to forgive if it dismissed him other than for cause. After plan confirmation, the liquidating trustee sued the former CEO to avoid the forgiveness as a fraudulent transfer. The trustee and the CEO settled, with bankruptcy court approval on notice to creditors. The CEO paid the trustee cash and agreed to pay a portion of the proceeds of an action against his former law firm in state court for malpractice in handling the dismissal and forgiveness transaction. In defense of the malpractice claim, the firm challenged the validity of provisions in the CEO's settlement agreement with the trustee. The CEO asked the bankruptcy court to enjoin the law firm from raising settlement agreement validity as a defense. Section 1109 permits a party in interest to raise and appear and be heard on any issue in a chapter 11 case. Courts must determine the meaning of "party in interest" on an ad hoc basis, based on whether the party has a financial stake, or in limited circumstances, a legal stake, in the outcome of the particular proceeding. In determining whether a particular party is a party in interest, the court must take into account the purposes of chapter 11 to foster reorganization and to give creditors and equity security holders a say in the proceedings. Here, the law firm was not a creditor and had no stake in the outcome of the proceeding to approve the settlement. It had too remote a stake in the proceedings to have standing to object to the court's approval of the settlement between the trustee and the former CEO. Therefore, it was not bound by the approval or the settlement, and it may challenge its validity in defending the malpractice action. *Savage & Assoc., P.C. v. K&L Gates LLP (In re Teligent, Inc.)*, 640 F.3d 53 (2d Cir. 2011).

11.1.kk. Bankruptcy court has jurisdiction over action related to an ancillary case. A foreign representative obtained recognition of a foreign proceeding under former section 304. He then commenced an action in state court against the debtor's accountants and others based on state law claims. The defendants removed the action to the federal district court. A district court has jurisdiction over an action that is "related to a case under title 11". Under section 301, a petition filed under section 304 commences a "case ancillary to a foreign proceeding". (The title of chapter 15 and references in the Bankruptcy Code to chapter 15 similarly use "case".) An action is related to a case if "the outcome might have any 'conceivable effect' on the bankrupt estate". The estate in the foreign proceeding is an "estate" for these purposes. Therefore, the court has jurisdiction over the removed action. *Parmalat Cap. Fin. Ltd. v. Cap. & Fin. Asset Mgmt S.A.*, 632 F.3d 71 (2d Cir.), *amended*, 639 F.3d 572 (2d Cir. 2011).

11.1.ll. Removal should be to district court, not bankruptcy court; referral is not automatic. The confirmed chapter 11 plan provided for the transfer to a liquidating trust of claims the estate had against the debtor's management for both prepetition and postpetition misconduct. The trustee brought the action in state court; the defendants removed to the district court. 28 U.S.C. § 157(a) permits the district court to refer bankruptcy proceedings over which they have jurisdiction to the bankruptcy courts, and the district court here had issued a standing reference order. However, 28 U.S.C. § 1452(a) authorizes removal to a district court. Because that section replaced a prior provision for direct removal to the bankruptcy court as part of an effort to restrict bankruptcy court jurisdiction for constitutional reasons, it should be construed strictly. Therefore, despite the standing reference order for cases and proceedings filed directly in the bankruptcy court and Bankruptcy Rule 9027(a)(1)'s providing for filing notice of removal with the bankruptcy clerk, the district court must, before referring the action, determine its jurisdiction over an action removed to the district court. So the action should be removed to the district court. *McKinstry v. Sergent*, 442 B.R. 567 (E.D. Ky. 2011).

11.1.mm. Bankruptcy court has core jurisdiction to hear state WARN Act claim. The state department of labor filed a proof of claim for amounts owing under the state's WARN Act. The labor department had not yet commenced an administrative proceeding against the debtor for the WARN Act claim, which the department argued would be subject to the police power exception to the automatic stay. The debtor in possession objected to the claim on the ground, among others, that the WARN Act did not apply because of a "liquidating fiduciary" exception. State courts had not yet determined whether that

exception applied under the state's WARN Act. A bankruptcy court has authority to hear and determine core proceedings, which include proceedings for the allowance or disallowance of claims. The possibility that a state administrative proceeding to determine the claim amount might be subject to the police power exception to the automatic stay does not divest the bankruptcy court of core jurisdiction. Therefore, the court may hear the claim objection. *In re Saint Vincent's Catholic Med. Centers of N.Y.*, 445 B.R. 264 (Bankr. S.D.N.Y. 2011).

11.1.nn. Court has postconfirmation jurisdiction to hear liquidating trust's actions. The confirmed chapter 11 plan provided for the transfer to a liquidating trust of claims the estate had against the debtor's management for both prepetition and postpetition misconduct. The trustee brought the action in state court; the defendants removed to the district court. Section 1334(b) grants bankruptcy courts jurisdiction over a proceeding that arises under title 11 or arises in or is related to a case under title 11. "Related to" is a broad basis for jurisdiction. These claim fit, because the trustee's claims by their nature maintain a connection to the bankruptcy, the result will affect creditor recoveries and the claims involve conduct during the bankruptcy. The narrower postconfirmation "close nexus" jurisdictional rule, authorizing related to jurisdiction only to interpret, implement, consummate, execute or administer a confirmed plan, should be viewed only as a prudential rule, not jurisdictional, because the statute does not distinguish between pre- and post-confirmation jurisdiction. Any such distinction makes little sense where the plaintiff is essentially a continuation of the estate and does not involve a reorganized debtor's postconfirmation operations or business. Moreover, the close nexus test triggers should not be exclusive, or else the bankruptcy court's post-confirmation core jurisdiction would be similarly limited, which it is not. Here, the trustee's claims at least relate to the bankruptcy case, because they involve prepetition and postpetition conduct, the trustee asserts them on behalf of unsecured creditors, the plan specifically assigned them to the trust, and they involve implementation and execution of the confirmed plan. *McKinstry v. Sergent*, 442 B.R. 567 (E.D. Ky. Jan. 12, 2011).

11.1.oo. Bankruptcy court has postconfirmation jurisdiction to characterize plan transaction for tax purposes. The debtor partnership confirmed a plan that restructured the partnership into a limited liability company, discharged a portion of the claims against the partnership property and provided that the plan transactions "do not provide for … and will not constitute, the liquidation of all or substantially all of the property of the Debtor's Estate". The state taxing agency later attempted to tax the partners for capital gains, characterizing the restructuring as resulting in a taxable sale, rather than non-taxable cancellation of debt income. The bankruptcy court issued an order to show cause why the agency should not be held in contempt for attacking and refusing to comply with the confirmation order. Although the bankruptcy court's post-confirmation jurisdiction is more limited than its pre-confirmation jurisdiction, it has post-confirmation jurisdiction to interpret, implement, consummate, execute or administer a confirmed plan. The court has jurisdiction over the dispute here because it involved interpretation of the plan. *In re Wilshire Courtyard*, 437 B.R. 380 (Bankr. C.D. Cal. Aug. 31, 2010).

11.1.pp. Bankruptcy court has core jurisdiction over malpractice claim against an estate professional. The chapter 11 debtor in possession sued counsel for the estate in state court. Counsel removed the action to the bankruptcy court. The debtor in possession moved to remand or for abstention. The bankruptcy court has jurisdiction over a proceeding that arises under title 11 or that arises in or is related to a case under title 11. A proceeding arises in a case under title 11 if it would have no existence outside of the case or if it is an essential part of administering the case. The services performed for a bankruptcy estate cannot stand alone and are part of the estate's administration. Therefore, an action challenging those services arise in the case, and the bankruptcy court has jurisdiction over the proceeding as a core proceeding. Remand for lack of jurisdiction is not required, and remand is discretionary and is not reviewable on appeal. *Baker v. Simpson*, 613 F.3d 346 (2d Cir. 2010).

11.1.qq. Bankruptcy court does not have postconfirmation jurisdiction to hear a claim for breach of real estate sale contract entered into during the case. The chapter 11 debtor co-owned property with a nondebtor. They contracted during the debtor's chapter 11 case to sell the property and gave the buyer a right of first refusal to an adjacent parcel. Closing of the sale was delayed until after confirmation of the debtor's plan. The plan referenced the sale and expressed the debtor's intention to sell the adjacent parcel either to the buyer or to a third party. Several years later, the debtor and his co-owner contracted to

sell the adjacent parcel to a third party. Ultimately, the bankruptcy court approved the sale on notice to the first buyer, finding that the sale to the third party did not violate the buyer's right of first refusal. The debtor used the sale proceeds to pay all creditors in the chapter 11 case, and the court issued a final decree and closed the case. The original buyer then sued the debtor, his co-owner and the third party in state court for breach of the original sale contract and for specific performance of the right of first refusal. The state court "remanded" the case to the bankruptcy court. A bankruptcy court's jurisdiction is limited by statute to cases under title 11 and to proceedings arising under title 11 or arising in or related to a case under title 11. A proceeding arises under title 11 only if it invokes a substantive right that title 11 provides. A proceeding arises in a case under title 11 only if it unique to the bankruptcy process and has no independent existence outside of bankruptcy. Here, the action was for breach of a state law-governed contract to sell real property and did not arise under title 11 or in the case. A post-confirmation proceeding is related to a case under title 11 if there is a close nexus to the plan. The state court action here lacked a close nexus because the bankruptcy court, like any other court, is not entitled to determine the preclusive effect of its own orders. That rests with the court where the order is tested. Finally, ancillary jurisdiction enables a court to vindicate its authority and effectuate its decrees. However, ancillary jurisdiction does not extend to disputes over breach of an agreement that produced a dismissal of a prior action. Thus, the bankruptcy court did not have jurisdiction to hear a breach of contract claim based on facts that came to light after the closing of the case, and nothing about the bankruptcy case precluded the state court from taking jurisdiction. *Battle Ground Plaza, LLC v. Ray (In re Ray)*, 624 F.3d 1124 (9th Cir. 2010).

11.1.rr. Postconfirmation jurisdiction is broader under a liquidating plan. Before bankruptcy, the debtor purchased excess workers compensation insurance for itself and its subsidiaries that were self-insured under applicable state insurance law and basic workers compensation insurance for subsidiaries that were ineligible to be self-insured. After bankruptcy, the debtor in possession assumed the insurance contracts and entered into new, similar contracts. The chapter 11 plan provided for the sale of all the debtor's assets and for the reorganized debtor simply to address claims and make distributions. After confirmation, the state workers compensation agency and insurance fund claimed that the debtor in possession had been self-insured during the case and asserted an administrative expense claim for postpetition workers compensation claims that it had paid. It also asserted that the insurer had provided coverage. The insurer commenced an adversary proceeding against the reorganized debtor and the state agency and fund seeking a declaration that it was not liable to the state under the policies. Confirmation shrinks the scope of the bankruptcy court's jurisdiction. The court retains jurisdiction only over matters that have a close nexus to the plan or the case, such as a matter affecting interpretation, implementation, consummation, execution or administration of the plan. However, where the reorganized debtor's sole purpose is to wind up its affairs, convert its assets to cash and distribute the cash to creditors, postconfirmation jurisdiction is broader because jurisdiction relates to core bankruptcy functions and does not require supervision of a reorganized business. The court here has jurisdiction over the adversary proceeding because it seeks determination of the estate's liability in connection with insurance policies that the estate purchased. *Ace Am. Ins. Co v. DPH Holdings Corp. (In re DPH Holdings Corp.)*, 437 B.R. 88 (S.D.N.Y. 2010).

11.1.ss. 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.tt. 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).

11.1.uu. Bankruptcy court may exercise jurisdiction related to a probate matter. The debtor's husband had promised her a substantial trust account, but he never amended his will to reflect his intentions. After he died, his son and sole heir probated the will in Texas probate court. The debtor filed bankruptcy, and the son filed a nondischargeability complaint against her, alleging defamation, and a proof of claim. The debtor counterclaimed in the bankruptcy court for tortious interference with an expected gift from her late husband. The bankruptcy court granted her judgment on her counterclaim. The son appealed to the district court. In the meantime, the son sought and obtained a ruling from the Texas probate court that the will was valid and the debtor was not entitled to any recovery. After the probate court ruled, the district court determined that the counterclaim was not a core proceeding, held a trial and entered judgment for the debtor. Section 157(b)(1) permits bankruptcy judges to "hear and determine … all core proceedings arising under title 11, or arising in a case under title 11". Section 157(b)(2)(C) defines core proceeding to include "counterclaims by the estate against persons filing claims against the estate". This definition does not permit the bankruptcy court to determine all counterclaims. Section 157(b)(1) still limits the bankruptcy court's authority to a counterclaim arising under title 11 or arising in a case under title 11, whether or not a compulsory counterclaim. But a bankruptcy court is not limited to determining only a claim that is bankruptcy specific or could not be brought in state court. Rather, the bankruptcy court may determine counterclaims that are so closely related to the claim that it must be resolved to determine the claim's allowance. The bankruptcy court may rely only on the record as of when the counterclaim is pleaded to determine whether it may determine the counterclaim. Here, determining the tortious interference counterclaim, though arising in part out of the same facts underlying the defamation claim, was not necessary to determining the defamation nondischargeability claim. Thus, the bankruptcy court did not have core jurisdiction to determine the tortious interference counterclaim. Because the Texas probate court determined that claim before the district court determined the tortious interference claim, the Texas judgment bound the district court under the Full Faith and Credit Clause. *Marshall v. Stern (In re Marshall)*, 600 F.3d 1037(9th Cir. 2010).

11.1.vv. Party that files counterclaim against an action by the trustee waives any jury trial right. The debtor contracted before bankruptcy to sell a condominium. The buyer made a deposit with the title company. A dispute arose, and the sale did not close. After bankruptcy, the title company filed an interpleader action against the trustee and the buyer. The trustee cross-claimed against the buyer; the buyer answered and counterclaimed against the trustee, asserting breach of contract, fraud and other common law claims against the debtor and seeking return of the deposit. The buyer demanded a jury trial. A party who asserts a claim against the estate participates in the equitable process of determining claims and distributing property and thus waives any Seventh Amendment right to a jury trial. Property that is "arguable" property of the estate, that is, property in which the debtor has only an arguable claim of right , is property of the estate. Thus, the buyer's claim to the escrowed funds amounts to a claim against the estate that waives the buyer's right to a jury trial. *William M. Condrey, P.C. v. Endeavour Highrise, L.P. (In re Endeavour High Rise, L.P.)*, 425 B.R. 402 (Bankr. S.D. Tex. 2010).

11.1.ww. Bankruptcy court has personal jurisdiction over non-U.S. fraudulent transfer defendant who maintained account with the debtor. The debtor stockbroker operated a Ponzi scheme through customer accounts. The customer maintained an account with the debtor in New York and regularly sent correspondence to the debtor in New York to direct transfers and withdrawals from the account. The customer designated a U.S. agent for service of process, and the account agreement specified New York law as the governing law. The trustee sued the customer for recovery of account withdrawals as fraudulent transfers. The Fifth Amendment Due Process Clause governs whether a non-U.S. defendant is subject to personal jurisdiction in the U.S. It requires that the defendant have minimum contacts with the U.S. and that the exercise of jurisdiction is reasonable, that is, that it will not offend "traditional notions of fair play and substantial justice". The customer's contacts with the U.S. in opening and maintaining the account suffice as minimum contacts and to make the exercise of personal jurisdiction reasonable. However, under the Hague Convention, service on the customer may not be effected by ordinary mail where the customer's jurisdiction has objected, which Switzerland has done. Therefore, service must be effected through the more formal procedures of the Hague Convention. *Picard v. Cohmad Secs. Corp. (In re Bernard L. Madoff Inv. Secs. LLC)*, 418 B.R. 75 (Bankr. S.D.N.Y. 2009).

11.1.xx. Malpractice claim for services rendered during a bankruptcy case are within the bankruptcy court's "arising in" jurisdiction. The debtor in possession and its zoning counsel parted ways during the chapter 11 case. The DIP objected to counsel's fees, which the bankruptcy court approved. After the bankruptcy case was closed, the debtor sued counsel in state court for malpractice, Counsel removed the case to the District Court. The bankruptcy court has jurisdiction over a proceeding arising under title 11 or arising in or related to a case under title 11. "Arising in" jurisdiction includes jurisdiction over matters that would not exist outside the context of a bankruptcy case. A bankruptcy court has an interest in ensuring that professional retained to represent the estate carries out its duties properly and that the fees charged are reasonable. Therefore, a malpractice claim against an estate professional "arises in" the bankruptcy case, and the bankruptcy court has jurisdiction. *Capitol Hill Group v. Pillsbury, Winthrop, Shaw Pittman, LLP*, 569 F.3d 485 (D.C. Cir. 2009).

11.1.yy. Determination of a prepetition credit agreement default is a core proceeding. The debtor filed its chapter 11 case with a prepackaged plan that proposed, among other things, that any defaults under its senior secured claims under a bank credit agreement would be cured, the claims would be reinstated and the class of claims would not be impaired. The banks asserted that the debtor had committed a prepetition non-monetary default that could not be cured and brought an adversary proceeding to determine that there was such a default. The banks stated in the action that the action's purpose was to prevent plan confirmation. "Core proceedings" include claim allowance or disallowance, plan confirmation and other proceedings affecting the adjustment of the debtor-creditor relationship. Courts construe "core proceedings" expansively to include matters that are unique to or uniquely affected by the bankruptcy case and matters that directly affect a core bankruptcy function. This adversary proceeding is uniquely connected to the bankruptcy case because of the connection with plan confirmation and directly affects the core bankruptcy function of plan confirmation. The legal and factual issues in the adversary proceeding are central to the plan and arise from the same operative facts that govern the confirmation hearing. Because the litigation's stated objective is to accelerate the court's consideration of a central plan confirmation issue, the matter is a core proceeding. *JPMorgan Chase Bank., N.A. v. Charter Comm'ns Operating, LLC (In re Charter Comm'ns)*, 409 B.R. 649 (Bankr. S.D.N.Y. 2009).

11.1.zz. Bankruptcy court has personal jurisdiction over a foreign creditor that violates the automatic stay. The debtors operated oceangoing shipping vessels. They were members of an English insurance "club". The club's English law governed insurance policies contained a "cesser" clause, under which the policies terminated not only upon the filing of a bankruptcy petition but also upon the adoption of a winding up resolution by a club member's board. The club attempted termination upon the debtors' bankruptcy filings. The bankruptcy court has jurisdiction over property of the debtor and of the estate, "wherever located". A U.S. court may exercise jurisdiction over a party whose actions have a substantial effect in the United States. A party whose action, such as violation of the automatic stay, has an effect on the administration of a U.S. bankruptcy case has an effect in the United States, wherever the violation occurs. Such a party's action affects the bankruptcy court's ability to administer the estate in the United

States and could subvert the United States' interest in administering bankruptcy cases in a single forum. If the rule were otherwise, a foreign creditor could violate the stay and disrupt a case's administration and create the damage that the automatic stay is designed to prevent. Therefore, a stay violation qualifies to subject the actor to personal jurisdiction. *LaMonica v. N. of England Protecting and Indem. Assoc. Ltd. (In re Probulk Inc.)*, 407 B.R. 56 (Bankr. S.D.N.Y. 2009).

11.1.aaa. A turnover action does not give rise to a jury trial right. After bankruptcy, the debtor received insurance proceeds for damage to property of the estate. The trustee sought recovery from the debtor by bringing an action under section 542(a) seeking turnover and an accounting. The debtor demanded a jury trial. Whether an action in bankruptcy gives rise to a jury trial right depends on first, a comparison to similar actions brought in the English courts at the time of the Seventh Amendment's adoption, second, the remedy sought and third, if the first two point to a jury trial right, whether Congress may and did assign the action to a non-Article III factfinder. Historically, bankruptcy has been an equitable proceeding, and the U.S. courts have so characterized it since bankruptcy laws were enacted in this country. Because an action under section 542(a) is not one to recover damages but to recover property belonging to the estate, it is part of the equitable bankruptcy proceeding. The remedy the trustee seeks here is also equitable. A turnover action seeks to restore the status quo and is therefore similar to a restitution action, which is an equitable remedy. In addition, the accounting remedy that the trustee seeks is an equitable remedy. That the trustee seeks money does not prevent the action from being equitable, as it seeks restitution of property of the estate that the debtor received. Therefore, the debtor is not entitled to a jury trial. *Braunstein v. McCabe*, 571 F.3d 108 (1st Cir. 2009).

11.1.bbb. Debtor may not remove police or regulatory power action to the bankruptcy court. The state sued the debtor for violation of state consumer protection laws for accepting deposits to sell product that the debtor knew it could not deliver. The debtor removed the action to the district court. Section 1452(a) permits removal of any proceeding over which the bankruptcy court would have jurisdiction under section 1334 except certain tax proceedings and "a civil action by a governmental unit to enforce such governmental unit's police or regulatory power". Section 1452(a)'s exception is similar though not identical to the police or regulatory power automatic stay exception in section 362(b)(4). Still, it is designed to work in tandem with that exception and should be construed in the same manner. The dominant tests are the public purpose test, that the government is trying to effectuate public policy rather than adjudicate private rights, and the pecuniary purpose test, that the government is not acting primarily for the government's pecuniary interest. An action does not have a pecuniary purpose solely because it seeks restitution if restitution is not the primary object of the suit. The government's action here meets both tests and may not be removed. The court remands the action to state court. *Mass. v. New England Pellet, Inc.*, 409 B.R. 255 (D. Mass. 2009).

11.1.ccc. Creditor may not collaterally attack a bankruptcy court's jurisdiction to issue a confirmation injunction. The debtor asbestos manufacturer confirmed a plan based on a settlement with, among others, its insurance carriers. The plan and the settlement contained a channeling injunction that enjoined all persons from suing the carriers for all "claims, demands, allegations, duties, liabilities and obligations … which have been, or could have been, or might be, asserted by any Person against [the carriers] based upon, arising out of or relating to any of all of the Policies". Many years after plan confirmation, some plaintiffs brought actions against the carriers alleging that the carriers, based on information they had learned from their insurer relationship with the debtor, had conspired to hide the dangers of asbestos from the public and had failed to warn about the dangers. They sought recover from the carriers only for the carriers' alleged state law violations, not for anything the debtor had done. The injunction did not contain any express limitation tied to the extent of the bankruptcy court's jurisdiction or power under the Bankruptcy Code. The carriers sought to enforce the injunction against the new lawsuits. The bankruptcy court construed the plan injunction as broad enough by its terms to cover the plaintiffs' new lawsuits. Once a confirmation order becomes final, it is res judicata as to parties and those in privity with them, even as to the issuing court's subject matter jurisdiction. Thus, parties may no longer attack the bankruptcy court's jurisdiction to issue the injunction in general or even as to matters at the periphery that might be beyond the bankruptcy court's reach. The only issue that the party objecting to the application of the injunction may address is whether the injunction's terms apply to the party's conduct, not whether the terms may apply to the conduct. *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 129 S. Ct. 2195, 174 L. Ed. 2d 99 (2009).

11.1.ddd. Core jurisdiction is determined claim by claim, not claimant by claimant. The domestic debtor and its foreign affiliates sold domestic and foreign assets to the domestic creditor and its foreign affiliates, respectively. The domestic debtor indemnified the foreign creditor if the debtor's foreign affiliates did not meet their own indemnification obligations to the creditor's foreign affiliates. The creditors pursued the debtor's foreign affiliates in state court and filed a contingent proof of claim against the domestic debtor in its chapter 11 case in case the debtor's foreign affiliates were liable and did not pay. A proof of claim generally subjects the creditor to the bankruptcy court's jurisdiction, and the proceeding on the proof of claim is a core proceeding. The debtor's indemnification of a creditor on a claim against a nondebtor may create related to jurisdiction in the bankruptcy court over the creditor's claim against the nondebtor, because the outcome of that claim could conceivably have an effect on the bankruptcy case. But such an indemnification obligation does not create core jurisdiction over the creditor's claim against the nondebtor. Core jurisdiction must be determined on a claim-by-claim basis, not a claimant-by-claimant basis. Here, the creditor's foreign affiliates' filing of proofs of contingent indemnification claims against the debtor did not give the bankruptcy core jurisdiction over their claims against the debtor's foreign affiliates, even though the creditor's foreign affiliates had filed proofs of claims against the debtor. *In re Exide Technologies*, 544 F.3d 196 (3d Cir. 2008).

11.1.eee. Tucker Act bars bankruptcy court jurisdiction to hear related claims against the United States. The debtor sued the United States in bankruptcy court for a prebankruptcy taking. The Tucker Act, 28 U.S.C. § 1491, waives sovereign immunity for and grants the Court of Federal Claims exclusive jurisdiction over takings claims against the United States. However, the Court of Claims' jurisdiction is not exclusive to the extent that other statutes expressly confer jurisdiction and waive sovereign immunity. Section 1334(b) of title 28 grants the district courts original but not exclusive jurisdiction over civil proceedings in bankruptcy cases "notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts". Section 1334 does not itself waive sovereign immunity, and the waiver of sovereign immunity in section 106 does not include non-bankruptcy claims that become property of the estate under section 541. (That is, section 541 is excluded from section 106(a)'s list of sections as to which the Code waives sovereign immunity.) Therefore, the district court and the bankruptcy court did not have jurisdiction over this noncore proceeding against the United States. *McGuire v. United States*, 550 F.3d 903 (9th Cir. 2008).

11.1.fff. A forum selection clause is enforceable in a bankruptcy case. The debtor had entered into an agreement authorizing a lender/investor to sell the debtor's assets and remit proceeds to the debtor. The lender sold the assets and deposited the proceeds in an escrow account. The debtor disputed the lender's calculations. The debtor filed a chapter 11 case before the dispute was resolved. The lender filed a proof of claim. The debtor in possession objected and counterclaim for the disputed amount. The agreement contained a forum selection clause under which the parties agreed to the exclusive jurisdiction of the New York state and federal courts for any dispute resolution. The bankruptcy court heard the action anyway and granted judgment against the lender. *M/S Bremen v. Zapata Off-Shore, Inc.*, 407 U.S. 1 (1972), requires enforcement of a forum selection clause unless it is inherently unfair, the product of fraud or overreaching or contravenes a strong public policy. The party opposing forum selection clause enforcement has the burden of proof. 28 U.S.C. § 1334(b) does not grant the bankruptcy court exclusive jurisdiction over civil proceedings, and 28 U.S.C. § 157(b) authorizes but does not require a bankruptcy court to hear core proceedings. Where a dispute arises out of a prebankruptcy contract rather than a bankruptcy cause of action, the pendency of a bankruptcy case and the public policy of centralizing administration do not excuse enforcement of a forum selection clause in every core proceeding. The party seeking the bankruptcy court as a forum has the burden of proof that forum selection clause enforcement would meet one of the three Bremen tests. Because the debtor in possession here did not show that enforcement would contravene public policy or would be inherently unfair, the district court vacates the bankruptcy court's judgment and remands the case for transfer to the United States District Court for the Southern District of New York. *D.E. Frey Group, Inc. v. FAS Holdings, Inc. (In re D.E. Frey Group, Inc.)*, 387 B.R. 799 (D. Colo. 2008).

11.1.ggg. Section 105(a) provides an exception to Anti-Injunction Act. The Anti-Injunction Act, 28 U.S.C. § 2283 ("AIA"), prohibits a federal court from issuing an order "to stay proceedings in a State Court except as expressly authorized by Acts of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments". The All Writs Act, 28 U.S.C. § 1651, authorizes federal courts to

"issue all writs necessary or appropriate in aid of their respective jurisdictions". The two statutes act in concert, so that where an AIA exception applies, the All Writs Act authorizes an injunction. Section 105(a), which authorizes a bankruptcy court to issue any order necessary or appropriate to carry out the provisions of the Bankruptcy Code, is an Act of Congress that expressly authorizes an injunction and therefore qualifies as an AIA exception. Thus, the bankruptcy court could enjoin state court litigation against an estate's accountant for malpractice where the state court litigation sought to relitigate issues that the bankruptcy court had resolved, over plaintiff's objections, at the plan confirmation hearing and at the hearing on approval of the accountants fees. *Ernst & Young, LLP v. Reilly (In re Earned Cap. Corp.)*, 393 B.R. 362 (Bankr. W.D. Pa. 2008).

11.1.hhh. Confirmation does not divest court of "related to" jurisdiction over a removed action. The plaintiff sued the debtor's former directors and officers and others in state court based on their prepetition conduct. The defendants removed the action to the district court under its "related to" jurisdiction. Before the court resolved the litigation, the bankruptcy court confirmed the plan, and the plan became effective. "Related to" jurisdiction encompasses any matter than can have an effect upon the estate but narrows upon plan confirmation and effectiveness, because there is no longer an estate that the litigation can affect. However, where the litigation was commenced before confirmation and is based on preconfirmation activities, confirmation does not divest the court of "related to" jurisdiction. *Newby v. Enron Corp. (In re Enron Corp. Secs., Derivative & ERISA Litigation)*, 535 F.3d 325 (5th Cir. 2008).

11.1.iii. Estate representative lawsuit on a claim a creditor assigned to the estate is a core proceeding. The debtor's CEO owned a 52% equity interest in the debtor. An independent investor owned the balance of the equity and was a substantial creditor as well. To receive his maximum annual bonus and remain in control, the CEO falsified the debtor's books over two years to hide the debtor's poor performance. The debtor's auditor did not detect the fraud until after it had issued clean audit opinions for the two years' financial statements. The estate representative objected to the auditor's claim for prepetition accounting fees and counterclaimed for breach of contract, negligence, negligent misrepresentation, and fraud or recklessness in connection with the two years' audits. As part of the plan settlement of the investor's claim, the investor assigned the estate representative its claims against the auditor for the same causes of action. Core proceedings include objections to claims and "counterclaims against the estate by persons filing claims against the estate", so the disbursing agent's objection to the auditor's claim is a core proceeding. A counterclaim based solely on a state law cause of action that arises independently of bankruptcy and that is wholly unrelated and disproportionate to the size of the creditor's claim might not be a core proceeding. Here, however, the counterclaim covered the same subject as the auditor's claim for fees, accounting services, and a professional malpractice claim is a defense to a fee claim, so the adversary proceeding against the auditor is a core proceeding. The investor's claims against the auditor do not, however, arise out of the auditor's fee claim against the estate, but they are counterclaims by the estate (even if only by way of assignment) against a person filing a claim against the estate. They arise out of the same transaction as the fee claim, their determination would likely dispose of the fee claim, and the resolution of the estate's and the auditor's claims would resolve many of the issues underlying the investor's claim. The investor's claim is therefore a core proceeding. *Bankr. Servs., Inc. v. Ernst & Young (In re CBI Holding Co., Inc.)*, 529 F.3d 432 (2d Cir. 2008).

11.1.jjj. Court has "related to" postconfirmation jurisdiction to interpret a liquidating trust agreement created under a plan. A liquidating plan created a liquidating trust, which had subsidiaries. The trustee entered into an employment agreement with the trust and with the subsidiaries. The agreements required the trust to advance defense costs to the trustee if the trustee were sued, and their forum selection clauses provided for bankruptcy court jurisdiction. The trust agreement required the trust advisory committee to approve any trustee employment agreement and permitted a successor trustee to deny defense cost advancement. A former trustee sued the trust in state court for advancement of defense costs in other litigation. The trust removed the advancement action to bankruptcy court. A core proceeding involves matters concerning administration and allowance of claims, including an inquiry into a court fiduciary's conduct. Here, however, the advancement claim does not involve either claims allowance or the former trustee's conduct, because the advancement claims are based solely on the employment agreements, not on a determination of the trustee's conduct, and so are non-core. A post-confirmation proceeding is related to a bankruptcy case if it has a close nexus to the plan or its implementation.

Because the right to advancement here depends on an interpretation of the trust agreement created under the plan and will affect plan consummation, the proceeding is related to the chapter 11 case, and the court has jurisdiction. The trustee's consent to bankruptcy court jurisdiction waives any claim for mandatory abstention or remand on an equitable ground. *Street v. The End of the Road Trust*, 386 B.R. 539 (D. Del. 2008).

11.1.kkk. Bankruptcy court lacks jurisdiction over tort claim related to a bankruptcy sale. The bankruptcy court authorized the sale of estate property. After the sale closed and after the bankruptcy court confirmed a chapter 11 plan, a disappointed bidder sued the successful bidder and certain insiders for intentional interference with business expectancy and for conspiracy. The bankruptcy court has jurisdiction over post-confirmation non-core actions only if the action's outcome "could conceivably have any effect on the estate". Neither common facts between the action and the bankruptcy proceedings, nor judicial economy, nor the terms of a confirmed plan can provide jurisdiction where the statutory terms do not. Here, the action was solely among third parties, not involving the debtor or the estate. Though the bankruptcy court was familiar with the issues based on having presided over the sale and the operative facts in the action substantially overlapped with the sale proceeding in the bankruptcy court, the bankruptcy court lacks jurisdiction to hear the action, because it could not conceivably have any effect on the estate. *GAF Holdings, LLC v. Rinaldi (In re Farmland Indus., Inc.)*, 378 B.R. 829 (8th Cir. B.A.P. 2007).

11.1.lll. Court must dismiss or transfer an improperly venued case. The debtor lived in northern Mississippi, in the Memphis, Tennessee suburbs. He filed his bankruptcy petition in the Western District of Tennessee, which he conceded was an improper venue under section 1408. The court transfers the case to the Northern District of Mississippi. Section 1406, entitled "Cure or waiver of defects" and applicable to civil and bankruptcy cases, requires a district court to dismiss an improperly venued case or transfer it to a proper venue. Section 1412, entitled "Dismissal and Change of Venue" and applicable only to bankruptcy cases, permits a district court to transfer a case to any other district "in the interest of justice or for the convenience of the parties". Section 1412 is not inconsistent with and therefore does not override section 1406, because it addresses only a portion of circumstances that section 1406 addresses. Taken together, these provisions require dismissal or transfer of an improperly venued case. Rule 1014(a)(2) reinforces section 1406 by permitting the court to dismiss an improperly venued case or transfer it to any other district. *Thompson v. Greenwood*, 507 F.3d 416 (6th Cir. 2007).

11.1.mmm. A valid jury trial demand does not divest a bankruptcy court of pre-trial jurisdiction. The preference defendant properly demanded a jury trial and did not consent to a jury trial before the bankruptcy court. The bankruptcy court still may hear all pre-trial matters, including a summary judgment motion. Allowing the bankruptcy court to hear pre-trial matters does not abridge a jury trial right, because that right is effective only at trial. Similarly, a summary judgment motion determines whether there are any genuine issues of material fact to be tried, which is not a fact-finding function of a jury. In addition, allowing pre-trial matters to proceed in the bankruptcy court is consistent with the bankruptcy system Congress has established to rely on the bankruptcy courts' expertise and familiarity with the cases before them. Finally, a jury trial right does not include a similar constitutional right to have all pre-trial matters heard before an Article III court. *Sigma Micro Corp. v. Healthcentral.com (In re Healthcentral.com)*, 504 F.3d 775 (9th Cir. 2007).

11.1.nnn. Postconfirmation "related to" jurisdictional limitation does not apply to a core proceeding, which includes a malpractice action against an estate professional. After the case was closed, creditors brought an action in state court against the estate's accountants for malpractice during the chapter 11 case in connection with plan confirmation. The action is a core proceeding. Core proceedings specifically include matters that concern "the administration of the estate" and "other proceedings affecting the liquidation of the assets of the estate." An action involving the plan confirmation process is inseparable from the bankruptcy case and implicates the integrity of the bankruptcy process. In addition, because the action "arises in" the chapter 11 case (the accountants performed their services during the chapter 11 case), the action is not merely "otherwise related to" the chapter 11 case and therefore is a core proceeding. The test for "related to" jurisdiction is narrower postconfirmation than preconfirmation. However, the narrower test does not apply at all where the postconfirmation proceeding

is a core proceeding. In dictum, the court explains that its narrowing of postconfirmation "related to" jurisdiction applies even where the claim arose preconfirmation, because after confirmation, there is no estate on which the action could conceivably have an effect. *Geruschat v. Ernst Young LLP (In re Seven Fields Dev. Corp.)*, 505 F.3d 237 (3d Cir. 2007).

11.1.ooo. Postconfirmation "related to" jurisdiction extends to interpretation of disputed plan provision. The confirmed plan required additional pension plan funding in certain circumstances. Nearly 10 years after confirmation, a retiree group moved to reopen the case to enforce the plan provision to require the additional funding. Postconfirmation "related to" jurisdiction is narrower than preconfirmation jurisdiction and exists only if "there is a close nexus to the bankruptcy plan", which includes "matters that affect the interpretation, implementation, consummation, execution or administration of the confirmed plan". Because this dispute requires a direct interpretation of the confirmed plan, the bankruptcy court has postconfirmation related to jurisdiction. *In re Shenango Group, Inc.*, 501 F.3d 338 (3d Cir. 2007).

11.1.ppp. The bankruptcy court does not have post-confirmation jurisdiction over an action against prepetition lenders. The debtor asserted two claims against its prepetition banks: for a breach of the loan agreement, which the debtor alleged caused its bankruptcy; and for tortious interference with contractual relationship, which the debtor alleged resulted from the banks' discussions with the debtor's tenant over the sale to the tenant at a below-market price of the debtor's property, which served as collateral for the banks' claims. The plan provided for payment in full of all creditors from postpetition earnings, not from any recovery from the banks, and for retention of jurisdiction after confirmation to liquidate the debtor's claims against the banks. After confirmation, the debtor sold the real property and used the proceeds to pay all creditors in full, including the banks. The debtor then brought an action against the banks in the bankruptcy court for breach of contract and for tortious interference. The bankruptcy court's "arising in a case under title 11" jurisdiction encompasses only claims that are not based on any right expressly created by title 11 but that would not exist but for the bankruptcy. The breach of contract claim does not meet that standard, because the alleged breach occurred before bankruptcy. The debtor's allegation that the breach caused the bankruptcy does not create "arising in" jurisdiction; if it did, any debt could confer such jurisdiction, because any debt could be the cause of a bankruptcy. Similarly, the post-petition tortious interference claim did not arise in the case, because it could equally exist had the banks taken the same action either before the bankruptcy or if the debtor had not filed bankruptcy. Post-confirmation "related to" jurisdiction is more limited than preconfirmation "related to" jurisdiction and requires a "close nexus to the bankruptcy plan or proceeding". Because the reorganized debtor paid all creditors in full from the property sale proceeds and the plan did not provide that the claims proceeds would be used to pay claims, the action against the banks did not have any nexus at all to the bankruptcy plan or proceeding. The bankruptcy court would not have jurisdiction over the claims even if they had remained property of the estate, because after confirmation, section 1334(b) still requires the close nexus for "related to" jurisdiction. The plan provision retaining jurisdiction does not change the result, because neither the parties nor a court order may create jurisdiction that the statute does not authorize. Similarly, the provision retaining jurisdiction, to which the banks did not object, does not bar the banks from litigating the bankruptcy court's post-confirmation jurisdiction, because the bankruptcy court does not have the power to determine its future (*i.e.*, post-confirmation) jurisdiction. *Valley Historic Ltd. P'shp v. Bank of N.Y.*, 486 F.3d 831 (4th Cir. 2007).

11.1.qqq. A 100% subsidiary of a 30% subsidiary is not an affiliate. The debtor owns 30% of an intermediate corporation's stock, which owns 100% of the subsidiary's stock. The debtor's 30% interest does not enable it to control the intermediate's voting of the subsidiary's stock. Under section 101(2)(B), an affiliate is a "corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor ...." Since the debtor neither owns, controls nor holds with power to vote at least 20% of the subsidiary's stock, the subsidiary is not an affiliate. *In re Reichmann Petroleum Corp.*, 364 B.R. 916 (Bankr. E.D. Tex. 2007).

11.1.rrr. An arbitration clause is enforceable in a noncore proceeding. The debtor in possession brought an adversary proceeding to recover from the general contractor for prepetition work that the debtor subcontractor had performed. The debtor had entered into an arbitration agreement with the general contractor before bankruptcy. The contractor sought to enforce the arbitration agreement. The

Federal Arbitration Act, 9 U.S.C. § 2 ("FAA"), requires federal courts to enforce arbitration agreements, unless Congress has provided otherwise. There is no evidence in the Bankruptcy Code's text or legislative history that Congress intended to override the FAA in bankruptcy cases. Therefore, the court must determine whether enforcement of an arbitration agreement would create an inherent conflict with the underlying purposes of the Bankruptcy Code. In this noncore proceeding to recover property for the estate, arbitration would not conflict with the purposes of the Bankruptcy Code. *Whiting-Turner Contracting Co. v. Elec. Mach. Enters., Inc. (In re Elec. Mach. Enters., Inc.)*, 479 F.3d 791 (11th Cir. 2007).

11.1.sss. An action to impose a constructive trust on property held by a third party is a noncore proceeding. The debtor subcontractor and the general contractor performed extra work for the property owner. The general contractor sought recovery from the owner for the extra work. After the general contractor obtained a reduced recovery from the owner, the debtor in possession sought to impose a constructive trust on a portion of the recovery, on the theory that the general contractor would be unjustly enriched if allowed to retain the full recovery and pay none of it to the debtor in possession. An action to impose a constructive trust on property in the possession of the debtor in possession may be a core proceeding because the property is already in the court's custody, and an action to impose a constructive trust on property that the debtor has transferred with actual intent to hinder, delay, or defraud creditors may also be a core proceeding, because federal bankruptcy law provides the right upon which the constructive trust remedy is based. Here, however, the property is not within the court's jurisdiction, and state law provides the basis for the action. Therefore, the action to impose the constructive trust is a noncore proceeding. *Whiting-Turner Contracting Co. v. Elec. Mach Enters., Inc. (In re Elec. Mach. Enters., Inc.)*, 479 F.3d 791 (11th Cir. 2007).

11.1.ttt. "Related to" jurisdiction is broad and does not require certainty of effect on the estate. The debtor purchased natural gas from a supplier and resold it to its customer. The customer sold on to third parties. Texas law provides a lien to the supplier, which continues in the gas unless it is sold in the ordinary course of business or the supplier consents. After bankruptcy, the supplier sued the customer, alleging that the debtor's sale to the customer was not in the ordinary course and that the supplier could collect from the proceeds of its lien, which was the customer's receivables and collections from the third parties. If the supplier were successful against the customer, the customer would have an unsecured claim against the debtor; if not, the supplier would have a claim secured against the debtor by the debtor's receivables from the customer. Thus, the outcome of the supplier-customer litigation could conceivably "alter, positively or negatively, the debtor's rights, liabilities, options, or freedom of action and could influence the administration of the bankrupt estate." Certainty is unnecessary. Therefore, the bankruptcy court has "related to" jurisdiction over the litigation. *Edge Petroleum Op. Co., Inc. v. GPR Holdings, L.L.C. (In re TXNB Internal Case)*, 483 F.3d 292 (5th Cir. 2007).

11.1.uuu. "Related to" jurisdiction does not encompass post-effective date state law claims. The plan vested all claims against third parties in a creditors' liquidating trust. In the Seventh Circuit, plan confirmation limits "related to" jurisdiction to matters to ensure plan implementation and to protection of estate assets devoted to plan implementation. The claims here are no longer property of the estate, so the litigation cannot affect the estate, only the liquidating trust. Therefore, the court does not have jurisdiction to hear them. *CLC Creditors' Grantor Trust v. Sonnenschein Nath & Rosenthal LLP (In re Comm'l Loan Corp.)*, 363 B.R. 559 (Bankr. N.D. Ill. 2007).

11.1.vvv. Jurisdiction solely under the supplemental jurisdiction statute does not trigger mandatory abstention. Section 1367 of title 28 gives the federal district courts supplemental jurisdiction over claims forming part of the same case of controversy with "any civil action over which the district courts have original jurisdiction," including bankruptcy jurisdiction under section 1334. Section 1334(c)(2) requires the bankruptcy court to abstain from hearing certain proceedings over which it might otherwise have jurisdiction if "an action could not have been commenced in a court of the United States absent jurisdiction under this section [1334]." The plaintiff brought an action under two legal theories: one was a core proceeding under section 157(b); the bankruptcy court had jurisdiction over the other only under section 1367. The plaintiff later waived the core proceeding theory, leaving only supplemental jurisdiction as the basis for federal jurisdiction. The district courts may retain an action over which they have only supplemental jurisdiction if the action, as originally commenced, had some other basis of federal

jurisdiction. The federal courts' jurisdiction over the plaintiff's remaining claim only under section 1367 is sufficient to take the proceeding out of section 1334(c)(2)'s mandatory abstention provision, because section 1367 provides an independent basis of federal jurisdiction. *Edge Petroleum Op. Co., Inc. v. GPR Holdings, L.L.C. (In re TXNB Internal Case)*, 483 F.3d 292 (5th Cir. 2007).

11.1.www. Section 1452 remand motion need not be filed within 30 days after removal. The trustee sold the debtor's business intact and assigned a contract to the buyer. The other party to the contract brought an action in state court against the buyer for a declaratory judgment that the contract could not be assigned without curing defaults and that it was therefore no longer bound by the contract. The buyer removed the action to the bankruptcy court. In the meantime, the bankruptcy court had decided that the buyer did not assume the obligations under the contract, which still remained enforceable against the other party. The plaintiff filed a remand motion 33 days after removal. The general federal remand statute, section 1447, requires that a remand motion be filed within 30 days. The special bankruptcy provision, section 1452, does not impose a time limit on remand and evidences Congress' intent to impose a liberal approach to remand in bankruptcy removals. Therefore, the remand motion was timely, but is denied. The action is a core proceeding because it relates to the sale of property of the estate. As such, abstention is not mandatory under section 1334(c)(2). Because the bankruptcy court had already addressed the same issue, discretionary abstention is not required. *Cargill, Inc. v. Man Fin., Inc. (In re Refco, Inc.)*, 354 B.R. 515 (8th Cir. B.A.P. 2006).

11.1.xxx. Bankruptcy court does not have related to jurisdiction over action involving foreign subsidiary. The debtor's unfiled Mexican subsidiary had entered into a joint venture agreement with a partner and agreed to arbitrate any disputes with the partner in Paris. When a dispute arose, the partner commenced an action in Mexico. The debtor's subsidiary brought an action in the bankruptcy court to compel arbitration. The Second Circuit has adopted the test from *Pacor, Inc. v. Higgins*, 743 F.2d 984 (3d Cir. 1984), under which the bankruptcy court has related to jurisdiction "if the outcome could alter the debtor's rights, liabilities, options, or freedom of action … and which in any way impacts upon the handling and administration of the bankruptcy estate." Possible reduction in the value of the subsidiary's stock arising from the partner's breach of the arbitration clause is not such an outcome. The subsidiary's assets are not property of the estate, and an action involving the subsidiary that affects the subsidiary's value indirectly neither alters the *debtor*'s "rights, liabilities, options, or freedom of action" nor affects the administration of the estate. Otherwise, the court would have jurisdiction over all actions in which the subsidiary were a party, as all actions could conceivably affect the value of its stock. *Tower Automotive Mexico, S. De R.L. De C.V. v. Grupo Proeza, S.A. De C.V. (In re Tower Automotive, Inc.)*, 356 B.R. 598 (Bankr. S.D.N.Y. 2006).

11.1.yyy. Bankruptcy court may not retain an improperly venued case. The debtors filed their chapter 7 cases in an admittedly improper venue. Section 1408 determines proper venue. It is more than precatory. Section 1412 governs transfer of venue but should be read as limited only to a properly venued case. Sections 1408 and 1412 parallel and replace the provisions of sections 1472 and 1475, which were enacted part of the original 1978 bankruptcy court system that was later held unconstitutional. Section 1477, which permitted a bankruptcy court to retain an improperly venued case, was not directly replaced. Its function has been taken over by section 1406(a), which requires transfer to a proper venue or dismissal of an improperly venued case. Rule 1014(a)(2) is in accord. Therefore, the bankruptcy court may not retain the cases but must transfer to a proper venue or dismiss. *In re MacDonald*, 356 B.R. 416 (W.D. Tenn. 2006).

11.1.zzz. Federal jurisdiction over core proceedings is not exclusive. The trustee filed an action in state court, with bankruptcy court approval, for recovery of a fraudulent transfer under section 544(b). The defendants removed the action to federal district court, arguing that the action was a core proceeding over which the bankruptcy court has exclusive jurisdiction under *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000). The district court remands the action to state court, concluding that the bankruptcy court's jurisdiction over a fraudulent transfer action, unlike the automatic stay issue in *Gruntz*, is not part of the "case" under section 1334(a), but is a "proceeding" under section 1334(b) over which the bankruptcy court's jurisdiction is not exclusive. Here, where the bankruptcy court has specifically authorized proceeding in

state court, the action does not interfere with the bankruptcy court's paramount jurisdiction. *Hopkins v. Plant Insulation Co.*, 349 B.R. 805 (N.D. Cal. 2006).

11.1.aaaa. Defamation is not a "personal injury tort" claim. The plaintiffs sued a television station and a public advocacy group for defamation. The television station filed bankruptcy. The public advocacy group removed the action to the district court. Section 1334(c)(2) requires the district court to abstain from an action based on a state law claim related to a title 11 case but not arising under title 11 or arising in the case if the action could not have been commenced in a federal court and if the action is commenced and can be timely adjudicated in a state court. Mandatory abstention does not apply, however, to a "personal injury tort" claim. A personal injury tort requires actual physical injury to the plaintiff. Therefore, the exception does not apply to a defamation claim. *Massey Energy v. W. Va. Consumers for Justice*, 351 B.R. 348 (E.D. Va. 2006).

11.1.bbbb. Probate exception to federal jurisdiction does not apply to a preference action. The debtor paid deferred compensation to an employee within 90 days before bankruptcy. The debtor in possession sued to recover the preference from the employee's executor, who defended under the "probate exception" to federal jurisdiction. *Marshall v. Marshall*, 126 S. Ct. 1735 (2006), narrowed the probate exception to actions that would interfere with probating a will or administering the decedent's estate. Here, the DIP did not seek immediate turnover or collection and agreed to enforce any judgment only through the probate court. The action therefore does not come within the probate exception to federal jurisdiction. *Enron Corp. v. Whalen (In re Enron Corp.)*, 351 B.R. 305 (Bankr. S.D.N.Y. 2006).

11.1.cccc. Post-confirmation jurisdiction is limited in the Fifth Circuit. The creditors' committee's financial advisor resigned to represent a potential acquirer. The acquirer's efforts to acquire the debtor in the chapter 11 case were unsuccessful. The acquirer, the financial advisor, the debtor, and other interested parties entered into a settlement agreement, which was incorporated into the confirmed plan. After confirmation, the acquirer sued the financial advisor for breach of fiduciary duty in its representation of the acquirer. A bankruptcy court has "related to" jurisdiction during a title 11 case. A proceeding is "related to" a title 11 case if its outcome "could conceivably have any effect on the estate." *In re Wood*, 825 F.2d 90, 93 (5th Cir. 1987). After confirmation, however, jurisdiction under Fifth Circuit precedent narrows to matters pertaining to the implementation or execution of the plan. Here, the settlement agreement underlying the plan did not govern the outcome of the litigation. Therefore, the court does not have jurisdiction over the action. *Bankruptcy Trading & Invs., L.L.C. v. Chiron Fin. Group, Inc.*, 342 B.R. 474 (S.D. Tex. 2006).

11.1.dddd. Bankruptcy court does not have jurisdiction to determine res judicata effect of confirmed plan. The plan required the debtor in possession to file claims objections within 60 days after the effective date. The debtor in possession failed to file an objection within the 60-day period to a claim listed in the schedules, and clearly described in the disclosure statement, as disputed. The creditor then filed a motion in pending (prepetition) state court litigation for a determination that the debtor's failure to object to the creditor's claim in the bankruptcy court within the 60-day period was res judicata and precluded the debtor from challenging the creditor's claim in any court. The debtor moved the bankruptcy court for an order determining that the failure to file the objection on time was not res judicata and to interpret the plan as preserving the debtor's right to challenge the claim. The bankruptcy court does not have jurisdiction to determine the res judicata effect of its own order in another court. That is solely the domain of the other court. The bankruptcy court does, however, have jurisdiction to interpret the plan, even under the narrower "close nexus to the plan" post-confirmation scope of "related to" jurisdiction. Section 1334, not the terms of a plan, determines the full extent of the bankruptcy court's jurisdiction. A plan cannot expand jurisdiction, although it can permissibly limit (by consent implied in a plan's terms) the exercise of the court's jurisdiction. Interpretation of a plan's terms provides perhaps the closest nexus to the plan, so the court retains and therefore must exercise jurisdiction to interpret the plan when properly asked to do so. *Thickstun Bros. Equip. Co. v. Encompass Servs. Corp. (In re Thickstun Bros. Equip. Co.)*, 344 B.R. 515 (6th Cir. B.A.P. 2006).

11.1.eeee. Bankruptcy court may exercise jurisdiction related to a probate matter. The debtor's husband had promised her a substantial trust account, but he never amended his will to reflect his

intentions. After he died, his son and sole heir probated the will in Texas probate court. The debtor filed later bankruptcy, and the son filed a proof of claim and nondischargeability complaint against her, alleging defamation. The debtor counterclaimed in the bankruptcy court for tortious interference with an expected gift from her late husband. The bankruptcy court granted her judgment on her counterclaim. (In the meantime, the son sought and obtained a ruling from the Texas probate court that the will was valid and the debtor was not entitled to any recovery.) The bankruptcy court had jurisdiction over the counterclaim. The Supreme Court narrows the scope of the "probate exception" to federal jurisdiction, without deciding whether it is based on a constitutional or statutory limitation, to probating a will or administering an estate. Federal courts must hear claims that are within their jurisdiction even though the outcome could affect the distribution of a probate estate. The only limitation is that the court may not "interfere with the probate proceeding"; that is, it may not "disturb or affect the possession of property in the custody of a state court." The bankruptcy court's judgment only establishes the debtor's tort claim against the son. It does not touch any purely probate matter, even though it might be inconsistent with the probate court's determination of the same issue. However, if it is, then the court must determine whether rules of claim or issue preclusion dictate a different result. Finally, the Texas probate court's ruling that it had exclusive jurisdiction over the matter does not deprive a federal court of jurisdiction that Congress grants. *Marshall v. Marshall*, 547 U.S. 293, 126 S. Ct. 1735, 164 L. Ed. 2d 480 (2006).

11.1.ffff. The estate's adversary proceeding is superior to a nonbankruptcy class action to adjudicate a claim against the debtor's prepetition lender. Class action plaintiffs, who purchased and still held notes from the debtor, alleged that the debtor's prepetition lender aided the debtor in violating the securities laws and took the proceeds of fraudulent securities issuances in repayment of its loans. Before class certification, the creditors' committee sued the lender in the bankruptcy court for disallowance and equitable subordination of the lender's claim. Certification of a class action requires the district court to determine that the class action is superior to any other form of adjudication of the controversy. In this case, it was not. The adversary proceeding in the bankruptcy case was superior, because the class action would duplicate the adversary proceeding and will yield a single result for all creditors, and the result it seeks overlaps substantially with the plaintiffs' class action claim. *Gregory v. Finova Cap. Corp.*, 442 F.3d 188 (4th Cir. 2006).

11.1.gggg. Bankruptcy court may not issue discharge while dismissal motion is on appeal. The bankruptcy court denied the creditor's motion to dismiss the individual debtor's case. While the creditor's appeal was pending, the bankruptcy court issued the discharged. The appeal divested the bankruptcy court of jurisdiction over the case, so the bankruptcy court did not have jurisdiction to grant the discharge, which was void. *Sherman v. SEC (In re Sherman)*, 441 F.3d 794 (9th Cir. 2006).

11.1.hhhh. Claims assigned to the trustee may be subject to bankruptcy court jurisdiction. The debtor posted a letter of credit with its landlord to secure its performance under a lease. The debtor posted collateral from the debtor with the bank to secure the debtor's reimbursement obligation under the letter of credit. The landlord drew on a letter of credit after bankruptcy. The trustee and the bank disputed whether the draw was proper under the lease and under the letter of credit itself. The bank assigned the trustee its claims for improper draw against the landlord, which the trustee brought in the bankruptcy court. Even though the claim is between third parties and the court may not obtain jurisdiction over a claim by assignment to the trustee, the court has jurisdiction. The outcome of the litigation would affect the allowability of the bank's reimbursement claim against the estate and the posted collateral. In addition, the trustee's rights implicated the landlord damage claim limitation under section 502(b)(6). Therefore, the matter was a core proceeding. *EOP-Colonnade of Dallas Ltd. P'ship v. Faulkner (In re Stonebridge Techs., Inc.),* 439 F.3d 260 (5th Cir. 2005).

11.1.iiii. PBGC's action for distress pension plan termination is not a core proceeding. The debtor reached an agreement with its union to modify a collective bargaining agreement and sought approval of the modification under section 1113. Under the agreement, the union agreed not to oppose the debtor in possession's effort to terminate the defined benefit pension plan under ERISA section 1341(c) after a specified future date. Before that date, the PBGC notified the debtor in possession of a distress termination under ERISA section 1342 and brought an action in district court, which was referred to the bankruptcy court. The PBGC's action is not a core proceeding. Its right to terminate arises solely under

ERISA. The PBGC brought its action in its capacity as a federal enforcement agency, against the debtor in its capacity as plan administrator, and the debtor would not have been a party if a different entity had been plan administrator. Although the outcome may have affected the amount of claims against the estate, such an effect is too tenuous to create core jurisdiction. Finally, termination does not affect administration of the case, because the plan assets are not property of the estate. *Air Line Pilots Assoc. Int'l v. Pension Benefit Guaranty Corp. (In re United Air Lines, Inc.)*, 337 B.R. 904 (N.D. Ill. 2006).

11.1.jjjj. Court compels arbitration of class action claim. The bank continued its automatic withdrawal of funds from the debtor's bank account after it had notice of the debtor's bankruptcy. The debtor brought a class action against the bank for damages under section 362(h) for the creditor's violation of the automatic stay. The bank sought arbitration as provided under the debtor's credit agreement with the bank. Bankruptcy courts generally do not have any discretion to deny arbitration in a non-core proceeding. However, in a core proceeding, the court has discretion only if the proceeding is based on a Bankruptcy Code provision that inherently conflicts with the Federal Arbitration Act or that would necessarily jeopardize the objectives of the Bankruptcy Code. In this case, the action was core, because it was brought under section 362(h). However, it did not directly affect the debtor's bankruptcy case. The discharge had already been granted, and the action was brought as a class action and therefore did not directly implicate the debtor's bankruptcy case. Therefore, arbitration would not seriously jeopardize the conduct of the debtor's case, the purposes of the automatic stay, or any Bankruptcy Code policies or provisions. *MBNA Am. Bank, N.A. v. Hill*, 436 F.3d 104 (2d Cir. 2006).

11.1.kkkk. Bankruptcy court must enforce arbitration clause in a section 541 action. The chapter 13 debtor brought an action against its mortgage lender to invalidate the mortgage based on federal and state consumer protection laws. The mortgage lender invoked an arbitration clause in the mortgage and moved to compel arbitration. The Federal Arbitration Act reflects strong Congressional policy in favor of enforcing arbitration clauses. A court may deny enforcement only where another federal statute shows a clear Congressional intent to preclude a waiver of judicial remedies for the statutory rights at issue. The Bankruptcy Code shows no such intent for actions under section 541(a), whether core or non-core. The bankruptcy court therefore has no discretion to deny the motion in a case in which the debtor sues on a "debtor derived" action (that is, one derived under section 541(a)). *Mintze v. Am. Gen. Fin. Servs., Inc. (In re Mintze)*, 434 F.3d 222 (3d Cir. 2006).

11.1.llll. Court withdraws the reference for fraudulent transfer, alter ego, and breach of fiduciary claims against debtor's former parent. The debtor in possession sued the debtor's former parent corporation for fraudulent transfers, unlawful dividend, recharacterization of claims as equity, liability for claims of creditors as an alter ego, breach of fiduciary duty while the debtor was still a subsidiary, and disallowance or equitable subordination of the parent's claims. The former parent demanded a jury trial and moved to withdraw the reference of the adversary proceeding and transfer it to the judicial district where the debtor and the former parent are both located. After plan confirmation, the district court withdraws the reference of the action. It concludes that the unlawful dividend claim, the alter ego claim, and the breach of fiduciary duty claim are non-core, because a core proceeding is only one that invokes a substantive right provided under the Bankruptcy Code or one that can arise only in a bankruptcy case. It also concludes that the former parent is entitled to a jury trial on the breach of fiduciary duty claim, the fraudulent transfer claim, and the illegal dividend claim, because they seek money damages. Distinguishing *Katchen v. Landy*, 382 U.S. 323 (1966), and *Langenkamp v. Kulp*, 498 U.S. 42 (1990), the court concludes that the former parent's filing of a proof of claim in the bankruptcy case does not waive its jury trial right on the debtor in possession's claims or convert them to equitable claims, because a constitutional right may be waived only knowingly and willfully and because the claims for relief were not related to the subject of the proofs of claim and will not directly implicate the bankruptcy court's claim resolution process. Finally, the district court transfers the action to the judicial district where both the debtor and the former parent are located, because the only connection to the district where the action was filed was the debtor's chapter 11 case, which is not an adequate basis for retaining the case in that venue. *Mirant Corp. v. Southern Co.*, 337 B.R. 107 (N.D. Tex. 2006).

11.1.mmmm. Negative notice is adequate to protect due process rights. The chapter 13 debtor objected to the creditor's proof of claim with a "negative notice." That is, the notice said that if the creditor

did not respond and request a hearing within 30 days, the bankruptcy court could enter an order without further hearing. Such notice is expressly authorized by section 102(1) in the definition of “after notice and a hearing” and is adequate to protect the creditor’s due process rights. *Roberts v. Pierce (In re Pierce)*, 435 F.3d 891 (8th Cir. 2006).

11.1.nnnn. Bankruptcy court applies Italian automatic stay in the United States in an ancillary proceeding. The Italian debtor filed bankruptcy in Italy. It suffered a judgment against it in a U.S. court shortly after the bankruptcy. In addition, its Italian bankruptcy trustee obtained a judgment in the United States against a third party. The U.S. creditor in the first action, with knowledge of the Italian bankruptcy, garnished the debt owing to the Italian estate in the second action. When the Italian trustee learned of the garnishment, he filed an ancillary proceeding under section 304 and sought to apply the Italian automatic stay against the U.S. judgment creditor to void the garnishment. The court grants the motion. Section 304 permits not only an injunction but also “other appropriate relief.” The Italian bankruptcy law provides, as the U.S. law does, that its automatic stay has extraterritorial reach. As such, the court stayed the U.S. judgment creditor’s enforcement action. The bankruptcy court orders other appropriate relief under section 304 by recognizing the Italian automatic stay’s extraterritorial reach. The factors in section 304 all weigh in favor of recognition of the Italian automatic stay: comity, just treatment of all creditors, protection of U.S. creditors from prejudice and inconvenience, prevention of preferential property dispositions, and equitable distribution of the estate, which are equally recognized by the Italian bankruptcy law and courts. Because the court recognizes the Italian stay from the time it was imposed, the garnishment violated the stay, so the court orders payment of the garnished funds to the Italian trustee for distribution in the Italian case. *Adinolfi v. Empire Marble and Granite, Inc. (In re Rosacometta, S.R.L.)*, 336 B.R. 557 (Bankr. S.D. Fla. 2005).

11.1.oooo. Bankruptcy court has jurisdiction to adjudicate maritime liens on vessels arrested elsewhere. The debtor’s vessels had been arrested in foreign ports, albeit after bankruptcy and therefore in violation of the automatic stay. The debtor sought a sale free and clear of liens in the bankruptcy court. The mortgage lienor consented to the sale free and clear, but three maritime lienors did not. After the sale and in compliance with the sale order, the debtor brought an adversary proceeding to determine rights in the proceeds. The maritime lienors participated in the adversary proceeding but objected to the bankruptcy court’s jurisdiction to extinguish their maritime liens. They argued that only a court with admiralty jurisdiction, which is vested exclusively in the district court, may do so. The court rules that the bankruptcy court may adjudicate maritime liens where the lienors voluntarily submit to jurisdiction. The bankruptcy court’s core subject matter jurisdiction encompasses adjudication of claims against the debtor’s assets. Although bankruptcy courts may not exercise jurisdiction reserved exclusively to Article III courts, the court did not reach the question here of whether Congress had improperly authorized the bankruptcy courts to exercise such exclusive jurisdiction, because Congress may authorize and did in fact authorize the bankruptcy court to exercise jurisdiction over maritime assets where the maritime lienor voluntarily submits to the court’s jurisdiction. *Universal Oil Ltd. v. Allfirst Bank (In re Millennium Seacarriers, Inc.)*, 419 F.3d 83 (2d Cir. 2005).

11.1.pppp. Bankruptcy court does not have jurisdiction over indemnification claim arising out of fraudulent transfer. The debtor purchased a business shortly before bankruptcy. The liquidating trustee alleged that the debtor did not receive reasonably equivalent value and sued the sellers for recovery of a constructively fraudulent transfer. The sellers filed a third-party complaint for negligent misrepresentation against the debtor’s officers and directors, who had represented in the purchase agreement that the debtor was solvent. The bankruptcy court does not have “related-to” jurisdiction over the third-party complaint, because its outcome could not affect the assets or liabilities of the bankruptcy estate. The bankruptcy court does not have ancillary jurisdiction to hear such an action, despite the commonality of the operative facts. *HA2003 Liquidating Trust v. Carramore Limited (In re HA-LO Indus., Inc.),* 330 B.R. 663 (Bankr. N.D. Ill. 2005).

11.1.qqqq. Injunction under section 105_does not require showing of irreparable harm. A chapter 11 plan provided for a liquidating trustee, who brought an action against the debtor’s former parent entity for a fraudulent transfer in the bankruptcy court in California. The former parent sued the liquidating trustee in Delaware, alleging a violation of a venue selection clause in a Settlement Agreement that the

debtor and the parent had entered into before bankruptcy. The trustee asked the bankruptcy court to enjoin the Delaware action under *Barton v. Barbour*, 104 U.S. 126 (1881), which requires leave of the appointing court before suing an equity receiver or, by subsequent case law extension, a bankruptcy trustee. The bankruptcy court may enjoin the Delaware action under section 105 without a showing of irreparable harm. Section 105 provides the necessary authority to issue an injunction to carry out the provisions of the Bankruptcy Code. That authority is adequate to authorize injunctions against violation of Bankruptcy Code principles or doctrines. *Beck v. Fort James Corp. (In re Crown Vantage, Inc.)*, 421 F.3d 963 (9th Cir. 2005).

11.1.rrrr. Confirmation order modifying leases between third parties is *res judicata* and may not be attacked. The debtor leased advertising kiosks to various lessees, then assigned its lessor interest to a finance company on a nonrecourse basis. Many lessees stopped paying before the debtor's bankruptcy because of related disputes. The debtor's plan proposed a modification in general of the terms of the leases, some of which had expired before bankruptcy. The lessees received notice of the plan and of confirmation and did not object. After confirmation, the lessor (the debtor's assignee) served the lessees with notice of the revised lease terms. The lease modifications were enforceable against the lessees. Even though it may have strained the bankruptcy court's jurisdiction to revive the expired leases or to modify leases between two non-debtors, the plan clearly did so, and when the confirmation became final, it was *res judicata* and binding on the lessees. The lessees were parties to the case and had notice of the plan and confirmation hearing and could have challenged the court's jurisdiction then. They may not do so after the order becomes final where, as here, the exercise of jurisdiction was not beyond constitutional bounds. *Finova Capital Corp. v. Larson Pharmacy Inc. (In re Optical Techs. Inc.)*, 425 F.3d 1294 (11th Cir. 2005).

11.1.ssss. Section 107(b)'s exception to public access to court documents should be narrowly construed. Because of a seemingly intractable dispute between the debtor and the creditors committee and among committee members, the parties agreed to the appointment of an examiner. The court authorized the examiner to have access to attorney-client and work product privileged documents for the purpose of preparing the report, without waiving the privileges as to third parties, and temporarily sealed the report pending a determination of whether it should be sealed to protect privilege or as required under section 107(b). The report was sharply critical of some committee members, who asked that the report be sealed. Section 107 reflects a presumption of public access to court documents. The exceptions are to be construed narrowly, and the proponent of sealing an examiner's report or applying an exception has the burden of proof. The evidentiary attorney-client and work-product privileges are distinct from any protection contemplated under section 107(b). The distinction can be addressed by redacting portions of the examiner's report without sealing the entire report. *In re Fibermark, Inc.*, 330 B.R. 480 (Bankr. D. Vt. 2005).

11.1.tttt. No right to jury trial in action for breach of fiduciary duty or recovery of fraudulent transfer. The liquidating trustee sued the debtor's former directors and lenders for breach of fiduciary duty in approving and financing a merger that led to the debtor's financial problems. Although one element of a claim for breach of fiduciary duty is negligence, a classic common law action, the claim for breach is equitable by its nature. Even though the trustee sought money damages, the action is not an action at common law, because the amount sought was in the nature of restitution, intending to "restore the status quo ante and return a sum rightfully belonging to another." Restitution is an equitable remedy that does not give rise to a jury trial right. The trustee also sought recovery of a fraudulent transfer. Although the lenders had not filed proofs of claim, their claims were listed on the schedules as fixed, undisputed, and liquidated. The lenders did not submit to jurisdiction nor waive jury trial by filing a proof of claim. However, because the fraudulent transfer claim mirrors the trustee's objection to the lenders' claim, which is deemed filed by the listing on the schedules, the action is part of the claims allowance process and therefore not entitled to a jury trial. In addition, the trustee seeks only the equitable remedy of avoidance of the repayment obligation and of the lenders' security interest. *Liquidation Trust v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537 (D. Del. 2005).

11.1.uuuu. District court may abstain in nonbankruptcy litigation on comity grounds in favor of foreign bankruptcy proceeding. The creditor maintained a collection account in a U.S. bank for some of the foreign debtor's receivables. The agreement permitted the creditor to apply the funds only in payment

of the debt and required return of any surplus to the debtor. The debtor filed a *suspension de pagos* (suspension of payments) proceeding, similar to a U.S. chapter 11 case, in Mexico and sought to enjoin the creditor from applying the bank account funds to the debt. The bank brought an action in federal district court, seeking a determination that it owned the funds. The court should abstain on international comity grounds in favor of the foreign bankruptcy proceeding. Although prior Second Circuit precedent did not require abstention where the case presented the threshold question of whether the debtor or the other party owned the property, *Koreag v. Refco F/X Assocs., Inc. (In re Koreag)*, 961 F.2d 431 (2d Cir. 1992), that case should be read as permitting the U.S. court to determine the issue only when there is a *bona fide* ownership dispute. Here, the creditor was plainly attempting to apply property to the payment of a debt, a matter which should be decided by the foreign bankruptcy court. Accordingly, the U.S. court must abstain. *JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V.*, 412 F.3d 418 (2d Cir. 2005).

11.1.vvvv. Bankruptcy jurisdiction does not extend to action by a tort victim against a debtor's insurer on a prepetition insurance settlement. A tort victim sued the debtor before bankruptcy. The debtor's insurer defended and, before bankruptcy, settled and agreed to pay the victim. Before payment was made, the debtor filed chapter 11. The insurer then refused to pay, arguing that the tort action was stayed. The victim sued in state court. The insurer removed the suit to the United States district court. The district court remanded because it does not have jurisdiction. The action does not arise under title 11, because it existed independently of the bankruptcy case before the case was filed. It does not arise in the title 11 case, because it does not arise during the bankruptcy case and concern the administration of the estate. Finally, the action is not related to the title 11 case. Although an insurance policy and its proceeds are normally property of the estate, in this case, it appears that the settlement amount was less than the debtor's self-insured retention under the policy, so the insurer's payment of the settlement amount does not implicate the policy at all. Moreover, the insurance company's obligation to the tort victim under the settlement agreement is independent of any obligation the debtor may have to the victim. *Wetzel v. Lumberman's Mut. Cas. Co.*, 324 B.R. 333 (S.D. Ind. 2005).

11.1.wwww. Mandatory abstention applies in a removed action. Section 1334(c)(2) requires a district court to abstain from hearing a non-core proceeding if, among other things, "an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction." Once an action is removed, it is no longer pending in the state court. However, the action was previously "commenced," even though not currently pending, so section 1334(c)(2) mandatory abstention applies to removed actions. This conclusion follows decisions from the Fifth, Sixth, and Eleventh Circuits and splits with the Ninth Circuit. *Mt. McKinley Ins. Co. v. Corning Inc.*, 399 F.3d 436 (2d Cir. 2005).

11.1.xxxx. Arbitration clause is enforceable in a non-core proceeding. The debtor was a distributor of medical products. The trustee sued the debtor's former supplier in the Rhode Island bankruptcy court for breach of the distribution agreement, which provided for arbitration in Tennessee, claiming that arbitration in Tennessee would be inconvenient and expensive. The bankruptcy court ordered arbitration, but in Rhode Island. The supplier appealed. In this non-core proceeding, the trustee stands in the debtor's shoes and is bound by the arbitration clause. Inconvenience and expense are not adequate reasons to disregard a forum selection clause. Therefore, arbitration must proceed in Tennessee. *Furness v. Wright Med. Tech., Inc. (In re Mercurio)*, 402 F.3d 62 (1st Cir. 2005).

11.1.yyyy. A core proceeding need not be arbitrated. The debtor and its principals, some of whom were foreign, had entered into international arbitration agreements for any dispute arising out of their relationships. After bankruptcy, the foreign principals initiated an arbitration proceeding in London. The U.S. principal, who had advanced substantial funds to the debtor, filed an adversary proceeding in the bankruptcy court to establish his claim and to enjoin the arbitration. The Convention on Recognition and Enforcement of Foreign Arbitral Awards, Dec. 29, 1970, 21 U.S.T. 2517, implemented by the federal Arbitration Act, 9 U.S.C. § 1 et seq., requires that the dispute be arbitrated unless Congress determined that the kind of dispute should be heard in the courts. An inherent conflict between domestic law and the Convention is a ground for refusing arbitration. The bankruptcy law contemplates centralization of all disputes relating to claims against a debtor's assets in the bankruptcy court as core proceedings. Arbitration would conflict with this policy. Therefore, enjoining the arbitration proceeding and hearing the

dispute in the bankruptcy court is proper. *Mowbay, L.L.C. v. White Mtn. Mining Co. (In re White Mtn. Mining Co.)*, 403 F.3d 164 (4th Cir. 2005).

11.1.zzzz. Tax Court may properly defer to the bankruptcy court on automatic stay issue. The IRS applied a payment from the debtor's wife's property on dischargeable taxes. The debtor sought internal IRS review, claiming, among other things, that the application of the payment violated the automatic stay. Although the Tax Court may determine whether the automatic stay applies in particular cases, this case presented an especially complex set of facts. The Tax Court believed that the bankruptcy court would have better expertise on the issue and deferred. Deferral under these circumstances is not an abuse of discretion. *Meadows v. Comm'r,* 405 F.3d 949 (11th Cir. 2005).

11.1.aaaaa. District court has jurisdiction to determine effect of automatic stay. The State Attorney General had sued the debtor before bankruptcy for a Clayton Act violation in a district court venue other than where the bankruptcy case was later filed. After bankruptcy, the debtor in possession filed a "suggestion of stay" with the district court, and the district court granted a discretionary stay, based in part on a concern about whether it had jurisdiction to decide whether the police or regulatory exception to the automatic stay applied. The court of appeals concludes that the district court has jurisdiction to decide whether the stay and the exception apply, although under *In re Gruntz*, 202 F.3d 1073 (9th Cir. 2002), its decision would not have preclusive effect on the bankruptcy court. *Lockyer v. Mirant Corp.*, 398 F.3d 1098 (9th Cir. 2005).

11.1.bbbbb. Dispute on a state law claim under a prepetition employment contract is not a core proceeding. The debtor's former employee sought relief from the stay to proceed with an arbitration under his prepetition employment contract with the debtor. The court granted relief from the stay because the dispute over the claim is not a core proceeding. The claim was governed solely by state law. The employee had not filed a proof of claim, except after the appeal, and then only under compulsion of an impending bar date and with a full reservation of all rights. Under Third Circuit law, a proceeding is core "if it invokes a substantive right provided by title 11 or if it is a proceeding that by its nature, could arise only in the context of a bankruptcy case." This claim met neither of those requirements. What's more, the filing of the proof of claim did not make the proceeding core, in part because of the reservation of rights, in part because the claim was filed while the appeal was pending and therefore not a part of the record, and in part because a proof of claim does not invariably turn a non-core proceeding into a core proceeding (on these points, the court may not have adequately distinguished the treatment of affirmative claims by the estate with claims against the estate). *Hylland v. Northwestern Corp. (In re Northwestern Corp.)*, 319 B.R. 68 (D. Del. 2005).

11.1.ccccc. Postconfirmation "related to" jurisdiction is more limited than preconfirmation jurisdiction. The chapter 11 plan provided for the establishment of a new corporation to undertake certain environmental remediation work. The State contracted with the new corporation to perform the work, and the debtor transferred funds to the corporation and the State to fund it. Within a few months after confirmation, disputes arose, and the State terminated the contract, directing the work to an unrelated company that hired many of the new corporation's employees. The new corporation and the chapter 11 liquidating trustee, which owned the stock of the new corporation, sued the State and the unrelated company for breach of contract, tortious interference, and fraud in the inducement and sought recovery of the transferred funds. The Ninth Circuit adopts the Third Circuit's "close nexus" test, *see In re Resorts Int'l, Inc.*, 372 F.3d 154 (3d Cir. 2004), to determine the extent of the bankruptcy court's postconfirmation jurisdiction. Under this test, the court has jurisdiction if there is a close nexus to the bankruptcy plan or proceeding sufficient to uphold jurisdiction. Here, the court had jurisdiction, because the claim for fraudulent inducement grew out of the plan and its negotiation, and the remedies sought could affect the implementation and execution of the plan. The bankruptcy court had supplemental jurisdiction over the remaining claims under 28 U.S.C. § 1367, which applies in bankruptcy cases, because the claims here are part of the same Article III case or controversy. *Montana v. Goldin (In re Pegasus Gold Corp.)*, 389 F.3d 1189 (9th Cir. 2005).

11.1.ddddd. Removal of entire civil action requires consent of all defendants. A chapter 11 debtor in possession brought a state court action against several defendants. One defendant removed the entire

civil action to the bankruptcy court. The plaintiff-debtor in possession moved to remand. Removal under 28 U.S.C. § 1446 (general federal question jurisdiction) requires the consent of all defendants. Section 1452 (bankruptcy jurisdiction removal), by contrast, permits removal of a single claim or cause of action. "Claim" is used in the same sense as used in the term "claim preclusion" and so is claim and party specific. Therefore, if a party removes only the claim or cause of action in which the party is involved, unanimity is not required. If, however, the party removes the entire civil action, as in this case, section 1452 does not apply, so the unanimity requirement does. *Orion Refining Corp. v. Fluor Enters., Inc.*, 319 B.R. 480 (E.D. La. 2004).

11.1.eeeee. Probate exception to federal jurisdiction applies in bankruptcy. The debtor challenged the probate of her late husband's will in Texas probate court and claimed that his son had interfered with his intent to give her an inter vivos gift. She also brought a claim in the bankruptcy court for damages against the son for tortious interference with the husband's intent to give the gift. The probate exception to federal jurisdiction applies whenever a federal court is asked to probate a will or to interfere with the probate proceedings, assume general jurisdiction of the probate, or assume control of property in the state court's custody. Here, the action on tortious interference and on whether the husband had intended to give an inter vivos gift interfered with the probate proceedings, because it was a disguised attack on the husband's will, and those proceedings had already resolved the question. Therefore, the claim is dismissed for lack of jurisdiction. *Marshall v. Marshall (In re Marshall)*, 392 F.3d 1118 (9th Cir. 2004).

11.1.fffff. Under FIRREA, a bank receivership does not oust a bankruptcy court of jurisdiction over pending preference action. The trustee sued the bank to recover a preference. The FDIC later took over the bank under FIRREA, which requires that all post-receivership claims against the bank be processed through an administrative procedure and that any pending actions at the time of the receivership be stayed for 90 days to permit the receiver to request a stay to permit administrative processing. The receiver here did not do so but raised the jurisdictional bar only after the appeal from the preference judgment was pending. Under the circumstances, FIRREA's jurisdictional restrictions do not apply to prevent the bankruptcy court from hearing the matter to conclusion. *Superior Bank, FSB v. Boyd (In re Lewis)*, 398 F.3d 735 (6th Cir. 2004).

11.1.ggggg. Corporation's domicile is its place of incorporation. A Cayman Islands corporation, with all of its assets and its place of business in the United States, filed a liquidation case in the Cayman Islands under Cayman law. Section 304 authorizes ancillary jurisdiction upon an application by a foreign representative in a "foreign proceeding," which is defined as a proceeding "in a foreign country in which the debtor's domicile, residence, principal place of business or principal assets were located." Section 304 applies in this case, because the corporation's domicile is the Cayman Islands. *Hoffman v. Bullmore (In re National Warranty Ins. Risk Retention Group)*, 384 F.3d 959 (8th Cir. 2004).

11.1.hhhhh. Plan provisions cannot create "related to" jurisdiction. Under the Third Circuit's *Pacor* test, a bankruptcy court has "related to" jurisdiction over a proceeding if "the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy". In this case, the plan proposed an injunction against claims asserted against a non-debtor third party. The injunction was critical to the success of the plan, and creditors' recoveries would have been seriously impaired if the injunction were eliminated and the plan were therefore not confirmed. The bankruptcy court did not have any other basis for asserting jurisdiction over the claims against the non-debtor. The plan provision, and the business needs underlying it, do not create related to jurisdiction to permit the bankruptcy court to issue the injunction when jurisdiction does not exist independently of the plan provision, because jurisdiction cannot be conferred by consent of the parties, such as through a plan. Similarly, the corporate affiliate between the debtor and the non-debtor injunction beneficiary does not create related to jurisdiction. *In re Combustion Eng'g, Inc.*, 391 F.3d 190 (3d Cir. 2004).

11.1.iiiii. Section 505(a) does not permit abstention. Section 505(a) provides that a bankruptcy court "may" determine certain tax claims. A majority of courts have construed the section to permit discretionary abstention when a trustee or debtor in possession seeks such a determination, basing the exercise of discretion on six factors, four of which address court considerations (complexity of the issues, burden on court's docket, etc.) and two of which balance the potential prejudice to the debtor, the

creditors, and the taxing agency. The court concludes, however, that section 505(a) does not authorize abstention at all. The statute's language and structure lead to the conclusion that abstention is governed only by section 1334(c) of title 28, not by section 505(a), which contains no statutory standards to govern an abstention decision. In addition, of the factors the courts have developed, the first four are not a proper basis in any proceeding for a court to determine whether to hear a dispute brought before it, and the latter two address the merits of whether the court should grant section 505(a) relief, not whether the court may abstain from exercising jurisdiction. Finally, a court may not abstain under section 1334(c) where abstention would be preclusive, that is, where there is no other forum available. It was not designed as a means of denying relief altogether, only of allocating responsibility for hearing proceedings in bankruptcy cases. The court will therefore proceed to a consideration of the merits of the section 505(a) request and determine in a subsequent proceeding whether relief should be granted, based in part on whether the relief is consistent with Congress's creditor-protection purpose in enacting section 505(a). *Hospitality Ventures/La Vista v. Heartwood 11, L.L.C. (In re Hospitality Ventures/La Vista)*, 314 B.R. 843 (Bankr. N.D. Ga. 2004).

11.1.jjjjj. Section 304-related dispute requires mandatory withdrawal. The debtor sought to restructure under the Argentine *acuerdo preventivo extrajudicial* (APE), which provides a procedure that is similar to a prepackaged chapter 11 case. A U.S. noteholder sought recovery in the U.S. courts of amounts owing under the bonds. The debtor commenced a section 304 proceeding, seeking ancillary relief in the form of an injunction against the creditor's action. The bankruptcy court granted a TRO and set the matter for trial. Before trial, on the creditor's motion, the district court withdraws the reference. It reasons that the issue before the bankruptcy court will be the interaction of section 304 of the Bankruptcy Code with the Trust Indenture Act, which generally prohibits a note issuer from restructuring its obligations to a particular noteholder without that noteholder's consent. Because the decision will turn on material consideration and interpretation of both statutes, one of which regulates "organizations or activities affecting interstate commerce," section 157(d) makes withdrawal mandatory. *In re Cablevision S.A.*, 315 B.R. 818 (S.D.N.Y. 2004).

11.1.kkkkk. Minimum contacts not required for personal jurisdiction within the United States. The Texas debtor in possession sued a California defendant in Texas to collect for the debtor's prepetition sale of goods to the defendant in California. The defendant moved to dismiss for lack of personal jurisdiction, arguing that it had no contacts with the forum state. The court denies the motion, holding that for federal subject matter jurisdiction, minimum contacts with the United States, not the forum state, is all that is required for personal jurisdiction, and that assumption of jurisdiction would not offend due process or notions of fair play. *L.D. Brinkman Corp. v. Anderco Carpet Co. (In re L.D. Brinkman Holdings, Inc.)*, 310 B.R. 68 (Bankr. N.D. Tex. 2004).

11.1.lllll. Claim against debtor's accountant for prepetition negligence is a core proceeding. The debtor's accountant's prepetition audits failed to uncover fraudulent financial statements that the debtor's management had prepared. The accountant performed prepetition services to restate the financial statements and filed a proof of claim for the services. The plan disbursing agent, who had been authorized to pursue estate claims for relief, brought an adversary proceeding against the accountant for damages resulting from the negligent performance of the audits. The proceeding was a core proceeding, because the claim against the accountant was directly related to and arose out of the same operative facts as the accountant's prepetition claim for fees for the restatement. Consideration of the allowance of that claim would require consideration of the disbursing agent's claim relating to the original audit. *Ernst & Young v. Bankruptcy Servs., Inc. (In re CBI Holding Co.)*, 311 B.R. 350 (S.D.N.Y. 2004).

11.1.mmmmm. Bankruptcy court may authorize rejection of FERC-regulated contract. The debtor had entered into a power purchase agreement, which had been approved by FERC. Under the filed rate doctrine, FERC has exclusive jurisdiction over rates charged under such a contract. Rejection of the contract under the Bankruptcy Code is not a challenge to the filed rate. Even if the reason for rejection is that the rate is too high for the debtor's rehabilitation, the rejection damage claim would be based on the filed rate, and rejection would have only an indirect effect on the filed rate. Payment on the rejection claim of an amount less than the filed rate arises not from the rejection itself but from the terms of a reorganization plan providing generally for payment of claims against the debtor. Still, the bankruptcy court

should consider authorizing rejection only under a more rigorous standard that takes account of the regulatory interest in the transaction. *Mirant Corp. v. Potomac Elec. Power Co. (In re Mirant Corp.)*, 378 F.3d 511 (5th Cir. 2004), *affirming in part, reversing in part, and remanding* 303 B.R. 304.

11.1.nnnnn. Bankruptcy court may enjoin regulatory proceeding. Section 362(b)(4) excepts police and regulatory proceedings from the automatic stay. Section 105(a) authorizes the bankruptcy court to enjoin such proceedings on a case-by-case basis, but only in exceptional circumstances. Section 105 permits orders only as necessary to carry out the provisions of the Bankruptcy Code. Therefore, an order enjoining FERC from taking any regulatory action that would negate the bankruptcy court's authorization to reject a power purchase agreement, such as by requiring continued performance under the agreement, is proper. But an injunction prohibiting FERC from taking any action with respect to the contract was too broad, because it was inconsistent with the Bankruptcy Code's presumption, reflected in section 362(b)(4), that a debtor in possession remains subject to on-going regulatory jurisdiction. *Mirant Corp. v. Potomac Elec. Power Co. (In re Mirant Corp.)*, 378 F.3d 511 (5th Cir. 2004), *affirming in part, reversing in part, and remanding* 303 B.R. 304.

11.1.ooooo. Bankruptcy court does not have jurisdiction over prepetition attorneys' fee paid by debtor's insurer to claimants' lawyers. Before bankruptcy, the debtor reached a settlement among one of its insurance companies, asbestos claimants, and their lawyers over asbestos liability. Under the settlement, the insurer would pay a sum to the claimants, who would release the insurer; the insurer would pay the claimants' attorneys' fees for negotiating the settlement, and the debtor would file a prepackaged chapter 11 to bind all claimants. The bankruptcy court confirmed the plan but ordered disgorgement of the fees. The district court reverses, holding that the bankruptcy court does not have jurisdiction over a prepetition transaction between two non-debtors. The dispute was not "related to" the chapter 11 case, because the debtor had not paid the fees and the agreement provided that if the fees were ordered returned, they would be repaid to the insurer. *In re Western Asbestos Co.*, 313 B.R. 859 (N.D. Cal. 2004).

11.1.ppppp. Postconfirmation jurisdiction is not available for litigating trust's malpractice claim. The plan created a litigation trust, which hired an accountant. A dispute arose between the trust and the reorganized debtor over interest on funds the trust held. The trustee alleged that the accountant committed malpractice because its audit incorrectly showed the reorganized debtor was entitled to a portion of the interest, leading to lengthy and expensive litigation over the question. The trustee sued the accountant on the malpractice claim in the bankruptcy court. The court dismisses for lack of jurisdiction. A plan provision providing for retention of jurisdiction cannot expand the bankruptcy court's jurisdiction beyond that granted by 28 U.S.C. § 1334. Postconfirmation jurisdiction is limited, in part because of the revesting of the estate. Thus, a dispute is less likely to have an effect on the estate. "[T]he claim must affect an integral aspect of the bankruptcy process—there must be a close nexus to the bankruptcy plan or proceeding." The court traces several postconfirmation jurisdiction decisions in drawing that line, providing a good analysis of the contours of postconfirmation jurisdiction. In this case, because the dispute does not require an interpretation of the plan or the related documents such as the trust agreement, affect the reorganized debtor, or interfere with the implementation of the plan, the bankruptcy court does not have jurisdiction. *Binder v. Price Waterhouse & Co., LP (In re Resorts Int'l, Inc.)*, 372 F.3d 154 (3d Cir. 2004).

11.1.qqqqq. Core jurisdiction requires express consent. A special counsel appointed by the bankruptcy court initiated disciplinary proceedings against an attorney by adversary proceeding. The complaint did not allege that the proceeding was core. The defendant's answer did not address the issue, and the question was not litigated in the proceeding. When the bankruptcy court issued an order for sanctions against the attorney which included a determination that the proceeding was core, the attorney moved for reconsideration, asserting that the proceeding was non-core and that he had not consented to the bankruptcy court's issuance of a final order. Although Bankruptcy Rule 7012(b) requires a defendant's answer to admit or deny an allegation that a proceeding is core or non-core, the complaint did not contain such an allegation, so the defendant's failure to assert whether the proceeding was core was not a waiver or consent. Moreover, the Advisory Committee Note to Rule 7008(a) says, "Only express consent in the pleadings or otherwise is effective to authorize entry of a final order or judgment by the bankruptcy judge in

a non-core proceeding." Since the defendant objected to jurisdiction the first time the issue was raised in the proceeding, he did not waive the objection. *Sheridan v. Michels (In re Sheridan)*, 362 F.3d 96 (1st Cir. 2004).

11.1.rrrrr. Omnibus disciplinary proceeding is non-core. Suspecting that an attorney had failed to adequately represent clients in over 75 chapter 13 cases, the bankruptcy court initiated disciplinary proceedings against the attorney by appointing a special counsel to investigate and bring an action to determine whether the attorney should be sanctioned. After trial, the bankruptcy court imposed sanctions. The Court of Appeals, over a vigorous dissent, vacates the order. Because the proceeding was non-core and the attorney did not consent to jurisdiction, the bankruptcy court was not authorized to issue a final order, only a recommended order for consideration by the district court. Section 157(b) does not include such a proceeding as core, because it does not relate to the administration of a particular case and would not affect the outcome of any case. The Court of Appeals carefully distinguishes such an omnibus disciplinary proceeding from a proceeding for sanctions for conduct in a particular case that is still open, leaving for another day the issue whether such single proceedings may be core. *Sheridan v. Michels (In re Sheridan)*, 362 F.3d 96 (1st Cir. 2004).

11.1.sssss. Individual Securities Act claims may be removed to the bankruptcy court. Section 1452(a) of title 28 permits any party to a civil action to remove to the bankruptcy court a claim or cause of action in a civil action over which there is bankruptcy jurisdiction, with exceptions only for police or regulatory proceedings brought by a governmental unit and proceedings before the United States Tax Court. Section 22(a) of the Securities Act of 1933 prohibits removal of individual (as opposed to class) actions to any court of the United States. The statutes appear categorical and contradictory. In a case of first impression at the court of appeals level, the Second Circuit resolves the conflict in favor of the bankruptcy removal statute, so as to further the bankruptcy goal of centralizing administration of the estate and dealing with all claims in one forum. *California Public Employees' Retirement System v. WorldCom, Inc.*, 368 F.3d 86 (2d Cir. 2004).

11.1.ttttt. Foreign reorganization proceeding may take precedence over Trust Indenture Act. The Argentine debtor, which had issued U.S. dollar denominated notes that was subject to the Trust Indenture Act, had commenced a reorganization proceeding under Argentine law. U.S. holders commenced a collection action in New York state court. The debtor sought protection under section 304. The holders sought dismissal on the ground that section 312(b) of the Trust Indenture Act prohibited a majority vote of holders in the Argentine proceeding from modifying their rights under the notes. The court denies the motion to dismiss. Citing an 1883 Supreme Court case and Second Circuit precedent, it rules that holder of foreign company notes, whether or not qualified under the TIA, are subject to the foreign country's bankruptcy laws. Comity requires that United States courts recognize foreign reorganization proceedings that bind home country creditors so that creditors abroad can also be bound. The court also grants recognition to the Argentine proceeding under section 304, ruling that the proceeding need not be identical to U.S. proceedings to merit recognition. *In re Board of Directors of Multicanal, S.A.*, 307 B.R. 384 (Bankr. S.D.N.Y. 2004).

11.1.uuuuu. Bankruptcy court has exclusive jurisdiction to interpret bankruptcy provisions of a confirmed plan. The bankruptcy court had confirmed a plan and had reserved jurisdiction to interpret it. After confirmation, one of the debtor's shareholders obtained a judgment against another in a Norwegian court and domesticated the judgment in a Washington state court. The Washington state court issued an order enforcing the judgment. While that was on appeal, the defendant shareholder sought a bankruptcy court injunction against enforcement, arguing that the terms of the confirmed plan were a *res judicata* determination of his liability. The Ninth Circuit B.A.P. concludes that the bankruptcy court had jurisdiction to consider the issue. Relying on *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000), the B.A.P. concludes that the bankruptcy court has exclusive jurisdiction over core proceedings, which are those that "arise under" the Bankruptcy Code, that the court's jurisdiction continues even after a case has been closed to enable a bankruptcy court to enforce its own orders, and that where jurisdiction has been retained, it will be considered exclusive. However, the exclusive jurisdiction extends only to core matters that fall within the bankruptcy court's "arising under" jurisdiction. By contrast, a plan often involves non-core matters. In this case, the plan provision at issue established the rights among the shareholders as a matter of bankruptcy

law. Therefore, as in *Gruntz*, the bankruptcy court had jurisdiction to review the state court judgment, which would have exceeded the state court's jurisdiction if it had construed the confirmed plan incorrectly. *Huse v. Huse-Sporsem, A.S. (In re Birting Fisheries, Inc.)*, 300 B.R. 489 (9th Cir. B.A.P. 2003).

11.1.vvvvv. State court may rule on applicability of automatic stay. A tort claimant had sued the debtor, the debtor's insurer, and a third party indemnitee of the debtor in state court. The judgment was issued prepetition, but after bankruptcy the state court issued a remitter, despite the pendency of the automatic stay. After subsequent proceedings in the bankruptcy court and the district court, the district court allowed the state court to determine the effect of the automatic stay on the judgment and the post-trial motions. The Fifth Circuit affirms, ruling that state courts may rule on the applicability of the automatic stay to state judicial proceedings, and the district court did not improperly delegate its appellate authority to the state court. *Chapman v. Bituminous Ins. Co. (In re Coho Resources, Inc.)*, 345 F.3d 338 (5th Cir. 2003).

11.1.wwwww. Bankruptcy court injunction against FERC is overturned. To preserve its jurisdiction to consider and rule upon a debtor in possession's motion to reject a wholesale power purchase agreement that was subject to FERC jurisdiction, the bankruptcy court enjoined FERC from taking any action to require performance of the contract. On appeal, the district court reverses. It holds that FERC has exclusive jurisdiction over prices and other terms for the sale of electricity for resale and that the bankruptcy court's authorizing contract rejection would affect the price at which power is to be sold. Because that issue is within FERC's exclusive jurisdiction, the bankruptcy court does not have jurisdiction to authorize the rejection and should not have enjoined FERC from proceeding. The district court suggests that the debtor in possession seek comparable relief from FERC, but under FERC's standard for modifying contract terms, not under the standard applicable for rejection of contracts in bankruptcy. *In re Mirant Corp.*, 303 B.R. 304 (N.D. Tex. 2003) (299 B.R. 152, *reversed*), *affirmed in part, reversed in part and remanded*.

11.1.xxxxx. Bankruptcy judge enjoins FERC proceeding. The debtor moved to reject a power supply agreement that was subject to FERC jurisdiction. Because of FERC rulings in recent cases, the debtor in possession was concerned that FERC would order the debtor in possession to continue providing power under the agreement even after the bankruptcy court approved rejection. The bankruptcy court rules that it has the power to enjoin a federal agency, reasoning that a district court has such power, all of the district court's power in bankruptcy cases has been referred to the bankruptcy courts, and there is no prohibition in the Bankruptcy Code against enjoining a federal agency. It concludes further that the power to reject under section 365 would be vitiated by any agency action that required continued performance under the contract and that the bankruptcy court needed to act as the gatekeeper to manage the multiple proceedings that might take place in the court and in a regulatory agency regarding the contract. Finally, it concludes that injunctive relief is warranted because the delay inherent in the regulatory proceedings could irreparably harm the debtor's ability to conclude its chapter 11 case in a reasonable period of time and that there is no irreparable harm to FERC, because the bankruptcy court can hear FERC's opposition to the rejection motion and take into consideration the regulatory objectives involved, perhaps even imposing a higher standard for rejection than the business judgment test. *Mirant Corp. v. Potomac Electric Power Co. (In re Mirant Corp.)*, 299 B.R. 152 (Bankr. N.D. Tex. 2003), *reversed*, 303 B.R. 304 (N.D. Tex. 2003).

11.1.yyyyy. "Related to" jurisdiction does not expire upon confirmation. The director defendants and underwriter defendants in a securities class action removed the action to the district court because the securities issuer was a debtor in a chapter 11 case. The plaintiffs sought remand by reason of the pending confirmation of the chapter 11 plan. They argued that the "related to" jurisdiction under which the actions were removed terminated upon confirmation, because once the plan was confirmed, the class action would not meet the jurisdictional test of having any conceivable effect on the bankruptcy estate. The court rules, however, that jurisdiction is determined when the case is commenced or removed. Adopting a contrary rule could create incentives to delay either the litigation or the bankruptcy. Therefore, the bankruptcy court retains jurisdiction even after confirmation. *In re Worldcom, Inc. Securities Litigation*, 294 B.R. 553 (S.D.N.Y. 2003)

11.1.zzzzz. Bankruptcy removal must be to bankruptcy court, not district court. After bankruptcy, the debtor brought an action in state court against a creditor for violation of the automatic stay and for various other state law causes of action. The creditor removed the action to the district court. The district

court grants the debtor's motion for remand. It reasons that the district court has jurisdiction over the action only under the bankruptcy jurisdictional section, 28 U.S.C. § 1334(a). All matters arising under that jurisdictional grant have been referred, however, to the bankruptcy court. Because the debtor's motion seeks only remand and not transfer to the bankruptcy court, the district court refuses to transfer and instead grants the motion for remand. *Couloute v. Hunt, Leibert, Chester & Jacobson, LLC*, 295 B.R. 689 (D. Conn. 2003).

11.1.aaaaaa. Potential preference defendant is not entitled to a declaratory judgment. The Declaratory Judgment Act, 28 U.S.C. §§ 2201-2202, was intended to provide a potential defendant with a forum to resolve a potential dispute that could affect the defendant's conduct. It was not intended to permit a potential defendant to force a determination of liability for past conduct. Accordingly, the bankruptcy court dismisses a declaratory judgment action by recipients of potentially avoidable transfers for a determination of the avoidability of the transfers. *Allen v. Official Employment-Related Issues Committee (In re Enron Corp.)*, 297 B.R. 382 (Bankr. S.D.N.Y. 2003).

11.1.bbbbbb. Bankruptcy court has exclusive jurisdiction over contract retainage. The subcontractor had not paid its sub-subcontractor; the prime contractor still held a retainage for the subcontractor. After the subcontractor, the sub- subcontractor sued the prime contractor to recover from the retainage. The court dismisses the case, holding that the bankruptcy court in which the subcontractor's case is pending has exclusive jurisdiction under section 1344(e) of the retainage, which is property of the subcontractor's bankruptcy estate. *Kane Enterprises v. MacGregor (USA), Inc.*, 232 F.3d 371 (5th Cir. 2003).

11.1.cccccc. Post-confirmation patent infringement action is related to the bankruptcy case. After confirmation, the reorganized debtors sued three non-creditor parties for pre-petition and post-petition infringement of patents that were critical to the success of the reorganization. The district court rules that the action is related to the bankruptcy case. It also rules that the minimum contact standard set out in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), does not apply in bankruptcy, giving the bankruptcy courts personal jurisdiction over defendants anywhere in the United States. *Cytomedix v. Little Rock Foot*, 287 B.R. 901 (N.D. Ill. 2002).

11.1.dddddd. An action pending in district court may not be removed. A creditor had brought a pre-petition action against the debtor in the United States District Court. The debtor filed a bankruptcy petition in the same district and sought to remove the action. The bankruptcy court rules that the removal notice is a nullity. Jurisdiction of bankruptcy cases is vested in the district court, subject to referral to the bankruptcy court. The district court's standing order of referral does not refer pending civil actions. Because a party may not remove a case to the same court in which it is pending, and because the reference order does not automatically refer the pending matter, the removal petition was ineffective to transfer the matter to the bankruptcy court. *Unnamed Individuals v. The Academy, Inc. (In re The Academy, Inc.)*, 288 B.R. 286 (Bankr. M.D. Fla. 2002).

11.1.eeeeee. Bankruptcy court not bound by district judge's decision. In a district in which there is more than one district judge, the bankruptcy court judges in the district are not bound by a decision of a single district judge. The court reasons that another district judge in the same district may reach a different conclusion, because the first district judge's conclusion is not generally binding on other judges in the district. Accordingly, the decision is not binding on bankruptcy judges either. *Talking Rain Beverage Co., Inc. v. NHB, LLC (In re NHB, LLC)*, 287 B.R. 475 (Bankr. E.D. Mo. 2002).

11.1.ffffff. Bankruptcy court may not enjoin pursuit of claim in a foreign proceeding. The creditor asserted a securities fraud claim that would be subordinated under section 510(b) in the debtor's chapter 11 case. But in the debtor's parallel proceeding in the Belgian bankruptcy court, the claim would not be subordinated. The debtor sought a declaration that the claim is subordinated. Instead, the bankruptcy court enjoined the creditor from pursuing the claim in the Belgian court. The Third Circuit rules that the order constituted an "anti-suit injunction," even though it attempted to enjoin only the party to the foreign proceeding. The Third Circuit follows the "restrictive" approach to permitting anti-suit injunctions (along with the Second, Sixth, and District of Columbia Circuits), contrasted with the liberal approach of

the Fifth, Seventh, and Ninth Circuits. Under the restrictive approach, the injunction may be granted only if the purpose of the foreign proceeding was specifically to interfere with the U.S. court's exercise of its own jurisdiction. Where, as here, there is simply a difference in the law of the two countries, an anti-suit injunction is not appropriate. Moreover, the "center of gravity" and choice of law analysis under *In re Maxwell Communication Corp.*, 93 F.3d 1036 (2d Cir. 1996), does not apply because *Maxwell* involved only a choice of law and a determination to dismiss the U.S. proceeding, not an injunction against a foreign proceeding. *Stonington Partners, Inc. v. Lernout & Hauspie Speech Products, N.V.*, 310 F.3d 118 (3d Cir. 2002).

11.1.gggggg. A motion to re-open is strictly administrative. The bankruptcy court denied a motion to re-open a bankruptcy case to permit the filing of a non-dischargeability complaint under section 523(a)(3)(B). The court based its denial in large part on the futility of the underlying complaint, which the court determined would be barred by laches. The Ninth Circuit reverses, holding that a court should not examine the underlying merits sought to be litigated upon the granting of the motion to re-open. Rather, the motion to re-open addresses only whether further administration appears to be warranted. In addition, a late non-dischargeability complaint under section 523(a)(3)(B) does not require a re-opening of the case, because it is an adversary proceeding that does not implicate the administration of the case. *Staffer v. Predovich (In re Staffer)*, 306 F.3d 967 (9th Cir. 2002).

11.1.hhhhhh. Plan jurisdiction retention provision trumps arbitration clause. A professional had performed services for the debtor before bankruptcy under an engagement agreement that provided for arbitration of any disputes. The debtor proposed a plan that would have settled some of the disputes. The professional objected, and the bankruptcy court required modification of the plan to remove the settlement. After confirmation, the debtor sued the professional in the bankruptcy court under the provision of the plan that provided for the bankruptcy court to retain jurisdiction "to adjudicate any pending adversary proceeding . . . ." The professional sought to compel arbitration. The Seventh Circuit rules that the plan provision effectively modified the pre-petition engagement agreement, eliminating the arbitration requirement and substituting the bankruptcy court's retained jurisdiction to adjudicate disputes. *Ernst & Young LLP v. Baker O'Neal Holdings, Inc.*, 304 F.3d 753 (7th Cir. 2002).

11.1.iiiiii. Bankruptcy court may decline to order arbitration of core proceeding. Before bankruptcy, the debtor brought litigation arising out of a partnership against her former partners. The partnership contained an arbitration clause. After bankruptcy, she removed the action to the bankruptcy court and added fraudulent transfer and strong-arm power recovery causes of action. The defendants moved to stay the proceeding and require arbitration. The Fifth Circuit rules that arbitration is not required, despite the Federal Arbitration Act, in a core proceeding. The bankruptcy court has discretion to determine whether the proceeding should proceed in the bankruptcy court. *Gandy v. Gandy (In re Gandy)*, 299 F.3d 489 (5th Cir. 2002).

11.1.jjjjjj. Court may not remand case to a stranger court. After the debtor plaintiff filed bankruptcy, it removed its Florida state court action to the Florida U.S. District Court, which transferred the case to the Delaware U.S. District Court. The Delaware District Court remanded the action under section 1452(b) to the Delaware Superior Court. The defendant appealed; the plaintiff petitioned for writ of mandamus. The Third Circuit rules that it does not have jurisdiction to review on appeal an order of remand made "on any equitable ground," which, in this case, included a remand based on the abstention grounds in section 1334(c)(1) of "in the interest of justice." It did conclude, however, that a remand to a stranger court is not permissible. Accordingly, the district court acted beyond its jurisdiction, and a writ of mandamus was appropriate to vacate the remand order. The Third Circuit suggested that the Delaware District Court could have authority to remand the case to the Florida state court, because the transferee court (Delaware) had all of the jurisdiction and power of the transferor court (Florida). *Allied Signal Recovery Trust v. Allied Signal, Inc.*, 298 F.3d 263 (3d Cir. 2002).

11.1.kkkkkk. Remand order not reviewable by mandamus. Friction Product Defendants, who had potential indemnification claims against the debtor, removed thousands of asbestos cases from state courts to district courts around the country. The district court in Delaware provisionally transferred the cases to itself under section 157(b), but ultimately remanded the cases to the state courts from which

they were removed. On appeal and on petition for writ of mandamus, the Third Circuit rules that the district court did not have "related to" jurisdiction over the actions, because the mere possibility of indemnification claims against the debtor did not make the cases sufficiently related to the debtor's bankruptcy case. The court also rules that the prohibition on review of a remand order "by appeal or otherwise" prohibits review of the order by writ of mandamus. Accordingly, the appeal is dismissed *In re Federal-Mogul Global, Inc.*, 300 F.3d 368 (3d Cir. 2002).

11.1.llllll. State court has no jurisdiction regarding discharged debt. The debtor listed a minor on his schedules. The minor did not bring a dischargeability complaint within the deadline set by section 523(c). After the minor reached majority, he sued the debtor in state court on the discharged claim. The state court ruled that notice to the minor creditor had not been adequate and that he was therefore not bound by the discharge. The debtor sought to reopen the bankruptcy case to enforce the discharge injunction. The Ninth Circuit rules that it was an abuse of discretion for the bankruptcy court not to reopen the case. Relying on its prior decision in *Gruntz v. Los Angeles*, 202 F.3d 1074 (9th Cir. 2000), which held that determination of the breach of the automatic stay was within the exclusive jurisdiction of the bankruptcy court, the Ninth Circuit reaches the same conclusion on the discharge of claims of creditors who were listed in the schedules. Although the court acknowledges that a state court has concurrent jurisdiction over matters related to claims of creditors that were neither listed nor had notice nor actual knowledge of the case (see § 523(a)(3)), the court rules that a creditor who is listed is expressly covered by the discharge, thus implicating the bankruptcy court's exclusive jurisdiction. Therefore, the bankruptcy court was required to reopen the case to protect its exclusive jurisdiction over the enforcement of its own orders. *McGhan v. Rutz*, 288 F.3d 1172 (9th Cir. 2002).

11.1.mmmmmm. A bankruptcy court's exclusive jurisdiction is coextensive with the automatic stay. The bankruptcy court has very broad jurisdiction. Where the automatic stay prohibits an action in another court, the bankruptcy court's jurisdiction is exclusive. Where an exception to the automatic stay applies, or where the bankruptcy court grants relief from the stay, its jurisdiction is concurrent. The non-bankruptcy court in which an action is pending may make a determination about the applicability of the automatic stay, but if it erroneously determines that the stay does not apply, the entire action may later be declared void. If the non-bankruptcy court is correct, it may issue orders that will later be enforced. Here, the Sixth Circuit reviews this question of exclusive and concurrent jurisdiction in the context of an action pending in a different district court from the district where the bankruptcy case was pending. *Chao v. Hospital Staffing Services, Inc.*, 270 F.3d 374 (6th Cir. 2001).

11.1.nnnnnn. Non-bankruptcy courts have concurrent jurisdiction over civil penalty dischargeability litigation. Shortly after filing bankruptcy, the debtor negotiated a settlement of a governmental environmental claim against him by stipulating in the district court litigation that the amount owing to the government in the settlement was a civil penalty that was non-dischargeable under section 523(a)(7). Neither of the parties litigated non-dischargeability in the bankruptcy court. Nevertheless, because the bankruptcy court has only concurrent, not exclusive, jurisdiction over dischargeability litigation other than under paragraphs (2) (4) (6), and (15), the district court had jurisdiction to determine that the settlement was, by stipulation, non-dischargeable under section 523(a)(7). *Whitehouse v. LaRoche*, 277 F.3d 568 (1st Cir. 2002).

11.1.oooooo. Withdrawn proof of claim does not provide basis for jurisdiction. The foreign creditor had filed a proof of claim but had withdrawn it as of right under Bankruptcy Rule 3006 several months before the debtor brought an adversary proceeding against the creditor. The court rules that because the claim had been withdrawn, the consent to jurisdiction had been revoked. *Cruisephone, Inc. v. Cruise Ships Catering and Services N.V. (In re Cruisephone, Inc.)*, 278 B.R. 325 (Bankr. E.D.N.Y. 2002).

11.1.pppppp. Bankruptcy court's jurisdiction continues after case is closed. Section 1334 of title 28 gives the bankruptcy court jurisdiction over proceedings "arising under title 11, or arising or related to cases under Title 11." The grant of jurisdiction does not depend upon whether the bankruptcy case has been closed (or re-opened) at the time the proceeding is brought. The court may interpret and effectuate its orders under its ancillary jurisdiction, and the court's "arising under" jurisdiction, which permits the court to resolve any dispute based on a right or cause of action created by title 11. The case also contains

a useful discussion of the distinction between dismissal and closing of the case and of the requirement and effect of re-opening a case. *Aheong v. Mellon Mortgage Co. (In re Aheong)*, 276 B.R. 233 (9th Cir. B.A.P. 2002).

11.1.qqqqqq. No home court venue for breach of post-petition contract dispute. The debtor brought an action in the home bankruptcy court against a customer for breach of a post-petition contract. The customer had no particular contacts with the forum state. The B.A.P. dismisses the action for improper venue. It reasons that section 1409(d), which governs venue of a claim arising out of the post-petition operation of the debtor's business, must be applied without regard to the nationwide service of process provision in Bankruptcy Rule 7004 (although those provisions would apply in the case of a pre-petition claim). On that basis, the B.A.P. concludes that applicable non-bankruptcy venue rules apply and that, in this case, such rules require minimum contacts between the defendant and the forum state. *Etalco, Inc. v. AMK Industries, Inc. (In re Etalco, Inc.)*, 273 B.R. 211 (9th Cir. B.A.P. 2001).

11.1.rrrrrr. Settlement agreement in one bankruptcy case may be binding in subsequent case. The debtor entered into an agreement to cure mortgage arrearages in a prior bankruptcy case. The agreement and order provided that it would be binding upon the debtor in any subsequent bankruptcy case. The debtor filed a subsequent chapter 13 case, proposing a plan that would modify the prior agreement and order. Although the court finds the subsequent chapter 13 case was filed in good faith and the debtor complied with the provisions of chapter 13, it enforces the agreement approved in the prior case, because a court can and should enforce its prior orders. *Litton v. Wachovia National Bank (In re Litton)*, 275 B.R. 259 (W.D. VA 2002).

11.1.ssssss. Plan confirmation is *res judicata* as to the debtor's claims against third parties. The estate had a substantial malpractice and breach of duty claim against a third party. Through inadvertence, it did not specifically disclose the claim in its disclosure statement, but generally reserved all claims or causes of action that the estate might own and vested them in a liquidating trust. The Sixth Circuit rules that the order confirming the plan was *res judicata* as to the claim against the third party, because it was a claim that could have been litigated in the bankruptcy court between the same parties as a non-core proceeding and because the confirmation order is a final judgment. The court rules that the omnibus general reservation provision in the disclosure statement is not adequate to except a claim from the *res judicata* effects of a confirmation order. *Browning v. Levy*, 283 F.3d 761 (6th Cir. 2002).

11.1.tttttt. Court disallows *nunc pro tunc* substantive consolidation. A creditor moved for substantive consolidation of the debtor, six affiliated corporations, and two affiliated individuals, *nunc pro tunc* as of the petition date. Although the creditor argued that the retroactive order would merely confirm that all entities were a single entity and had been subject to the court's jurisdiction since the petition date, the court rules that a *nunc pro tunc* order can be used only to correct the record, not to retroactively impose jurisdiction where none previously existed. *United States v. AAPC, Inc. (In re AAPC, Inc.)*, 277 B.R. 785 (Bankr. D. Utah 2002).

11.1.uuuuuu. Professional's forum selection clause disapproved. In its application for employment, Ernst & Young required that the debtor in possession consent to litigation over any dispute only in a federal court without a jury. Upon objection by the United States Trustee, the bankruptcy court refused to approve the provision, holding that the right to sue in state court and obtain a jury are fundamental to the debtor in possession and that waiver was inappropriate, especially insofar as waiver sought to bind a subsequent chapter 7 trustee. *In re Komag, Inc.*, 268 B.R. 566 (Bankr. N.D. Cal. 2001).

11.1.vvvvvv. Bankruptcy court does not have post-confirmation jurisdiction over ordinary contract disputes. The Fifth Circuit rules that the bankruptcy court does not have jurisdiction over an action for breach of a pre-petition contract that the debtor assumed under its confirmed plan and that was necessary for its successful operation under the plan. The court concludes that the expansive bankruptcy court jurisdiction necessary to the administration of the estate does not apply to post-confirmation breach of contract actions, even though the bankruptcy case may still be open. *Bank of Louisiana v. Craig's Stores of Texas, Inc. (In re Craig's Stores of Texas, Inc.)*, 266 F.3d 388 (5th Cir. 2001).

11.1.wwwwww. Automatic stay defines scope of bankruptcy court's exclusive jurisdiction. The Secretary of Labor had commenced a "hot goods" action in federal district court under the Fair Labor Standards Act against the trustee to prevent her from moving business records in interstate commerce. The trustee defended on the grounds that the action was stayed by the automatic stay and the non-bankruptcy federal court did not have jurisdiction. The Secretary countered that the action fell under the police and regulatory powers exception of section 362(b)(4). On appeal, the Sixth Circuit rules that whether the district court had jurisdiction depends on whether the automatic stay applies. If the stay applies, the bankruptcy court has exclusive jurisdiction over actions directed at the debtor or its property. If the automatic stay does not apply, for example, if the action is subject to one of the exceptions of section 362(b), then the bankruptcy court's jurisdiction is concurrent with other courts of competent jurisdiction. Such other courts may determine whether the stay applies and, if it does not, proceed with the non-bankruptcy litigation. However, if that court's initial jurisdictional determination is in error, the entire action may later be declared void. The bankruptcy court's determination of that issue takes precedence over the determination of that issue by a state court or an administrative agency, but a conflict between a bankruptcy court and a federal district court would likely need to be resolved by an appellate court with appellate jurisdiction over both lower courts. *Chao v. Hospital Staffing Services, Inc.*, 270 F.3d 374 (6th Cir. 2001).

11.1.xxxxxx. Bankruptcy court has exclusive jurisdiction over automatic stay issues. After bankruptcy, an unscheduled creditor brought an action against the debtor before a state agency. The debtor responded with a letter asserting the applicability of the automatic stay, but the state agency determined that the stay did not apply and proceeded to issue an order against the debtor. The debtor turned to the bankruptcy court for an injunction against the agency and the creditor. Relying on its decision in *Gruntz v. County of Los Angeles (In re Gruntz)*, 202 F.3d 1074 (9th Cir. 2000) (*en banc*), the Ninth Circuit affirms the jurisdiction of the bankruptcy court to re-examine the automatic stay issue, despite the prior ruling of the state agency. The Ninth Circuit reasons that "Congress vested the federal courts with 'the final authority to determine the scope and applicability of the automatic stay,'" and that actions in violation of the automatic stay are void. *Contractors' State License Board v. Dunbar (In re Dunbar)*, 245 F.3d 1058 (9th Cir. 2001).

11.1.yyyyyy. State court may determine applicability of automatic stay. Disagreeing with the Ninth Circuit's decision in *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000), a New York bankruptcy court holds that a state court determination that its own order and actions did not violate the automatic stay binds the bankruptcy court under the *Rooker-Feldman* doctrine. In this case, the debtor was incarcerated post-petition under a pre-petition arrest warrant for contempt of the state court in a debt collection proceeding. The debtor unsuccessfully sought a state court order that the arrest violated the automatic stay. The state court's determination was binding, and the bankruptcy court would not revisit it. *Siskin v. Complete Aircraft Services, Inc. (In re Siskin)*, 258 B.R. 554 (Bankr. E.D.N.Y. 2001).

11.1.zzzzzz. Bankruptcy court lacks personal jurisdiction over foreign creditor's stay violations. The debtor lived and worked in Hong Kong, where he was sued by various creditors. He moved to the United States, filed a chapter 13 case, and notified the Hong Kong creditors by letter of the automatic stay. The Hong Kong creditors proceeded to judgment in Hong Kong nevertheless, and the debtor sought sanctions against them for violation of the stay. The bankruptcy court ruled that it did not have personal jurisdiction over the Hong Kong defendants, whose only contact with the United States was the sending of letters and other documents to the debtor after he had moved to the United States, because they did not have the required "minimum contacts," including "continuous and systematic general business contacts with the United States." *Williams v. Law Society of Hong Kong (In re Williams)*, 264 B.R. 234 (Bankr. D. Conn. 2001).

11.1.aaaaaaa. Litigation in a foreign court in violation of the automatic stay subjects the foreign creditors to personal jurisdiction. The debtor's reorganization plan provided for a contribution to an insurance fund by its insurance carrier and a channeling injunction prohibiting any litigation against the debtor or the carrier. Canadian creditors nevertheless continued litigation in Canada against the insurance carrier. The debtor and the carrier brought an action in the bankruptcy court against the Canadian creditors for violating the channeling injunctions. The Canadian creditors did not transact any business in

the United States or take any action in the United States, although they had United States affiliates. The court rules that their relationship with their United States affiliates does not subject them to personal jurisdiction in the United States but that doing an act elsewhere that has an effect in the United States, that is, continuing the litigation in Canada that would have an effect on the bankruptcy estate in the United States, subjects them to personal jurisdiction for violation of the channeling injunction. *In re Chiles Power Supply Co.*, 264 B.R. 533 (Bankr. W.D. Mo. 2001).

11.1.bbbbbbb. Filing of a proof of claim does not confer core jurisdiction. The creditor filed a proof of claim, and the debtor counterclaimed in an amount substantially in excess of the creditor's claim for a matter that did not arise out of the same transaction or occurrence. The district court rules that section 157(b)(2)(C), which designates as a core proceeding any counterclaim "against persons filing claims against the estate," should not be read literally. The court notes that the core proceeding definition is limited by section 157(b)(1) to "arising in" and "arising under" proceedings and does not include "related to" proceedings. Because the counterclaim was strictly a "related to" matter, it was not within the general definition of "core proceedings," and therefore did not come within section 157(b)(2)(C). In addition, the court cites footnote 31 of the Supreme Court's *Marathon* decision to support its view that expanding core jurisdiction to include all counterclaims, including "related to" proceedings, would raise serious constitutional questions. *Marshall v. Marshall (In re Marshall)*, 264 B.R. 609 (C.D. Cal. 2001).

11.1.ccccccc. Core proceeding jurisdiction continues after dismissal of the case. Under the bankruptcy court's order, the chapter 13 trustee made payment to the secured creditor of funds deposited by the debtor before plan confirmation was denied and the case was dismissed. The B.A.P. reversed. On the debtor's later motion to compel turnover of the funds, the B.A.P. holds that the bankruptcy court's core jurisdiction extends to enforcing the order on appeal reversing its prior order, even though the bankruptcy case had been dismissed in the interim. *Williams v. City Financial Mortgage Co. (In re Williams)*, 256 B.R. 885 (8th Cir. B.A.P. 2001).

11.1.ddddddd. Bankruptcy court may not abstain from administrative matters. Section 1334(e) of title 28 grants the bankruptcy court "exclusive jurisdiction of the property. . . of the estate." The First Circuit B.A.P. reads this language as granting exclusive jurisdiction over matters relating to the administration of the case to the bankruptcy court. Hence, the bankruptcy court could therefore not abstain from the determination of the administrative tax claim of the Internal Revenue Service. *United States v. Sterling Consulting Corp. (In re Indian Motorcycle Co., Inc.)*, 261 B.R. 800 (1st Cir. B.A.P. 2001).

11.1.eeeeeee. Bankruptcy court may not abstain from an unfiled case. The bankruptcy trustee brought an action for negligence against a former trustee in state court and promptly moved for the bankruptcy court to abstain from hearing the case. The bankruptcy court denied the motion, holding that the state court proceeding was a core proceeding. The B.A.P. reversed the bankruptcy court's order, not on the merits, but because the bankruptcy court did not have jurisdiction to issue the order. Because there was no proceeding pending before the bankruptcy court from which it could abstain, it could not hear and determine a motion to abstain. *Krasnoff v. Marshack (In re General Carriers Corp.)*, 258 B.R. 181 (9th Cir. B.A.P. 2001).

11.1.fffffff. Mandatory abstention does not apply to a diversity action. Section 1334(c)(2) of title 28 requires the district court to abstain from hearing a "related to" proceeding if, among other things, "an action could not have been commenced in a court of the United States absent jurisdiction under this section." In this case, the action could have been brought in federal court under diversity jurisdiction. Accordingly, mandatory abstention did not apply. *Blanton v. IMN Financial Corp.*, 260 B.R. 257 (M.D.N.C. 2001).

11.1.ggggggg. Bankruptcy court has no jurisdiction over FCC licenses. The bankruptcy court applied the automatic stay to prevent the FCC from canceling and re-auctioning radio spectrum licenses. The Court of Appeals previously ruled that the FCC's requirements that spectrum bidders pay in full and on time for any licenses is a regulatory issue for the FCC. *In re NextWave Personal Communications, Inc.*, 200 F.3d 43 (2d Cir. 1999). Enforcing its prior decision, the Court of Appeals now rules that the bankruptcy court has no jurisdiction to review any regulatory action of the FCC. Accordingly, the Second

Circuit issues mandamus to vacate the bankruptcy court's order. *In re Federal Communications Commission*, 217 F.3d 125 (2d Cir. 2000).

11.1.hhhhhhh. Court may not abstain from removed action. Where the trustee removed a state action to the bankruptcy court, the bankruptcy court must determine whether to remand under section 1452(b) "on any equitable ground," but may not abstain on grounds of comity under section 1334(c)(1) or by legislative mandate under section 1334(c)(2). According to the Ninth Circuit, "abstention can exist only where there is a parallel proceeding in state court." *Schulman v. California (In re Lazar)*, 237 F.3d 967 (9th Cir. 2001).

11.1.iiiiiii. U.S. bank accounts create bankruptcy jurisdiction. Section 109(a) of the Bankruptcy Code permits "only a person that resides or has a domicile, a place of business or property in the United States" to be a debtor. The debtors in this case were all foreign and had only some bank accounts in the U.S. The court finds that the bank accounts constitute adequate property in the U.S. for eligibility purposes under section 109(A). *In re Global Ocean Carriers Ltd.*, 251 B.R. 31 (Bankr. D. Del. 2000).

11.1.jjjjjjj. B.A.P. loses jurisdiction when the mandate issues. The Bankruptcy Appellate Panel affirmed the decision of the Bankruptcy Court, which had issued a stay pending appeal. In accordance with Bankruptcy Rule 8017, the B.A.P. mandate issued to the bankruptcy court 17 days after decision, terminating the bankruptcy court's stay pending appeal. Immediately after the issuance of the mandate, the appellant sought a stay of the judgment pending appeal to the Court of Appeals. The court of appeals ruled that the B.A.P. did not have jurisdiction to issue the stay once the mandate had issued to the bankruptcy court. *Payne v. Clarendon National Ins. Co. (In re Sunset Sales, Inc.)* 195 F.3d 568 (10th Cir. 1999).

11.1.kkkkkkk. Bankruptcy Court may not stay judgment pending appeal from the District Court to the Court of Appeals. Relying heavily on *Payne v. Clarendon National Insurance Co. (In re Sunset Sales, Inc.)* 195 F.3d 568 (10th Cir. 1999), the bankruptcy court holds that until the district court has issued its mandate affirming the bankruptcy court's decision, the bankruptcy court is without jurisdiction to grant a stay of enforcement of its judgment pending a further appeal to the court of appeals. Following an exhaustive analysis Bankruptcy Rule 8017 in a related statute, the court also concludes that only the district court and court of appeals may stay enforcement of the bankruptcy court's judgment. Finally, the court concludes that the supersedes bond posted with the bankruptcy court to obtain the initial stay of enforcement of the judgment is not released, and therefore the stay is not terminated until the district court's issuance of the mandate. *Lindner & Assocs., P.C. v. Richards (In re Richards)*, 241 B.R. 769 (Bankr. D.D.C. 1999).

11.1.lllllll. Rule 7004 authorizes nationwide service of process. Reversing its prior panel decision, the Eighth Circuit *en banc* holds that Bankruptcy Rule 7004(d) which authorizes nationwide service of process, is constitutional and that process need not be limited to situations where the defendant had minimum contacts with the forum state. *Warfield v. K.R. Entertainment, Inc. (In re Federal Fountain, Inc.)*, 165 F.3d 600 (8th Cir. 1999).

11.1.mmmmmmm. "Related to" jurisdiction is limited. Having obtained a nondischargeability judgment in a Utah bankruptcy case, the creditor registered the judgment in Texas and brought an action in the Texas bankruptcy court to collect after the Utah case had been closed. Although the action "could alter the debtor's rights, liabilities, [or] options," it would not have an effect on the administration of the estate and so was not within the "related to" jurisdiction of 28 U.S.C. § 1334(b). It was also not within the core bankruptcy jurisdiction under 28 U.S.C. § 157(b)(2)(O) because, even though it "could adjust the debtor-creditor relationship," it did not arise in or arise under the bankruptcy case and so could not be a core proceeding. Finally, section 157 does not allow referral of diversity or Federal question jurisdiction to the bankruptcy court when the case does not otherwise meet bankruptcy jurisdiction requirements. *Bass v. Denney (In re Bass)*, 171 F.3d 1016 (10th Cir. 1999).

11.1.nnnnnnn. State court jurisdiction to determine the scope of the automatic stay is limited. The state court rejected the debtor's claim that his criminal prosecution was stayed by the automatic stay. The debtor sought an injunction from bankruptcy court and an order voiding the state court conviction. The

bankruptcy court denied the injunction, but the Ninth Circuit reversed, holding that even though the state court may determine whether the automatic stay applies, a Federal court may subsequently independently determine the issue and set aside the state court's ruling if it was erroneous. *Gruntz v. County of Los Angeles (In re Gruntz)*, 177 F.3d 728 (9th Cir. 1999).

11.1.ooooooo. Confirmation order effects claim preclusion of "related to" claim. The Fifth and Seventh Circuits have refused to bar a claim over which the bankruptcy court had only "related to" jurisdiction based on an order in a core proceeding, reasoning that the "related to" matter could not be litigated in the core proceeding. The Third Circuit joins the Second, Sixth and Ninth Circuits in going the other way. Here, the senior creditor objected to plan confirmation on unfair discrimination grounds because the subordinated creditor had received partial payment of its claim. In a subsequent non-bankruptcy action for recovery of the funds, the Third Circuit holds that the confirmation order precluded litigation of the terms of the subordination agreement, which could have been raised and the substance of which was raised during the confirmation hearing. The court rejects the argument that a confirmation order can not have claim preclusive effect on a dispute between two creditors. *Corestates Bank, N.A. v. Huls America, Inc.*, 176 F.3d 187 (3d Cir. 1999).

11.1.ppppppp. A bankruptcy judge may not revoke the reference. Confronted with a potential constitutional jurisdictional problem, the bankruptcy judge terminated a standing order of reference and transferred all proceedings to the district court. The district judge reversed, holding that only the district judge can withdraw the reference. *Moore, Owens, Thomas & Co. v. Coffey (In re Kool, Man, Coffee & Co.)*, 234 B.R. 873 (D.V.I. 1999)

11.1.qqqqqqq. Potential defendant/creditor may object to assignment of claim against him. The trustee sold litigation rights to one creditor in exchange for a percentage of the recovery. Another creditor, who would be a defendant in the potential litigation objected and appealed. The objecting creditor had standing to object to the assignment. *Duckor Spradling & Metzger v. Baum Trust (In re P.R.T.C., Inc.)*, 177 F.3d 774 (9th Cir. 1999).

11.1.rrrrrrr. Creditor committee service may subject foreign corporation to bankruptcy court jurisdiction. A German creditor, with no place of business or business activities in the United States, engaged a New York attorney in a New York chapter 11 case. The creditor filed a proof of claim, designating the attorney's address for "all notices in the case." The attorney attended all meetings of the creditors' committee, to which the creditor was appointed. The court held the attorney to be the creditor's agent for service of process in a preference action. *Ms. Interpret v. Rawee Druck-Und-Veredlungs-Gmbh (In re Ms. Interpret)*, 224 B.R. 409 (Bankr. S.D.N.Y. 1998).

11.1.sssssss. Bankruptcy court exercises extraterritorial jurisdiction. The bankruptcy court may enjoin a foreign bank, which did business in the United States, from pursuing a debtor against whom the bank had filed a proof of claim in the debtors' chapter 7 case. Congress has expressed its intention to permit the bankruptcy court to exercise extraterritorial jurisdiction, at least where the creditor filed a proof of claim in the bankruptcy case, and there is no constitutional impediment in such a case. *Hong Kong and Shanghai Banking Corp., Ltd. v. Simon (In re Simon)*, 153 F.3d 991 (9th Cir. 1998).

11.1.ttttttt. Malpractice claim against examiner's accountants is a core proceeding. The examiner's accountants failed to investigate and pursue a claim that the debtor had against a third party, because the third party was a client of the accountants. The debtor's claim against the accountant is a core proceeding, even though malpractice is a state-created cause of action, because policing professionals retained at the expense of the estate is integral to the bankruptcy function and can affect the amount creditors receive. *Southmark Corp. v. Coopers & Lybrand (In re Southmark Corp.)*, 163 F.3d 925 (5th Cir. 1999).

11.1.uuuuuuu. A bankruptcy discharge defense does not support removal of a state court action. In a prior bankruptcy case, the bankruptcy court had ordered a sale free of liens and ordered the county recorder to expunge the liens from the record. The county recorder failed to do so. Subsequently, the lienor sued a buyer on the lien in state court. The buyer removed the action to district court based on the

federal law defense. Construing the federal removal statute, 28 U.S.C. § 1441(a) as permitting removal only where the federal claim is contained in the plaintiff's cause of action, not in a defense, the Supreme Court ordered reward. *Rivett v. Regions Bank of Louisiana*, 118 S. Ct. 921 (1998).

11.1.vvvvvvv. Nationwide service of process rejected. The Eight Circuit rules that despite Bankruptcy Rule 7004, a defendant is not subject to suit in bankruptcy or district court in a state with which the defendant does not have minimum contacts. The court thus splits with the Second, Fifth and Seventh circuits in applying the general federal civil practice rule, rather than the rule intended by the drafters of Bankruptcy Rule 7004. *Warfield v. K.R. Entertainment, Inc. (In re Federal Fountain, Inc.)*, 143 F. 3d 1138 (8th Cir. 1998).

11.1.wwwwwww. "Minimum contacts" required for nationwide service of process. A Missouri bankruptcy trustee sued a Nevada defendant in the bankruptcy court in Missouri. Despite Rule 7004, which provides for nationwide service of process, the District Court rules that the defendant must have minimum contacts with the forum state to be subject to personal jurisdiction, citing the Eight Circuit's narrow interpretation of personal jurisdiction rules. *Warfield v. K.R. Entertainment, Inc. (In re Federal Fountain, Inc.)*, 212 B.R. 960 (E.D. Missouri 1997).

11.1.xxxxxxx. Bankruptcy court jurisdiction may be limited. The terms of a confirmed plan can limit the jurisdiction that a bankruptcy court retains after confirmation. *Grossman v. Murray (In re Murray)*, 214 B.R. 271 (Bankr. D. Mass. 1997).

11.1.yyyyyyy. Post-confirmation jurisdiction approved. The bankruptcy court has jurisdiction to hear an action by a chapter 7 trustee for breach of fiduciary duty against the debtor's principals where the plan was confirmed, the case was closed, and the case was later re-opened by the bankruptcy court because the debtors defaulted on payments under the plan. *Donaldson v. Bernstein*, 104 F.3d 547 (3d Cir. 1997).

11.1.zzzzzzz. Post-confirmation jurisdiction upheld. The bankruptcy court has jurisdiction over a dispute concerning disposition of a sales tax refund relating to property sold under the plan, based on a provision of the plan that the bankruptcy court retain jurisdiction until the plan has been fully consummated for various purposes, including interpretation and enforcement of the terms of the plan. *Norwest Equipment Finance, Inc. v. Nath (In re D & P Partnership)*, 91 F.3d 1072 (8th Cir. 1966).

11.2 Sanctions

11.2.a. Bankruptcy court may not impose criminal contempt sanctions. The creditor brought a bad faith involuntary petition against the debtor. The court dismissed and awarded attorneys' fees, damages and punitive damages under section 303(i). The creditor then filed his own voluntary bankruptcy petition, which was later dismissed. After the dismissal, the creditor paid the section 303(i) award from the first case. The debtor sought additional attorneys' fees and punitive damages for the effort to challenge the creditor's bankruptcy and collect the award because of the creditor's bad faith conduct. A civil contempt sanction only includes an order to coerce future compliance or to compensate for past noncompliance. Any form of punishment, such as punitive damages, for noncompliance is a criminal sanction. Bankruptcy courts, like all courts, have inherent power to "achieve the orderly and expeditious disposition of their cases." In addition, section 105(a) authorizes a bankruptcy court to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions of" the Code. Neither authority allows a bankruptcy court to issue a criminal sanction. A civil contempt sanction aids compliance by its coercive effect. By contrast, a criminal sanction is not necessary to facilitate compliance with the Code and a court's orders; it only punishes. Therefore, the bankruptcy court may not impose punitive damages for violation of its order. *Adell v. John Richards Homes Bldg Co., LLC (In re John Richards Homes Bldg Co., LLC)*, 475 B.R. 585 (E.D. Mich. 2012).

11.2.b. 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).

11.2.c. Bankruptcy court may hold a party in civil contempt for violating an oral injunction. At a hearing, the bankruptcy court ordered an asset protection trustee not to dispose of property. Before the written order was entered, the trustee disposed of the property. The court later found that the trustee knew of the oral order when he violated it. Civil contempt may be coercive or remedial, but not punitive. Bankruptcy courts may sanction a civil contempt. The contempt power is essential for a court to enforce its orders. The elements of civil contempt are that a court order is in effect, the order requires certain conduct and the respondent does not comply with the order. Bankruptcy proceedings move quickly, and a party can dispose of property before the court can issue a written order. Therefore, an oral injunction may be necessary, and the court may punish for violation of an oral injunction. Because the trustee violated the oral injunction here, the civil contempt judgment to restore the property was proper. *Ingalls v. Thompson*, 588 F.3d 255 (5th Cir. 2009).

11.2.d. A bankruptcy court may impose sanctions under 28 U.S.C. § 1927. Section 1927 of title 28 permits a "court of the United States" to impose sanctions against counsel "who so multiplies the proceedings in any case unreasonably and vexatiously". A lawyer filed and then consented to dismissal of a second bankruptcy case solely to obtain the automatic stay's protection for his client. The bankruptcy court imposed sanctions against the lawyer under 28 U.S.C. § 1927 for the second case filing. Section 451 of title 28 defines "court of the United States" to include the district courts but does not mention bankruptcy courts. Section 151 of title 28 defines the bankruptcy court as a "unit of the district court", and section 157(a) permits a district court to refer all bankruptcy cases and proceedings to the bankruptcy courts. The delegation of authority includes the authority to issue sanctions under section 1927. *In re Schaefer Salt Recovery, Inc.*, 542 F.3d 90 (3d Cir. 2008).

11.2.e. Bankruptcy court may not sanction for contempt an individual who has not been served or appeared. The debtor's officer refused to testify in a Rule 2004 examination in the bankruptcy case. A creditor sought to hold her in contempt, but did not comply with Rule 7004 in serving her with process. As the debtor's representative, the officer was only the debtor's agent. Appearance as an agent does not make an individual a party in an individual capacity. Therefore, she could be held in contempt only if she were properly served with process in her individual capacity. Because she was not, she was not subject to the court's jurisdiction and could not be held in contempt. *In re Teknek, LLC*, 512 F.3d 342 (7th Cir. 2007).

11.2.f. Court sanctions attorney for inadequate investigation of debtor's prior bankruptcy filings. The debtor had filed several prior bankruptcy cases, the last two of which had been dismissed under an order prohibiting refiling for one year. Although the debtor's new bankruptcy counsel inquired about prior chapter 7 filings, he did not access any of the bankruptcy court records such as VCIC or PACER to determine whether the debtor had actually previously filed any cases and to review the dismissal orders. Counsel's conduct did not meet the standard of reasonable investigation under Bankruptcy Rule 9011 and subjected counsel to sanctions for the filing. *In re Reaver*, 307 B.R. 834 (Bankr. S.D. Miss. 2002).

11.2.g. Bankruptcy court has inherent power to sanction. The lawyer and one of the debtors abused the bankruptcy process to delay state court litigation. The bankruptcy court found that they had acted in bad faith. The bankruptcy court has the inherent power to sanction this conduct where the statutes and rules are not adequate to remedy the misconduct. However, where the statute or rules apply, the bankruptcy court may not use its inherent power to go beyond what is authorized in the statute or rules. *In re DeVille*, 361 F.3d 539 (9th Cir. 2004).

11.2.h. Court of appeals reviews B.A.P. imposition of sanctions for abuse of discretion. The B.A.P. had dismissed an appeal for failure to supply a record and to comply with B.A.P. rules. On appeal to the court of appeals, the appellant argued the underlying merits of the bankruptcy court's decision. The Ninth Circuit bypasses that issue to review the B.A.P.'s summary affirmance as a sanction and concludes that it should apply an abuse of discretion standard to the decision of the B.A.P. (or the district court) on appeal. To do otherwise would undercut the ability of those courts to enforce their rules and orders. *Morrissey v. Stuteville (In re Morrissey)*, 349 F.3d 1187 (9th Cir. 2003).

11.2.i. Attorney sanctioned for bad faith chapter 11 filing. Sanctions may be warranted under Rule 9011(b) in the case of a filing that is both frivolous and for an improper purpose. The more compelling the showing as to one element, the less compelling the showing as to the other needs to be. In this case, the debtor, represented by counsel, filed a chapter 11 petition two days before the state court was to set a trial date on a specific performance action against the debtor for sale of real property. The value of the property plus the debtor's other assets was more than enough to pay all claims, including the specific performance claim, and the nature of the debtor's financial condition made it impossible for the debtor to confirm a plan without the consent of the specific performance plaintiff. Therefore, the petition was filed both for an improper purpose and was frivolous, in that it would not have accomplished any restructuring objective. Sanctions on both the debtor and his attorney were appropriate. *Dressler v. The Seeley Co. (In re Silverkraus)*, 336 F. 3d 864 (9th Cir. 2003).

11.2.j. Bankruptcy court has disciplinary authority. The bankruptcy court appointed special counsel to investigate an attorney's violations of state bar rules, including the duty to handle matters competently and to protect client funds. Based on special counsel's investigation and recommendation, the bankruptcy court disbarred the attorney for one year, awarded special counsel its fees from the court itself, and ordered the attorney to reimburse the court for the fees as a condition of reinstatement. The B.A.P. upholds the order, ruling that the bankruptcy court has jurisdiction, inherent authority, power under section 105(a), and authority under the local bankruptcy rules to protect the integrity of the court and court processes and to punish violation of state bar rules. The B.A.P. agrees that the bankruptcy court had jurisdiction to order payment of special counsel fees and discretion to determine the punishment for violation, including suspension or disbarment. *In re Disciplinary Proceedings, Sheridan v. Michaels*, 282 B.R. 79 (1st Cir. B.A.P. 2002).

11.2.k. Creditor is sanctioned for undisclosed dual fee structure. The secured creditors law firm charged the creditor a blended hourly rate but sought reimbursement at a higher rate, which the creditor agreed to pay only if the debtor was actually held liable for and paid the amount under section 506(b). In its section 506(b) motion, the creditor failed to disclose the dual fee structure. The court awarded sanctions under Rule 9011 for the nondisclosure. *1095 Commonwealth Corporation v. Citizens Bank of Massachusetts (In re 1095 Commonwealth Corporation)*, 236 B.R. 530 (D. Mass. 1999).

11.2.l. Bankruptcy court has civil contempt power to incarcerate. The bankruptcy judge may incarcerate for a civil contempt, that is, until the contemnor complies with the court's order. Unless the contemnor objects within 10 days, as required under Rule 9020(c), the bankruptcy judge need not submit a report and recommendation to the district court for the incarceration order to be effective. *In re Burkman Supply Co., Inc.*, 217 B.R. 223 (W.D. Mich. 1998).

11.2.m. Contempt sanctions for violation of automatic stay. The Eleventh Circuit joins the Second and Ninth Circuits in holding that "individual" in section 362(h) does not include a corporation, but that the bankruptcy court has contempt power under section 105(a) to award monetary and other forms of relief for automatic stay violations. Because this case involved a stay violation by the IRS, the court further

ruled that "section 106(a) unequivocally waives sovereign immunity for court-ordered monetary damages under section 105," but that any attorney's fees awarded against the IRS must be consistent with the Equal Access to Justice Act, 28 U.S.C.§ 2412(d)(2)(A) and section 7430 of the Internal Revenue Code. The court also prohibited any punitive sanction for the civil contempt violation of the automatic stay. *Jove Engineering, Inc. v. Internal Revenue Service*, 92 F.3d 1539 (11th Cir. 1996).

11.2.n. Criminal contempt is an appropriate remedy for disclosure and solicitation violations. A creditor improperly solicited rejections of the small business debtor's plan, suggesting that the creditor's own plan, which would follow denial of confirmation of the debtor's plan, would be a better choice. The district court confirmed a criminal contempt sanction by the bankruptcy judge as a remedy for the violation of Section 1125. *Colorado Mountain Express, Inc. v. Aspen Limousine Service, Inc. (In re Colorado Mountain Express, Inc.)*, 198 B.R. 341 (D. Colo. 1996).

11.2.o. Bankruptcy court lacks authority to award fees for on appeal. The trustee filed a motion for sanctions for violation of the automatic stay, including withholding funds pending an appeal. The bankruptcy court granted the fees incurred in the prior appellate proceeding as a compensatory penalty for the stay violation. The Ninth Circuit rules that the bankruptcy court lacks power under section 105(a) to grant fees related to an appeal. *State of California Employment Department v. Taxel (In re Dell Mission Ltd.)*, 98 F.3d 1147 (9th Cir. 1996).

11.3 Appeals

11.3.a. Creditor does not have standing to appeal order granting stay relief to pursue litigation. Before bankruptcy, the creditor sued the debtor in Virginia, the debtor sued the creditor in Puerto Rico, and the creditor counterclaimed against the debtor in the Puerto Rico action, all involving the same dispute. After bankruptcy, the trustee obtained stay relief for the Puerto Rico action, including for the counterclaim against the debtor. The creditor appealed. A party may appeal only if it is a person aggrieved, that is, a person whose property is diminished, whose burdens are increased, or whose rights are adversely affected by the trial court's order. Here, the creditor did not lose any rights to argue in the Puerto Rico action that the dispute should be resolved in the Virginia court. The ruling was only that the bankruptcy court would not decide that issue. Because all the creditor's rights were preserved, the creditor was not a person aggrieved and did not have standing to appeal the stay relief order. *Pinpoint IT Servs., LLC v. Atlas IT Export, LLC (In re Atlas IT Export, LLC)*, 491 B.R. 192 (1st Cir. B.A.P. 2013).

11.3.b. Notice of appeal filed with the district court while an appeal was pending before the BAP is a nullity. In a BAP circuit, section 158(c)(1) requires an appellant to elect the district court when filing the appeal. Rule 8001(e)(1) requires the appellant to make the election in a separate writing, not in the notice of appeal. After the bankruptcy court announced its decision but before entry of judgment, the debtor filed with the district court a notice of appeal "to the district court". He did not file the separate election required by Rule 8001(e). The district court clerk promptly transmitted the notice to the bankruptcy court clerk. Rule 8002(a) provides that a notice of appeal filed after announcement of a decision but before entry of the order is effective without refilling upon entry of the order. Accordingly, the BAP recognized the appeal, entered it on the docket and issued an order denying the debtor's election to appeal to the district court because it was not made in a separate writing. (The opinion does not relate how the BAP learned of the notice of appeal.) Coincidentally, the bankruptcy court entered judgment on the same day. Apparently unaware of the court's entry of judgment, the debtor, two days later, filed a voluntary withdrawal of the notice of appeal, stating an intention to refile after entry of the judgment. Upon learning of the entry, the debtor timely filed a "renewed" notice of appeal and an election in a separate writing to proceed before the district court. The BAP apparently did not recognize the prior voluntary withdrawal and maintained the docket on the original notice of appeal. The debtor failed to file other papers in the appeal, so the BAP dismissed the appeal for failure to prosecute. The appellee filed a motion with the district court to dismiss the appeal that appeared to be pending there based on the renewed notice of appeal. The district court denied the motion and proceeded to the merits, affirming the bankruptcy court. The debtor timely appealed to the court of appeals. Rule 8001(c) permits voluntary dismissal of an appeal only by stipulation or court order. Therefore, the voluntary withdrawal that the debtor filed was ineffective, and the original notice of appeal remained effective. Because the debtor had

not properly elected the district court to hear the appeal, it remained pending at the BAP. When the BAP dismissed it, the matter concluded. The second notice of appeal with the election to the district court filed while the original appeal was already pending before the BAP was a nullity. Therefore, the district court did not have jurisdiction over the appeal and should have dismissed it. *Woodman v. Concept Constr., LLC (In re Woodman)*, 698 F.3d 1263 (10th Cir. 2012).

11.3.c. An order granting stay relief, in whatever guise and whether issued by the bankruptcy court or the district court, is appealable. The debtor contracted with an investor to develop wind power projects. The contract required the investor, upon commercial operation, to pay 75% of the projects' purchase price to the debtor and 25% to an advisor. The debtor transferred the development contract to an affiliate without consideration. It later filed bankruptcy. The debtor's bankruptcy trustee sued the affiliate and the advisor to avoid as a fraudulent transfer and recover the transfer of the contract and therefore the right to the purchase price. After commercial operation, the affiliate and the advisor sued the investor in state court for the purchase price. The state court issued judgment against the investor but, based on the trustee's notice of bankruptcy, ordered the payment to be deposited with the bankruptcy court. The state court then transferred the issue of whether the judgment was part of the bankruptcy estate to the bankruptcy court. The affiliate and the advisor successfully removed the action to the district court, where the trustee's fraudulent transfer action was pending. The district court consolidated the two actions. Over the trustee's opposition that the payment was property of the estate to which the automatic stay applied, the affiliate and the advisor obtained an order from the district court requiring distribution to them of the investor's payment. Under 28 U.S.C. § 1291(a), a court of appeals has jurisdiction only over a district court's final order. The grant or denial of automatic stay relief is generally an appealable final order, to promote quick resolution of stay relief matters. By ruling that the payment was not property of the estate, the district court effectively granted stay relief. 28 U.S.C. § 158(d) does not limit the courts of appeals to review of district court orders on appeal from bankruptcy court stay orders. Section 1291(a) applies to review of district court orders when the reference has been withdrawn. Nor does the pendency of the trustee's fraudulent transfer action in the consolidated case prevent review. A bankruptcy case has multiple discrete units of litigation, so finality concepts are applied more flexibly in bankruptcy cases. Stay orders are such discrete units and are appealable as final orders whether issued in the first instance by the district court or the bankruptcy court. Therefore, the court of appeals has jurisdiction over the appeal. *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013).

11.3.d. Payment of judgment to plaintiff does not moot defendant's appeal. The debtor contracted with an investor to develop wind power projects. The contract required the investor, upon commercial operation to pay 75% of the projects' purchase price to the debtor and 25% to an advisor. The debtor transferred the development contract to an affiliate without consideration. It later filed bankruptcy. The debtor's bankruptcy trustee sued the affiliate and the advisor to avoid and recover the transfer of the contract and therefore the right to the purchase price as a fraudulent transfer. After commercial operation, the affiliate and the advisor sued the investor in state court for the purchase price. The state court issued judgment against the investor but, based on the trustee's notice of bankruptcy, ordered the payment to be deposited with the bankruptcy court. The state court then transferred the issue of whether the judgment was part of the bankruptcy estate to the bankruptcy court. The affiliate and the advisor successfully removed the action to the district court, where the trustee's fraudulent transfer action was pending. The district court consolidated the two actions. Over the trustee's opposition that the payment was property of the estate to which the automatic stay applied, the affiliate and the advisor obtained an order from the district court requiring distribution to them of the investor's payment. An appeal is moot if the appellate court cannot grant effective relief. The payment had been distributed to the affiliate and the advisor, and it was even possible that they had dissipated the funds. Still, the court of appeals could order the repayment of the funds, so the appeal was not moot. *Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013).

11.3.e. Appeal from cramdown interest rate ruling is not moot. The hotel debtor confirmed a new value plan over the secured lender's objection to the interest rate on the notes issued under the plan. The debtor's plan forecasts showed substantial operating income after final payment to unsecured creditors. The secured lender appealed but did not obtain a confirmation order stay pending the appeal. The debtor consummated the plan, paying out about $8 million to other creditors. An appeal from a confirmation order is equitably moot if the appellate court cannot order effective relief, because ordering relief would

adversely affect the rights of third parties who are not before the court or the success of the plan. However, if the court can order even partial relief, the appeal is not moot. Here, the debtor's projections show that it could pay a higher interest rate without affecting other creditors or the plan's success. A reversal might affect the new equity investors, but they are before the appellate court. Therefore, the appeal is not moot. *Wells Fargo Bank N.A. v. Texas Grand Prairie Hotel Realty, L.L.C. (In re Texas Grand Prairie Hotel Realty, L.L.C.)*, 710 F.3d 324 (5th Cir. 2013).

11.3.f. Debtor loses standing to appeal on behalf of the estate upon conversion to chapter 7. The debtor in possession moved to surcharge the secured creditors' collateral for the costs of sale, which did not produce sufficient proceeds to pay secured claims in full. The bankruptcy court denied the motion and converted the case to a chapter 7 case. Only an appellant with standing may appeal. Upon conversion, the chapter 7 trustee steps into the debtor in possession's shoes as representative of the estate. Accordingly, the former debtor in possession no longer may appeal on behalf of the estate. Alternatively, a debtor may appeal if it is a "person aggrieved", which is one whose pecuniary interests are adversely affected by the appealed order. Because a surcharge would not produce enough estate assets to pay unsecured claims and provide a recovery to the debtor, the debtor was not a person aggrieved by the order denying surcharge. *Formatech, Inc. v. Sovereign Bank (In re Formatech, Inc.)*, 483 B.R. 363 (1st Cir. B.A.P. 2012).

11.3.g. Chapter 7 debtor does not have standing to appeal remand order. The debtor sued contractors before bankruptcy for damages to its business. After bankruptcy, the debtor removed the action to the bankruptcy court. The bankruptcy court remanded the action to the state court. The debtor appealed. The chapter 7 trustee did not join the appeal. Only a person aggrieved has standing to appeal a bankruptcy court order. A person is aggrieved only if the person is directly and adversely affected pecuniarily by the bankruptcy court's order. Ordinarily, only a trustee has standing to protect the estate's interests. However, a debtor may have standing if a successful appeal could result in a surplus estate. Here, successful prosecution of the action might result in a surplus, but a successful appeal would result only in the action remaining in the bankruptcy court. Therefore, the remand order did not directly and adversely affect the debtor pecuniarily, so the debtor does not have standing to appeal. *Minerals Continental Inc. v. LaCampana, Inc. (In re Minerals Continental Inc.)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 47415 (S.D. Tex. Apr. 2, 2013).

11.3.h. Appeal from asbestos plan confirmation order is not equitably moot. The debtor proposed a plan that provided for transfer to an asbestos trust of $600 million by settling liability insurers and of $500,000 in cash, a promissory note for $1.25 million and a claim against another asbestos trust by the reorganized debtor and for the debtor's assignment to the trust of liability insurance policies issued by non-settling insurers, despite anti-assignment provisions in the policies. The bankruptcy court confirmed the plan. The insurers appealed. They sought but were denied a stay pending appeal by the court of appeals and by the Circuit Justice. At the time the court of appeals heard the appeal, the settling insurers had transferred only $135 million to the trust, and the trust had made some distributions to claimants. To determine whether an appeal is equitably moot, a court must consider whether the appellant sought or obtained a stay, whether substantial consummation has occurred, the effect a remedy may have on third parties and whether the bankruptcy court can fashion effective and equitable relief without defeating the plan. Declaring an appeal equitably moot where appellants seek but do not obtain a stay would inequitably elevate expedience over justice. If appellants sit on their hands, it would not be inequitable to dismiss the appeal. Here, appellants sought but did not obtain a stay, so the court considers the other factors. Substantial consummation requires, among other things, transfer of all or substantially all of the property proposed to be transferred by the plan. Here, only $135 million of the committed $600 million of property had been transferred. An appellate remedy may affect third parties if the effect is not inequitable. Here, the plan permits amendments to the asbestos trust with the consent of the future claims representative, so amendments are not per se inequitable, though the bankruptcy court must take care on remand to ensure that the effects are not inequitable. Finally, equity vests broad discretion in the bankruptcy court to devise an equitable remedy that does not fully upset plan confirmation. The availability of equitable relief, though incomplete, renders the appeal not moot. Here, there are alternatives that the bankruptcy court could order, if the confirmation was improper, that would not upset the plan. Therefore, the appeal is not

moot. *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869 (9th Cir. 2012).

11.3.i. Third Circuit limits equitable mootness doctrine on appeal after plan confirmation. The court disallowed an administrative expense claim. While the court's order was on appeal, the debtor consummated its chapter 11 plan. The plan required a reserve for disputed administrative claims. Because of the appeal, the debtor treated the claim as disputed. The equitable mootness doctrine requires dismissal of an appeal when granting relief would be inequitable because of changed circumstances, for example, if a successful appeal would be fatal to the plan or injure third parties. In evaluating equitable mootness, a court should consider whether the plan has been substantially consummated, a stay has been obtained, and the requested relief would affect parties who are not before the court or the plan's success and the public policy of affording finality to bankruptcy judgments. Taken together, the factors limit the doctrine's scope and permit a court to apply equitable mootness only if it would "unscramble complex bankruptcy reorganizations when the appealing party should have acted before the plan became extremely difficult to retract." Substantial consummation alone, coupled with the absence of a stay, does not require the doctrine's application where reversal on appeal will not upset the plan. Here, a reversal would not unscramble the plan or upset third parties' rights. Therefore, the appeal is not equitably moot. *In re Phila. Newspapers, LLC*, 690 F.3d 161 (3d Cir. 2012).

11.3.j. Court dismisses unstayed confirmation order appeal as equitably moot. The debtor proposed a prepackaged plan that required the full cooperation of its principal parent shareholder to preserve net operating loss carryovers and prevent a default in its senior credit facility. In exchange, the plan gave the shareholder substantial consideration and a release, even though the other parent shareholders received nothing under the plan. A parent bondholder and a parent shareholder objected to confirmation and appealed from the confirmation order after plan consummation. They sought but were denied a stay of plan consummation pending appeal. The equitable mootness doctrine permits an appellate court to dismiss an appeal, even though effective relief is conceivable, when implementation would be inequitable. It requires the court to balance finality against the appellant's review rights. An appeal is presumed equitably moot when the plan has been substantially consummated. The appellant may overcome the presumption by showing that the court can still order some relief, the relief will not affect the debtor's emergence from chapter 11 or unravel the plan, the parties who would be affected have notice of and an opportunity to participate in the appeal, and the appellant diligently sought a stay. The court of appeals reviews the district court's mootness decision for abuse of discretion. Here, the appellants diligently sought a stay, some relief could be possible, such as requiring the shareholder to disgorge the consideration or voiding the release, and the shareholder was a party to the appeal. However, the shareholder consideration was integral to the plan, and changing it on appeal could require unwinding the plan. Therefore, the appeal was equitably moot and must be dismissed. *R^2 Invs. v. Charter Commc'ns, Inc. (In re Charter Commc'ns, Inc.)*, 691 F.3d 476 (2d Cir. 2012).

11.3.k. An administrative claimant does not have standing to appeal denial of derivative standing to another. After the case converted from chapter 11 to chapter 7, the debtor's chapter 11 lawyer asserted a claim for administrative expenses and demanded that the chapter 7 trustee pursue an avoiding power claim against a judicial lien creditor. When the trustee refused, the lawyer commenced an adversary proceeding against the creditor and sought derivative standing. The former chapter 11 examiner moved to substitute in as plaintiff, but the court denied the motion. The lawyer appealed. Only a "person aggrieved", that is, someone whose property is diminished, burdens increased or rights impaired by the underlying order, has standing to appeal. The effect must be direct, not too remote or contingent. Here, the denial of the former examiner's derivative standing would have an effect on the lawyer only if the examiner prevailed in the avoiding power action and then only if the lawyer's administrative claim were allowed. The effect on him was too remote, so the lawyer did not have standing to appeal. *Robert F. Craig, P.C. v. Greenlight Cap. Qualified, L.P. (In re Prosser)*, 469 B.R. 228 (D.V.I. 2012).

11.3.l. 28 U.S.C. § 1291 finality rules apply to an order of a district court who has withdrawn the reference of a bankruptcy case. The debtor was a defendant before the district court in Nevada. After an adverse ruling, it filed a chapter 11 case in New York. The New York court transferred the case to the District of Nevada, and the district judge withdrew the reference of the case. The district judge converted

the case to chapter 7 and issued monetary sanctions against the debtor and its attorneys for a frivolous filing and for attempting to evade the court's jurisdiction. The court of appeals has jurisdiction over appeals from final orders of a district court under 28 U.S.C. § 1291 and, in bankruptcy cases and proceedings, under 28 U.S.C. § 158(d) when the district court sits as an appellate court in bankruptcy. The finality standards differ under the two sections, because of the need for a more flexible finality standard in bankruptcy. However, the flexibility applies only in appeals under section 158(d); section 1291 does not vary depending on the kind of case from which the appeal arises. Therefore, the strict finality rules of section 1291 apply when a district court has withdrawn the reference and is sitting as a court of original jurisdiction. Under strict finality rules, a sanction order is not a final order and is not appealable until the end of the case. Therefore, the court of appeals does not have jurisdiction to hear the appeal. A concurrence argues vigorously that the Ninth Circuit should reconsider its precedent requiring this result. *Klestadt & Winters, LLP v. Cangelosi*, 672 F.3d 809 (9th Cir. 2012).

11.3.m. Appeal from denial of stay relief motion is not moot because the issue is capable of repetition but evading review. The bankruptcy court determined that the debtor was not a single asset real estate debtor and denied the secured creditor stay relief. The secured creditor appealed. While the appeal was pending and briefing had been completed, the bankruptcy court confirmed a plan, which was consummated. The secured creditor retained its lien and claim under the plan. Confirmation terminated the automatic stay, making unavailable the relief the secured creditor had sought. However, the dispute here is capable of repetition if the reorganized debtor files another chapter 11 case, and the time required to resolve an appeal may prevent review in this or future cases. Abandoning the case now would be wasteful of judicial resources. Therefore, the appeal is not moot. *Meruelo Maddux Props.-760 S. Hill St. v. Bank of Am. N.A. (In re Meruelo Maddux Props., Inc.)*, 667 F.3d 1072 (9th Cir. 2012).

11.3.n. Appeal from orders approving a settlement and denying derivative standing is not moot. The lenders demanded that the trustee pursue a fraudulent transfer claim. The trustee investigated and settled with the defendants for a cash payment. The lenders objected to approval of the settlement and sought derivative standing to pursue the claims. The court approved the settlement and denied derivative standing. The settling parties paid the trustee, who held the cash. The lenders appealed but did not obtain a stay. An appeal is moot if the appellate court cannot grant effective relief. If the settlement can be unwound, then the appeal is not moot. Here, the cash remained with the Trustee, who could return it if the appellate court reversed the settlement approval order. Unwinding the settlement would not be difficult or complex and would not defeat any party's reliance on finality. Therefore, the appeal is not moot. *In re VOIP, Inc.*, 461 B.R. 899 (S.D. Fla. 2011).

11.3.o. Bankruptcy court may not strike issue from statement of issues of appeal. After the bankruptcy court's decision, the defendant appealed. In compliance with the Bankruptcy Rules, the appellant filed a statement of issues on appeal, listing an issue that the appellant had not raised below. The bankruptcy court issued an order striking that issue from the statement of issues. If the bankruptcy court could strike an issue from the statement of issues on appeal, it could effectively insulate its decisions from appellate review. Accordingly, the district court vacates the bankruptcy court's order striking the issue. *Fox v. Picard (In re Bernard L. Madoff Inv. Secs. LLC)*, 848 F. Supp. 2d 469 (S.D.N.Y. 2012).

11.3.p. Court of appeals does not have jurisdiction over direct appeal from core proceeding that was beyond bankruptcy judge's constitutional authority. A Wisconsin health care provider filed proofs of claim in numerous chapter 13 cases. The proofs of claim disclosed the debtors' medical information. A Wisconsin statute makes patient information confidential and gives patients a claim for damages for willful violation of the statute. Three debtors brought a class action in the bankruptcy court against the providers for damages but soon filed a motion for the bankruptcy judge to abstain in favor of a state court proceeding. Other debtors brought a state court class action, which the provider removed to the bankruptcy court. The provider then moved to withdraw the reference. The bankruptcy judge first heard the abstention motion and determined that the proceedings were core because the claims could arise only in a bankruptcy case and fell under 28 U.S.C. § 157(b)(2)(C) (counterclaims against a person filing a proof of claim). Based on the core determination, the district court denied the withdrawal motion. The bankruptcy judge granted summary judgment for the provider on the ground that the statute permitted recovery only if the debtors showed actual damages from the violations, which they did not. The parties

stipulated to a direct appeal under 28 U.S.C. § 158(d)(2). A court of appeals has jurisdiction to hear a direct appeal from a final judgment, order or decree or, with leave of court, from an interlocutory order or decree. The claims arise in the bankruptcy cases because they are predicated on the provider's participation in the cases. However, under *Stern v. Marshall*, 131 S. Ct. 2594 (2011), the bankruptcy judge may not determine even a core proceeding if it involves adjudication of private rights between private parties that were not historically determined by the executive or legislative branches and did not flow from a federal statutory scheme or address a particularized area of the law where Congress devised a specialized system to resolve facts expeditiously. The claims are ordinary state law claims. Though they arise in bankruptcy cases, the bankruptcy judges do not have constitutional authority to determine them. Therefore, the bankruptcy judge did not have authority to issue final judgments on the claims. As a result, the court of appeals does not have jurisdiction to hear appeals from the orders as final judgments. Moreover, the bankruptcy judge's order could not function as proposed findings and conclusions under section 157(c), because the proceeding was core, and section 157(c) applies only to noncore proceedings. Finally, the parties did not adequately consent to the bankruptcy judge's determination of the proceedings, despite the debtors' initiation of one of the actions in the bankruptcy court and the provider's removal of the state court case to the bankruptcy case, because the debtors sought abstention and the provider sought withdrawal. Therefore, the court does not determine whether the bankruptcy court could have acted on consent. *Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 665 F.3d 906 (7th Cir. 2011).

11.3.q. Rule 8002(a) time limit for filing a notice of appeal is jurisdictional. Section 158(a) of title 28 grants the district courts jurisdiction to hear appeals from bankruptcy courts' final judgments. Section 158(c)(2) requires such appeals to be taken "in the time provided by Rule 8002". Bankruptcy Rule 8002(a) requires that a notice of appeal from a bankruptcy court judgment be filed within 14 days after entry of the judgment. A time period specified in a Rule is ordinarily non-jurisdictional, as it was in *Kontrick v. Ryan*, 540 U.S. 443 (2004), where the Supreme Court held that a Bankruptcy Rule fixing a deadline for objecting to a discharge is a non-jurisdictional claims processing rule. But where the statute requires the appeal to be filed within a time period specified in the statute or incorporated by reference from a rule, compliance with the time period is a condition to the appellate court's jurisdiction. In this case, the debtor filed a notice of appeal from the bankruptcy court's order dismissing his chapter 11 case after the time specified in Bankruptcy Rule 8002(a). The debtor failed to designate items to be included in the record or file a statement of issues, as required by Bankruptcy Rule 8006. The district court dismissed the appeal for failure to prosecute. The debtor timely appealed to the court of appeals. The court of appeals dismissed the appeal with instructions to the district court to dismiss the appeal there for lack of subject matter jurisdiction. *In re Caterbone*, 640 F.3d 108 (3d Cir. 2011).

11.3.r. BAP lacks jurisdiction to hear appeal from order issued before venue transfer by a court in a different circuit. Three creditors filed an involuntary petition against the debtor in Delaware. The debtor moved to dismiss and moved to transfer venue to Colorado. The court denied the motion to dismiss but did not issue an order for relief. Following a discovery dispute hearing, the Delaware bankruptcy court issued an order transferring venue, noting incorrectly that an order for relief had been entered. After the case was transferred to Colorado, the Delaware bankruptcy court, on the creditors' motion, corrected the transfer order to include an order for relief. The debtor appealed from the Delaware court's post-transfer order for relief in both Delaware and Colorado. The Delaware district court granted the debtor's motion to transfer the appeal to Colorado. The Bankruptcy Appellate Panel for the Tenth Circuit heard the Colorado appeal, because the parties did not object or request that the district court hear it. Section 158(a) of title 28 permits an appeal to "be taken only to the district court for the judicial district in which the bankruptcy judge is serving". Based on that provision, the BAP determined that it did not have jurisdiction to hear the appeal from the order for relief and dismissed. The debtor appealed to the court of appeals. The court of appeals has jurisdiction only over a final order of the BAP. The court of appeals has jurisdiction over a dismissal that has the same effect as an affirmance only if the underlying order is a final order. An order for relief is a discrete order in a bankruptcy case that conclusively determines the debtor's status in bankruptcy, is res judicata and may seriously affect the parties' rights and obligations if not reviewed until the end of the bankruptcy case. Therefore, it is a final order, which the court of appeals may review. Although section 158(a) of title 28 does not address appellate jurisdiction over an order issued before venue transfer, analogous case law under section 1294(a) does. Both section 158(a) and section 1294(a) speak in territorial terms and require an appeal to be taken in the same district or circuit in which

the order was issued. Therefore, the Tenth Circuit BAP did not have jurisdiction over the Delaware bankruptcy court's order for relief and properly dismissed the appeal. *Healthtrio, Inc. v. Centennial River Corp. (In re Healthtrio, Inc.)*, 653 F.3d 1154 (10th Cir. 2011).

11.3.s. Appeal of an order authorizing the assignment of a contract is not moot if some remedy is possible. The trustee moved for an extension of time to assume a contract. While an appeal from the court's extension order was pending, the trustee assumed and sold the contract with bankruptcy court approval. An appeal is moot if the appellate court cannot grant effective relief. Section 363(m) prohibits an appellate order from affecting the validity of a sale and renders most appeals from sale orders moot. However, where the appellee, who carries the burden of showing mootness, does not show that the appellant cannot obtain effective relief that does not affect the validity of the sale, such as a claim for damages against the estate, the court will not dismiss the appeal as moot. Here, the trustee failed to make such a showing, so the court denied the motion to dismiss the appeal. *C.O.P. Coal Devel. Co. v. C.W. Mining Co. (In re C.W. Mining Co.)*, 641 F.3d 1235 (10th Cir. 2011).

11.3.t. Appeal of an order determining ownership of property does not divest the bankruptcy court of jurisdiction to confirm a plan that disposes of the property. The bankruptcy court determined that certain property belonged to the estate rather than to an adverse claimant. The claimant appealed. While the appeal was pending, the debtor proposed a plan that disposed of the property. An appeal divests the trial court of jurisdiction to issue any further orders on the subject of the dispute. However, Rule 8005 provides, "the bankruptcy judge may suspend or order the continuation of other proceedings in the case during the pendency of an appeal". The court is prohibited only from altering the appealed order. Otherwise, an appeal would have the effect of automatically staying the remainder of the bankruptcy case pending the appeal. Plan confirmation here would have the effect of enforcing the appealed order, not modifying it, even though confirmation and consummation might moot the appeal. Therefore, the court may consider plan confirmation. *In re Wash. Mut., Inc.*, 461 B.R. 200 (Bankr. D. Del. Sept. 13, 2011).

11.3.u. Interlocutory order denying exclusivity termination becomes appealable upon plan confirmation. The small business debtor filed a plan on the last day of the debtor's exclusive period. Three days later, a creditor filed a motion to terminate exclusivity to allow the creditor to file a plan, which the bankruptcy court denied. The creditor filed a notice of appeal. A few days later, the court confirmed the debtor's cram down plan over the creditor's objection. The creditor appealed from the plan confirmation order. The confirmation order is similar to a final judgment and therefore renders previously interlocutory orders final for purposes of appeal. Therefore, the district court has jurisdiction to hear the appeal from the exclusivity order. *H.G. Roebuck & Son, Inc. v. Alter Comm'ns, Inc.*, 2011 U.S. Dist. LEXIS 59781 (D. Md. June 3, 2011).

11.3.v. Out of the money creditor has standing to appeal a confirmation order. The debtor proposed a plan that provided a partial distribution to senior creditors, limited distribution to junior creditors and a distribution to equity holders. The junior creditor class did not accept the plan. The debtor's overall value was insufficient to pay the senior creditors in full, so neither the junior creditors nor the equity holders would have received anything if the senior creditors had not permitted the distribution. The court confirmed the plan on the theory that the senior creditors could give a portion of their recovery to the equity holders without regard to the absolute priority rule. A junior creditor whose claim was disputed appealed. The Bankruptcy Code does not specify a standing test for an appeal, but the courts have developed the "person aggrieved" standard, under which a party may appeal if its interest is "directly and adversely affected pecuniarily by the challenged order". Creditors generally have such an interest and do not lose it in appealing a confirmation order solely because the debtor's value is insufficient to pay more senior claims in full. Standing does not turn on valuation, or else appellate courts would have to determine valuation as a standing question. Nor does standing depend on whether the creditor's claim is disputed, because standing does not depend on the merits, especially of an issue that is not before the court on appeal. Therefore, the junior creditor has standing to appeal. *DISH Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79 (2d Cir. 2011).

11.3.w. Clearly erroneous standard of review is relaxed where the trial court adopts prevailing party's findings. After a two-week, heavily contested trial, in which 20 witness testified, the bankruptcy court adopted the findings and conclusions proposed by the winning litigant with relatively minimal changes. Bankruptcy Rule 7052 requires the court to make findings of fact and conclusions of law. The ordinary standard of review on appeal for findings of fact is a clearly erroneous standard. However, where the trial court adopts the prevailing party's findings, the standard is relaxed. *3V Cap. Master Fund Ltd. v. Official Comm. Of Unsecured Creditors (In re TOUSA, Inc.)*, 444 B.R 613 (S.D. Fla. 2011).

11.3.x. Request for limited remedy may prevent mootness of appeal from confirmation order. The individual debtor's plan did not pay creditors in full but allowed him to retain his property. A creditor in an non-accepting class objected to confirmation. The creditor appealed, arguing the plan violated the absolute priority rule. The creditor did not obtain a stay pending appeal. In the appeal, the creditor did not seek recovery of any payments that had been made to senior secured creditors. An appeal from a confirmation order may become moot if the plan has been substantially consummated. In determining mootness, the court must strike a "balance between the equitable considerations of finality and good faith reliance on a judgment and the competing interests that underlie the right of a party to seek review". Here, where the creditor did not seek to upset payments that the debtor had already made under the plan, a reversal would not necessarily lead to prejudice to absent third parties. Therefore, the appeal is not moot. *Ala. Dep't of Eco. & Community Affairs v. Lett (In re Lett)*, 632 F.3d 1216 (11th Cir. 2011).

11.3.y. Creditor may raise absolute priority challenge for the first time on appeal. The individual debtor's plan did not pay creditors in full but allowed him to retain his property. A creditor in an non-accepting class objected to confirmation but did not raise the violation of the absolute priority rule as a ground of objection. The court asked the debtor about compliance with the absolute priority rule, the debtor offered evidence of compliance and the court confirmed the plan. The creditor appealed and raised an absolute priority rule objection. A court may confirm a plan that has not been accepted by all impaired classes if the plan complies with section 1129(b), which requires that the plan be fair and equitable to the non-accepting class. The bankruptcy court must make specific findings of compliance and ensure that its requirements are met before it may confirm the plan. Therefore, an appellant may raise the issue for the first time on appeal. A concurrence suggests that an appellant may do so only in the appeal to the district court, not to the court of appeals. *Ala. Dep't of Eco. & Community Affairs v. Lett (In re Lett)*, 632 F.3d 1216 (11th Cir. 2011).

11.3.z. Only district court may certify direct appeal once appeal has been docketed there. The appellant appealed, under 28 U.S.C. § 158(a)(1), an order denying a motion to dismiss the case, claiming that the order was a final order, and requested from the district court certification of a direct appeal under section 158(d)(2) to the court of appeals. The district court determined that the order was an interlocutory order and therefore determined that the motion for certification of a direct appeal was moot, because section 158(d)(2) permits direct appeal only of final orders. The appellant argued that once the district court determined that the order below was interlocutory, the appeal should not be considered docketed at the district court and asked that the certification be transferred to the bankruptcy court for consideration. Section 158(d)(2) requires certification by the court "involved", which means the court where the action is pending. Rule 8007(b) requires the docketing of the appeal with the district court upon completion and transmittal of the record on appeal, which had already occurred in this case. Upon docketing of the appeal with the district court, the action is pending there. Therefore, the certification motion was properly before the district court and would not be transferred. The denial of leave to appeal did not change the result. *Ambac Assurance Corp v. Las Vegas Monorail Co. (In re Las Vegas Monorail Co.)*, 2011 U.S. Dist. LEXIS 36943 (D. Nev. Mar. 25, 2011).

11.3.aa. Appeal from an adequate protection order is not equitably moot where some relief is possible. In separate orders, the court confirmed a chapter 11 plan and determined that the secured creditor had not suffered diminution in its collateral value and therefore was not entitled to a section 507(b) administrative expense claim. The creditor appealed both orders. The court of appeals permitted a direct appeal from the confirmation order and affirmed. An appeal, especially of a confirmation order, may be equitably moot where the relief requested would affect the rights of parties not before the court or the success of the plan. An appeal is not equitably moot simply because it may be impossible to grant the

appellants all the relief they seek, as long as some relief is possible. That the appellee (here, the reorganized debtor) may be unable to pay the amount the appellate court awards also does not render the appeal moot. In this case, the consequences of an adverse appellate result were foreseeable to the reorganized debtor, who is a party that is before the court. Thus, the adequate protection order appeal is not moot. *Bank of New York Trust Co. NA v. Pac. Lumber Co (In re Scotia Pac. Co., LLC)*, 624 F.3d 274 (5th Cir. 2010).

11.3.bb. Appeal from cash collateral order is not moot. When the debtor, a resort developer, filed bankruptcy, it held cash that was subject to its lenders' lien and an uncompleted project that was subject to the lenders' and mechanics liens. The lenders and the mechanics lienors disputed the priority of their liens on the project. The court authorized the debtor in possession to use the cash collateral to stabilize and maintain the project and to pay the chapter 11 expenses of administration, including the cost of an examiner. The authorizing order deemed that the debtor in possession repaid the cash to the lenders and reborrowed it from them under section 364(d), granted the lenders a priming lien on the project, ahead of the mechanics liens, and required that any third party debtor in possession financing proceeds be used first to repay the lenders the amount of cash collateral that the debtor in possession used. Later, the debtor in possession obtained such third party financing from a good faith lender and used the proceeds to pay the lenders as the original cash collateral order required and for other purposes. The mechanics lienors appealed the cash collateral order and the financing order, contending that the court did not provide adequate protection of their interests. They sought but did not obtain a stay pending appeal. An appeal is constitutionally moot if the court is not able to grant any effective relief, but not if the court can grant some relief, even though the relief would not restore the parties to their prior positions. Here, the court could not undo the financing, because section 364(e) protects a good faith lender. But the court could order the prepetition lenders to return the financing proceeds to the estate to protect the mechanics lienors' claim that the cash collateral order did not provide adequate protection. Therefore, the appeal is not constitutionally moot. An appeal is equitably moot if the court cannot grant effective relief without inequitably affecting the rights of third parties. Equitable mootness is a pragmatic doctrine that recognizes that in time, effective relief may become impractical, imprudent or inequitable. Although equitable mootness is most commonly applied to an appeal from a plan confirmation order, it also may apply to other orders during a bankruptcy case. The absence of a stay pending appeal does not require a finding of equitable mootness but is only one factor in the equitable analysis. Here, granting relief to the mechanics lienors would not upset a reorganization nor affect any third parties who were not before the court or who were not aware of the challenges to the order that benefited them. The appeal therefore is not equitably moot. Although section 364(e) protects the debtor in possession lender from the effects of reversal or modification on appeal of the financing order, it does not protect those who received the proceeds of the financing. Therefore, the appeal as to the lenders is not statutorily moot. *Desert Fire Protection v. Fontainebleau Las Vegas Holdings, LLC (In re Fontainebleau Las Vegas Holdings, LLC)*, 434 B.R. 716 (S.D. Fla. 2010).

11.3.cc. Appeal from sale order challenging purchaser's good faith does not require stay pending appeal. A party appealed from an order approving a sale, challenging the bankruptcy court's finding that the purchaser was a good faith purchaser. The appellant did not seek or obtain a stay pending appeal. The purchaser acquired the property and moved to dismiss the appeal as moot. Section 363(m) provides that a reversal or modification on appeal of a sale authorization order does not affect the validity of a sale to a good faith purchaser, so that an appeal of an unstayed order is typically moot, because the appellate court cannot grant effective relief. However, where the appeal challenges the bankruptcy court's determination that the purchaser was in good faith, a reversal could result in an order affecting the validity of the sale. Therefore, the appeal is not moot. *Petroleum & Franchise Funding LLC v. Bulk Petroleum Corp.*, 435 B.R. 589 (E.D. Wis. 2010).

11.3.dd. Section 363(m) mootness applies to an order authorizing sale of a co-owner's interest under section 363(h). The debtor owned seven properties as a tenant in common with 30 co-owners. The trustee sought to sell the properties, including the interests of the co-owners, in a single sale. Section 363(h) permits a trustee to "sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common" if certain conditions are met. The sale that the trustee

proposed met the necessary conditions, and the court approved the sale under both subsections (b) and (h) and found that the purchaser was a good faith purchaser. Section 363(m) provides that "the reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of the sale" to a good faith purchaser unless the sale was stayed pending appeal. Section 363(m) therefore moots any appeal of the sale of the estate's interest, which was authorized under subsection (b). However, subsection (b) does not directly authorize the sale of the co-owners' interests, and subsection (m) does not directly address an appeal from such an authorization under subsection (h). Still, the sale authorization was under a single order that included authorization under subsection (b), and it would create an anomalous result to permit co-owners to appeal such a sale order without a stay, especially when a holder of another kind of interest, such as a lien, may not appeal an unstayed order that authorizes a sale free and clear under subsections (b) and (f). Therefore, the appeal is moot, and the court dismisses the appeal. A concurrence argues that the statutory language does not directly support the result but policy reasons do. *Official Comm. Of Unsecured Creditors v. Anderson Sr. Living Property, LLC (In re Nashville Sr. Living, LLC)*, 620 F.3d 584 (6th Cir. 2010).

11.3.ee. 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.ff. 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.gg. 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).

11.3.hh. Appeal from order authorizing sale free and clear is moot. The bankruptcy court authorized a sale of assets free and clear of liens. The sale order referenced section 363(b). Section 363(m) prevents a reversal or modification of a sale "authorization under subsection (b) or (c)" from affecting the validity of the sale, thereby mooting any appeal from an unstayed order. The secured creditor objected and appealed, seeking reversal only of the portion of the order authorizing the sale free and clear, and relying on *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25 (9th Cir. B.A.P. 2008), to argue that section 363(m) did not apply, because a sale free and clear is authorized under subsection (f). However, subsection (f) provides, the "trustee may sell property under subsection (b) or (c) of this section free and clear …". Therefore, section 363(m) applies to any sale free and clear of liens or interests. A reversal or modification of a provision in the order would affect the sale's validity if the absence of the provision would, in effect, unwind the sale. The free and clear provision here was integral to the sale, as the buyer would not have consummated the transaction without that provision. Therefore, the court dismisses the appeal as moot. *Asset Based Resource Group, LLC v. U.S. Trustee (In re Polaroid Corp.)*, 2010 U.S. App. LEXIS 14012 (8th Cir. July 9, 2010).

11.3.ii. Appeal from order confirming liquidating plan is not moot. The debtor in possession liquidated its tangible assets during the case; the intangible assets remained to be liquidated or collected and distributed under the plan. The plan created a class of equity security holders and a class of claims for damages arising from violations of the securities laws with respect to the common stock but did not specify the relative treatment of the two classes, leaving that for the court to determine if there were more than sufficient assets to pay all unsecured claims in full. Members of the equity security holders class appealed the confirmation order. An appeal from a chapter 11 confirmation order may be equitably moot if a stay was not obtained, the plan has been substantially consummated and the relief requested would affect the rights of parties not before the court or the success of the plan. Although the appeal here seeks to reverse the confirmation order, the only relief sought is an appropriate determination of the relative rights of the two equity security-related classes. The court can fashion effective relief without upsetting the rights of parties not before the court or the success of the plan. Therefore, the appeal is not moot. *Schaefer v. Superior Offshore Int'l, Inc. (In re Superior Offshore Int'l, Inc.)*, 591 F.3d 350 (5th Cir. 2009).

11.3.jj. Tenth Circuit adopts equitable mootness doctrine, with additional considerations. Two creditors proposed competing chapter 11 plans, one jointly with the chapter 11 trustee. Each creditor filed its plan to obtain ownership of the estate's most valuable asset. Each plan provided for payment of all administrative expenses and claims in full. The court confirmed the joint plan, largely because it reflected an asset purchase agreement that the trustee and the creditor had entered into and the court had approved earlier in the case. The joint plan provided for pursuit of litigation against the other creditor over ownership of the asset. The other creditor appealed. The plan provided that it would not become effective while an appeal was pending, but the creditor and the trustee could waive that condition, which they did and then consummated the plan. A court must dismiss an appeal when it is constitutionally moot, that is, when the court cannot fashion any meaningful relief. However, if the court can fashion some relief, even if not all the relief the appellant seeks, the appeal is not constitutionally moot. A court may dismiss an appeal when it is equitably moot, that is, when equitable, prudential or pragmatic considerations counsel against granting some or all of the relief sought. Courts should weigh six factors in deciding whether to dismiss an appeal as equitably moot, though all factors will not apply in all cases, and the factors are not conclusive. (1) Whether the appellant sought or obtained a stay. Equity is less likely to protect one who fails to seek a stay through all possible means, but failure to obtain a stay does not preclude appellate relief. (2) Whether the plan has been substantially consummated. Substantial consummation may make appellate relief more difficult, especially if it affects the rights of absent innocent third parties. However, substantial consummation is not dispositive, and the plan proponents' rush to waive the effective date condition cuts against equitable relief for them as appellees. (3) Whether appellate remedies would affect third parties. (4) Public policy and finality. Creation of an unmanageable situation on remand to resolve the chapter 11 case counsels in favor of equitable mootness. (5) Impact on the likelihood of a new plan. A fair likelihood of a new plan after remand counsels against equitable mootness. (6) The merits. An appellate court should not review the merits on a mootness review, but a quick look at the merits may suggest that the appeal should be heard. Here, the first five factors were largely in balance, but the merits

review suggested a serious conflict of interest issue that an appellate court should review and tipped the balance against dismissal for mootness. *Search Market Direct, Inc. v. Jubber (In re Paige)*, 584 F.3d 1327 (10th Cir. 2009).

11.3.kk. Appeal from assumption of an executory contract under a plan is not moot. The creditor sought an order that its executory contract was a non-assumable technology license. The bankruptcy court denied the motion. The creditor then sought to require the debtor in possession to assume or reject the contract. The court also denied that motion. The creditor appealed both denials. While the appeal was pending, the debtor confirmed and consummated its plan, which assumed the contract. The creditor appealed the confirmation order as well. Before the district court, the debtor stipulated that contract rejection would not affect the confirmed plan, but the district court rejected the stipulation. No other evidence in the record showed whether contract rejection would adversely affect the plan. An appeal from a confirmation order is equitably moot if the court cannot order effective relief, such as if a reversal would require unwinding plan consummation. Substantial consummation is not fatal to an appeal; the appeal is moot only when the relief sought would unravel the plan. Because the record did not contain evidence that reversal of the confirmation order on the issue of the plan's contract assumption would unravel the plan, the appeal was not equitably moot. Section 1127(b) does not permit plan modification after substantial consummation. However, modification necessarily resulting from an appeal of the confirmation order or an order earlier in the case is not a plan modification that section 1127(b) prohibits. Otherwise, section 1127(b) would bar all post-consummation appeals and render the equitable mootness doctrine superfluous. *Alberta Energy P'ners v. Blast Energy Servs. Inc. (In re Blast Energy Servs. Inc.)*, 593 F.3d 418 (5th Cir. 2010).

11.3.ll. Appeal from a consummated settlement and distribution in a chapter 7 case is not moot. A lender sued the debtor's officer, subject to the limits of the directors and officers insurance policy, for negligent misrepresentation in executing a sale-leaseback transaction that was not authorized. The debtor and its principal officer filed bankruptcy. The trustee removed the action to the bankruptcy court, along with other actions that could be satisfied in part by the insurance. The trustee settled with the insurance company, who paid a portion of policy limits in exchange for a dismissal with prejudice of all claims against the policy and sought court approval of the settlement and of an interim distribution of proceeds. The lenders opposed both. The bankruptcy court approved the settlement, on the basis that all policy proceeds were property of the estate, and authorized the distribution. The lenders appealed. An appeal is equitably moot if the appellate court cannot order effective relief. However, equitable mootness in bankruptcy is usually applied upon chapter 11 plan confirmation, where it often focuses on whether the requested appellate relief would affect the rights of parties not before the court. Here, the insurance company, the trustee and the other distributees of the funds were all before the court in connection with the settlement's approval. Therefore, the appeal is not equitably moot. The court notes little difference between this case, which involves the distribution of money, and an ordinary civil appeal, where the defendant's payment to the plaintiff/appellee does not moot the appeal, even if the plaintiff is, after a reversal, unable to repay the money. *Tech. Lending P'ners v. San Patricio County Community Action Agency*, 575 F.3d 553 (5th Cir. 2009).

11.3.mm. Appeal from settlement approval in a chapter 7 case is not moot. The chapter 7 trustee settled with a custodian over the custodian's prebankruptcy fees. A creditor opposed the settlement and appealed. While the appeal was pending, the trustee distributed all funds in the estate, including the custodian's fees, and closed the case. An appellate court must consider three factors in determining whether an appeal from a chapter 11 plan confirmation order is moot: whether the appellant obtained a stay, whether the plan has been substantially consummated and whether the requested relief would affect rights of parties not before the court or the success of the plan. It is unclear whether these standards also apply in a chapter 7 case. However, in this case, even if those standards apply, the court may grant effective relief. The only real third party is the estate, and reopening would not require the same disruption involved in setting aside plan confirmation. Therefore, the appeal is not moot. *Szwak v. Earwood (In re Bodenheimer, Jones, Szwak, & Winchell L.L.P.)*, 592 F.3d 664 (5th Cir. 2009).

11.3.nn. Court substantially limits application of equitable mootness doctrine. One affiliated debtor was an operating business; the other was a single purpose entity that owned timberland that secured bonds. The debtors proposed a joint plan that provided for the transfer of each debtor's assets to new companies created and owned by two plan sponsors. One plan sponsor was unrelated to the debtors. The

other held a large unsecured claim against the operating debtor. The plan provided for the sponsors to fund cash sufficient to pay the secured bonds the value of the timberland and provide working capital and to convert the sponsor's unsecured claim to equity. The plan classified the bonds into a secured claim class and an unsecured deficiency claim class, separate from other unsecured claims. Neither bond class accepted the plan. The bankruptcy court heard extensive valuation testimony and valued the timberland collateral at less than the amount owing on the bonds. The plan also provided a minor impairment to a bank working capital claim class, which accepted the plan, and exculpation of the plan sponsors, the new companies and the unsecured creditors' committee and its members from liability related to proposing, implementing and administering the plan. The plan was consummated within 60 days after confirmation, with the debtors dissolved, assets transferred to the new companies, exit financing funded and creditors other than bondholders paid. Equitable mootness requires the court to "strik[e] the proper balance between the equitable considerations of finality and good faith reliance on a judgment and competing interests that underlie the right of a party to seek review of a bankruptcy order adversely affecting him." The doctrine applies to specific claims, not to entire appeals, and should be applied with a scalpel, not an axe. A stay is not required where there would be no significant consequences to the reorganization from a reversal of particular issues. The secured claims' treatment is subject to constitutional limitations, and the complexity of cramdown may demand appellate review. Reversal of the claims' treatment would likely affect only the plan sponsors, for whom an appeal was foreseeable and who are parties to the appeal. Denying mootness may also encourage consensual plans. Therefore, the court hears the appeal from the confirmation order's cramdown. It also hears the appeal from the exculpation provisions. Equity supports integrity and transparency in chapter 11 cases, and there is little equitable about protecting non-debtors from negligence liability arising out of a reorganization. In addition, exculpation is easily severable from other plan issues. Equitable mootness prevents review, however, of the classification scheme and of the "artificial" impairment plan provisions, because substantial consummation resulted in payment of the affected creditors, and there would be no remedy other than unwinding confirmation. *Bank of N.Y. Trust Co., N.A. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

11.3.oo. Court provides limited standards for certification of a direct appeal. The bankruptcy court denied a stay pending appeal of a $700 million secured claim cram down confirmation order and certified a direct appeal under 28 U.S.C. § 158(d). The certification provision is intended to expedite appellate review and generate binding precedent. An order for secured debt cramdown in a case this size deserves certification. A certification is not necessarily facially inconsistent with denying a stay pending appeal but can be incongruous. In certifying an appeal, a bankruptcy court's denial of a stay pending appeal may be too simplistic a response. The court should consider other alternatives, such as a supersedeas bond or expediting the appeal. Nevertheless, in this case, the court accepts the certification and determines on an issue by issue basis whether the appeal is equitably moot. *Bank of N.Y. Trust Co., N.A. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

11.3.pp. Person aggrieved standing requirement does not apply to second level appeal. The debtor transferred assets to an affiliate. A creditor brought a fraudulent transfer action against the affiliate and later filed an involuntary chapter 7 petition against the debtor. After the order for relief, the trustee determined not to pursue a fraudulent transfer action against the affiliate. The creditor sought derivative standing. The trustee and the affiliate, which asserted claims as a creditor, both opposed derivative standing, and the bankruptcy court denied the creditor's motion. The creditor appealed to the district court. The affiliate defended the appeal, but the trustee did not. The district court reversed. The affiliate appealed to the court of appeals, which granted leave for an interlocutory appeal. Ordinarily, a party may appeal an order only if it is a "person aggrieved", that is, only if the order has a direct and adverse pecuniary effect on the appellant. The rule prevents the myriad persons with claims or interests in a bankruptcy case from prolonging the proceedings in matters in which they do not have a direct interest. However, where a person aggrieved has appealed an order to the district court, the matter has already embarked on the appellate road, and there is no need to apply the prudential standing rule to prevent a person not aggrieved from appealing to the court of appeals. Therefore, the affiliate may pursue the appeal to the court of appeals. A vigorous dissent argues otherwise. *Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231 (6th Cir. 2009).

11.3.qq. A defendant in an action brought under an order granting a committee standing to sue does not have standing to appeal the order. The administrative claimants' committee obtained a Standing Order authorizing it to bring actions against the debtors' directors and officers. It promptly sued

the debtor's former CEO. He appealed the Standing Order. Only a "person aggrieved" has standing to appeal a bankruptcy court's order. A person is aggrieved if the order diminishes his property, increases his burdens or impairs his rights. Having to defend a lawsuit does not make a person aggrieved. Therefore, the court dismisses the appeal. The opinion relies in part on the dissent in *Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231 (6th Cir. 2009). *Moran v. LTV Steel Co., Inc. (In re LTV Steel Co., Inc.)*, 560 F.3d 229 (6th Cir. 2009).

11.3.rr. A court must judge equitable mootness differently in an appeal of an order confirming a liquidating plan. The related debtors had numerous intercompany claims, and many creditors' claims could be asserted against more than one debtor. The plan compromised both of these issues, among others, by allowing multi-debtor claims at 130% of face amount against the parent debtor, disallowing the claims against the other debtors and providing for distribution of the aggregate assets of the debtors among all claims against them, pro rata, based on the allowed amounts of the claims. Each creditor class voted separately, and all but one accepted the plan. The court confirmed the plan and denied the nonaccepting class's members' motion a stay pending appeal. On the effective date, a liquidating trust was created, the estates' assets were distributed to the trust, all outstanding notes, securities, indentures and stock were cancelled and 127,000 parties received notice of confirmation and the effective date. Since the effective date, the trust expended small amounts in administration and settled and made distributions on certain claims. An appeal from a confirmation order should be dismissed as equitably moot if granting the relief appellant seeks would be inequitable. Considerations include whether the plan has been substantially consummated, a stay has been obtained, or relief would affect the rights of parties not before the court or the plan's success and the public policy of affording finality to bankruptcy judgments. The court may apply these factors differently under a liquidating plan, because unraveling a liquidating plan is likely to have less significant consequences than unraveling a reorganization. Here, reversing the plan would not likely result in great difficulty in unwinding the rather minimal transactions that occurred, there does not appear to have been substantial third-party reliance and the reversal would not affect the debtor's ability to liquidate under a revised plan. Therefore, the appeal is not moot. *Schroeder v. New Century Liquidating Trust (In re New Century TS Holdings, Inc.)*, 2009 U.S. Dist. LEXIS 50708 (D. Del. June 16, 2009).

11.3.ss. Appeal is not moot where court may order relief against appellee's counsel. The plan established a reserve account for a secured creditor's disputed claim. The bankruptcy court disallowed the claim and, while an appeal from the disallowance order was pending, authorized the disbursement of the reserve account to pay the administrator's professional's fees. The secured creditor separately appealed the disbursement authorization. The court of appeals later reversed the claim disallowance. The administrator argued that the appeal from the disbursement authorization was moot, because the plan had been consummated and the funds disbursed. Equitable mootness protects non-adverse third parties who have relied on the plan and are not before the court by inquiring whether the court can grant relief without undermining the plan. The court must consider whether the appellant obtained a stay, whether the plan has been substantially consummated and whether the requested relief would affect either the rights of third parties not before the court or the success of the plan. Where effective relief can be granted, an appeal might not be moot even in the absence of a stay after plan consummation. Here, the administrator's counsel, who had received the reserve funds, is before the court, even though not as a party. Therefore, the court could order effective relief, and the appeal is not moot. *Wooley v. Faulkner (In re SI Restructuring, Inc.)*, 542 F.3d 131 (5th Cir. 2008).

11.3.tt. Sixth Circuit applies the equitable mootness doctrine to dismiss an appeal from a consummated plan. The debtor consummated its plan by canceling old membership interests and issuing new ones in exchange for new membership fees, dissolving a subsidiary, closing a new loan facility, and making distributions on priority and general unsecured claims, among other things. Equitable mootness differs from constitutional mootness in that it is an equitable doctrine designed to protect parties' expectations and a debtor's ability to emerge from bankruptcy. An appellate court may dismiss an appeal from confirmation as equitably moot based on three factors: whether the appellant has obtained a stay, whether the plan has been substantially consummated, and whether the relief requested would affect the rights of parties not before the court. Here, the appellants did not seek a stay, and the plan had been substantially consummated. The appellants sought reversal of the confirmation order, not minor modifications or interpretations. Therefore, the relief sought on appeal would default the exit loan,

jeopardize the debtor's ability to continue to make loans to 68,000 farmers who are members and customers, halt livestock transaction payments, and otherwise disrupt operations. It would also create uncertainty about all the plan consummation transactions. The appellants' argument that their plan would provide better creditor recoveries and sounder post-emergence operations goes to the merits of the appeal but is irrelevant to mootness. Therefore, the court dismisses the appeal as equitably moot. *Curreys of Neb., Inc. v. United Producers, Inc. (In re United Producers, Inc.)*, 526 F.3d 942 (6th Cir. 2008).

11.3.uu. Appeal from order authorizing sale free and clear is not moot. The trustee sold real property to the senior lienor under a credit bid free and clear of the junior lien. The sale involved transfer of possession, document recordation, assumption of contracts and cure of defaults. The junior lienor appealed the order approving the sale free and clear. Constitutional mootness requires impossibility of relief. Here, though relief may be difficult or inequitable, the trustee and both lienors are parties to the appeal, so relief is not impossible. Equitable mootness looks beyond impossibility to the consequences of a reversal and its effect on third parties who changed position in reliance on the sale order or to whether the transaction is too difficult or complex to unwind. Here, the sale involved third parties, so an appeal from the authorization to sell is equitably moot. However, an appeal from the lien-stripping portion of the sale order is not. Both the senior and junior lienor are parties to the appeal, and the lien can be reattached to the property without adverse consequences to anyone but the senior lienor. Statutory mootness under section 363(m) is similar to equitable mootness but is limited by the statutory language. Section 363(m) limits mootness to "an authorization under subsection (b) or (c) of a sale or lease" and prohibits an appeal from affecting the validity of the sale or lease. It does not address an order under subsection (f) to sell free and clear. Although the senior lienor's contract was to purchase the property free and clear, treating that term and the sale authorization as a single provision has the same effect as an express provision prohibiting an appeal from the sale order, which would not be permissible. Therefore, the appeal from the order authorizing the sale to be free and clear of the junior lien is not moot. *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25 (9th Cir. B.A.P. 2008).

11.3.vv. Direct appeal requires certification from the court where the matter is pending. A party may file a direct appeal from a bankruptcy court decision to the court of appeals if "the bankruptcy court, the district court, or the bankruptcy appellate panel involved" certifies the case is appropriate for direct appeal. Rule 8001(f)(2) adopts a bright-line test to determine which court is "involved": it is the bankruptcy court until an appeal is docketed at the district court or bankruptcy appellate panel. Rule 8007(b) provides for the clerk to docket the appeal only after the record (including any transcript) is complete and the clerk transmits it to the appellate court, although a local rule permits the bankruptcy court clerk to retain the record and transmit only a certificate that the record is ready. Therefore, a petition for certification filed with the B.A.P. before the appeal is docketed is erroneously filed. Rule 5005(c) requires a court in which a paper is erroneously filed to transmit it to the proper court, here, the bankruptcy court. If the bankruptcy court does not certify the appeal for a direct appeal before the appeal is docketed at the B.A.P., the appellant may renew the certification petition at the B.A.P. *Frye v. Excelsior College (In re Frye)*, 389 B.R. 87 (9th Cir. B.A.P. 2008).

11.3.ww. Absence of judgment on separate document tolls time to appeal. The Bankruptcy Appellate Panel issued a 6-page "Order and Judgment", which contained a detailed statement of facts and legal reasoning and the judgment. The debtor filed a notice of appeal with the B.A.P. 34 days after the Order and Judgment was entered on the B.A.P.'s docket. Fed. R. App. P. 4(a)'s deadline for filing a notice of appeal is 30 days after entry of the lower court's judgment. But it defines "entry" by reference to Fed. R. Civ. P. 58, which requires that a judgment be set forth on a separate document. If the judgment is not contained in a separate document, it is not deemed "entered" to start the appeal period for 150 days from the date the judgment is entered. A judgment that is a separate document must be self-contained, reciting only who has won and what relief the court has ordered, without a statement of facts or legal reasoning. The rule is a mechanical one that is to be construed to preserve a party's opportunity to appeal. Therefore, the "Order and Judgment" in this case did not start the 30-day appeal period running, and the appeal was timely. *Taumoepeau v. Mfrs & Traders Trust Co. (In re Taumoepeau)*, 523 F.3d 1213 (10th Cir. 2008).

11.3.xx. Denial of motion, based on removal procedural defects, to remand is not appealable. After the case was closed, creditors brought an action in state court against the estate's accountants for

malpractice in connection with plan confirmation. The accountants removed the action to the bankruptcy court without reopening the case. The creditors motion to strike the removal on the ground that the action could not be removed unless the chapter 11 case were first reopened. The bankruptcy court denied the motion. Section 1452(b) of title 28 permits the bankruptcy court to remand "on any equitable ground" and provides that "an order entered under this subsection remanding a claim or cause of action, or a decision to not remand, is not reviewable by appeal or otherwise by the court of appeals". A decision based on procedural issues, such as this one, or the timeliness of removal falls within the scope of the appeal prohibition. Therefore, the court of appeals does not have jurisdiction to review the bankruptcy court's decision. However, the court has jurisdiction to review whether the bankruptcy court had subject matter jurisdiction over the proceeding. *Geruschat v. Ernst Young LLP (In re Seven Fields Dev. Corp.)*, 505 F.3d 237 (3d Cir. 2007).

11.3.yy. Parties may take direct appeal to court of appeals only if a district court or B.A.P. appeal is pending. The trustee appealed a chapter 13 plan confirmation to the district court. The trustee and the debtor then filed a joint request for a certification of appeal to the court of appeals under section 158(d)(2). Under the interim procedure provided in uncodified BAPCPA section 1233(b)(4)(A), if the district court certified the appeal, the trustee would have had 10 days to petition the court of appeals to hear the appeal. Instead, the district court remanded to the bankruptcy court to certify, which it did. The parties then filed their joint petition to the court of appeals to hear the appeal, but the trustee did not file a new notice of appeal to the district court. Interim Rule 8001(f)(1) provides that a certification shall not be treated as entered on the docket "until timely appeal has been taken" in the manner specified in Rule 8001(a) or (b), governing ordinary appeals. Although the Interim Rule 8001(f)(1)provision appears to be a means to delay the start of the 10-day period specified in section 1233(b)(4)(A), the court of appeals reads it as a requirement of a direct appeal. It concludes that a timely appeal to the district court or B.A.P. is a condition to seeking permission for a direct appeal and actually benefits the appellant by preserving an intermediate appeal if the court of appeals declines to take the case. Despite this apparent procedural misstep, the court of appeals reaches the direct appeal question and determines that “"percolation through the district court would cast more light on the issues and facilitate a wise and well-informed decision", quoting *Weber v. U.S. Trustee*, 484 F.3d 154, 158 (2d Cir. 2007). *In re Davis*, 512 F.3d 856 (6th Cir. 2008).

11.3.zz. Bankruptcy court may not issue a discharge while dismissal motion is on appeal. The bankruptcy court denied the creditor's motion to dismiss the individual debtor's case. While the creditor's appeal was pending, the bankruptcy court issued the discharge. The appeal divested the bankruptcy court of jurisdiction over the case, so the bankruptcy court did not have jurisdiction to grant the discharge, which was void. *Sherman v. SEC (In re Sherman)*, 491 F.3d 948 (9th Cir. 2007).

11.3.aaa. Appellate court reviews bankruptcy court's interpretation of a confirmed plan for abuse of discretion. The confirmed plan required additional pension plan funding in certain circumstances. Nearly 10 years after confirmation, a retiree group moved to reopen the case to enforce the plan provision to require the additional funding. A confirmed plan is a court order. Construing a confirmed plan generally requires application of contract principles, and contract construction generally presents a question of law for *de novo* review, but reviewing the bankruptcy court's interpretation of its own order (the plan) requires a more deferential standard. Therefore, unless the issue being reviewed presents only a question of law, the court of appeals applies an abuse of discretion standard to reviewing the bankruptcy court's plan interpretation. *In re Shenango Group, Inc.*, 501 F.3d 338 (3d Cir. 2007).

11.3.bbb. BAP decisions are binding on bankruptcy courts throughout the circuit. The Bankruptcy Appellate Panel had issued a decision in an appeal from another district that was directly on point. The district court from this district had not addressed the issue. The BAP has previously ruled that its decisions are binding on all bankruptcy courts in the circuit. Although a district judge is not bound by the decisions of another district judge even in the same district, the BAP's rules require a BAP panel to follow decisions of other BAP panels (unless overruled by the court of appeals or the Supreme Court). Moreover, part of Congress's intent in establishing the BAPs was to promote uniformity of decisions within a circuit. Under these circumstances, the BAP's precedent is binding on the bankruptcy court. The court does not address whether it would be binding if there were also a contrary district court decision directly on point. *In re Vue*, 364 B.R. 767 (Bankr. D. Ore. 2007).

11.3.ccc. Bankruptcy court lacks jurisdiction over stay relief motion while confirmation appeal is pending. Generally, an appeal divests the trial court of jurisdiction. Because a bankruptcy case raises so many unrelated issues, however, the bankruptcy court may continue to hear matters where the appeal concerns unrelated aspects of the case. Here, the debtor appealed the confirmation of a secured creditor's chapter 11 plan. The plan provided for a liquidating trustee to sell the creditor's collateral by a particular date, after which the stay was lifted to permit the creditor to sell at foreclosure. The relief the creditor sought in a stay relief motion was inconsistent with the plan provision and therefore was sufficiently related to the confirmation order that the appeal divested the bankruptcy court of jurisdiction over the stay relief motion. *Whispering Pines Estates, Inc. v. Flash Island, Inc. (In re Whispering Pines Estates, Inc.)*, 369 B.R. 752 (1st Cir. B.A.P. 2007).

11.3.ddd. Court of appeals declines direct appeal. The bankruptcy court applied a state's homestead exemption increase to apply even to existing mortgages and certified a direct appeal by the creditor to the court of appeals under 28 U.S.C. §158(d)(2)(A). That section permits a direct appeal if the court of appeals "authorizes" it, which gives the court of appeals discretion to exercise or decline to exercise jurisdiction. Among the considerations the court of appeals might use are whether there is a conflict among the bankruptcy or district courts on the legal issue, whether the ruling is manifestly correct or incorrect, whether an appellate ruling would materially advance or alter the conduct of the case below, and whether the legal issue would be resolved more wisely if there is more time for percolation through the lower courts and for development and consideration of the issues. In this case, the decision was in accord with the other three bankruptcy courts in the state who had ruled on the issue, it was not manifestly correct or incorrect, resolution would not materially advance or affect the progress of the bankruptcy case, and the issue would benefit from further consideration and analysis by the district courts. Accordingly, the court declines to hear the appeal. It cautions, however, that its reasoning is dicta and that other panels of the court remain free to authorize a direct appeal if they believe doing so would better further Congress' goals in permitting direct appeals. *Weber v. U.S. Trustee*, 484 F.3d 154 (2d Cir. 2007).

11.3.eee. Minute order granting summary judgment motion is not a final order. The bankruptcy court orally granted the creditor's motion for summary judgment in an adversary proceeding in which the debtor sought to impose sanctions for a stay violation. The judge signed a minute order later that same day, "ORDERED denying the debtor motion for summary judgment and granting [creditor's] motion for summary judgment," which was entered on the docket. But the court took under submission the creditor's sanctions motion against the debtor's attorney. The time to file a notice of appeal under Rule 801 runs only from entry of a final order. To be a final order, the order must clearly and unequivocally reflect the judge's intention that it finally dispose of the matter pending before the court. Typically, an order granting a summary judgment motion without granting judgment to the prevailing party in a separate document as required under Rule 7058 does not reflect such an intention. The absence of a final judgment in favor of the creditor and the continued pendency of the sanctions motion here negated any such intention. *Brown v. Wilshire Credit Corp (In re Brown)*, 484 F.3d 1116 (9th Cir. 2007).

11.3.fff. Rule 60 does not apply in bankruptcy appeals. The appellant moved under Bankruptcy Rule 9024, which incorporates Fed. R. Civ. Proc. 60 by reference, for relief from the district court's order dismissing her appeal. Civil Rule 81(a) provides that the Civil Rules applies "to proceedings in bankruptcy [in the district courts] to the extent provided by the" Bankruptcy Rules. Rule 9024 applies by its terms only to a bankruptcy court's order or judgments. It therefore does not apply in the district court. The court instead treats the motion as one for reconsideration under Rule 8015, which imposes a 10-day deadline on such a motion. As such, it was untimely and therefore denied. *Ben-Baruch v. Island Props.*, 362 B.R. 565 (E.D.N.Y. 2007).

11.3.ggg. Direct appeal statute applies only to bankruptcy cases, not appeals, filed on or after BAPCPA's effective date. The debtor filed his chapter 13 case on September 13, 2005 and filed a notice of appeal from its dismissal on March 21, 2006. The debtor requested a certificate permitting direct appeal to the court of appeals, as authorized by BAPCPA. BAPCPA provides, with exceptions not relevant here, that it applies to "cases under title 11" filed on or after October 17, 2005. The debtor's chapter 13 case was filed before BAPCPA's effective date. Therefore, BAPCPA's direct appeal provision

does not apply, and the court denies the request for the direct appeal certificate. *Berman v. Maney (In re Berman)*, 344 B.R. 612 (9th Cir. B.A.P. 2006).

11.3.hhh. Appeal from unstayed confirmation of simple plan is not moot. The real estate developer's plan adjusted the claims of the secured creditor by issuance of new notes and did little else to restructure the debtor. No assets were sold, no stock was issued, and no capital was invested. Under the circumstances, the appellate court could grant effective relief to the secured creditor appellants, so the appeal was not moot. *F.H. Partners, L.P. v. Inv. Co. of the Sw., Inc. (In re Inv. Co. of the Sw., Inc.)*, 341 B.R. 298 (10th Cir. BAP 2006).

11.3.iii. Appeal from approval of negotiated terms of financing agreement is moot. The trustee entered into a postpetition financing agreement that provided for funds to complete the debtor's housing project and a specified amount for payment of expenses of the trustee and his professionals, but not any debtor in possession professionals, and that any amount not used for that purpose would be returned to the lender. The debtor in possession's counsel appealed, seeking a modification of the order to require that the specified funds be available pro rata for all professionals with allowed chapter 11 administrative claims. The appeal is moot, even though it would not affect the validity of the debt or the priority of the lender's lien, because the relief sought would modify the terms of the financing, which is impermissible under the Ninth Circuit's broad reading of section 364(e). *Weinstein, Eisen & Weiss LLP v. Gill (In re Cooper Commons, LLC)*, 430 F.3d 1215 (9th Cir. 2005), *amending and superseding* 424 F.3d 963 (9th Cir. 2005).

11.3.jjj. Appeal from approval of a consummated settlement is not moot. The debtor had contracted to build a methane gas recovery facility on a landfill and, separately, to sell the gas. The debtor's lenders had a security interest in both contracts (among other assets). The debtor breached both contracts. The debtor's chapter 11 trustee settled disputes with the landfill operator and the gas purchaser over the debtor's breaches by agreeing to accept a small payment and a release of claims from both counterparties and to give up the estate's right to the gas. The lenders proposed instead that they waive a portion of their secured claim, make a larger payment to the estate, and indemnify the estate against the counterparties' claims in exchange for the trustee's abandonment of the right to collect the gas. The bankruptcy court denied the lenders' objection and approved the trustee's settlement with the counterparties. The trustee consummated the settlement. The lenders' appeal was not moot, because the appellate court could order effective relief. Even though it might be complicated to unwind the settlement, it was possible to do so. The trustee could be ordered to return the payment to the counterparties, reinstate the claims, and redirect delivery of the gas. *In re Resource Tech. Corp.*, 430 F.3d 884 (7th Cir. 2005).

11.3.kkk. Sixth Circuit adopts less stringent equitable mootness rule. The Sixth Circuit follows the Fifth Circuit in adopting the following test to determine whether an appeal from a plan confirmation order is equitably moot: "(1) whether a stay has been obtained; (2) whether the plan has been 'substantially consummated'; and (3) whether the relief requested would affect the rights of parties not before the court or the success of the plan." In this case, the secured lenders appealed the valuation of their collateral and the cram down interest rate. They did not seek or obtain a stay, but failure to do so is not fatal on the first factor. The plan had been substantially consummated. There was sufficient evidence in the record below that reversal on the valuation and interest rate issues would not affect the plan's success. Erring on the side of caution, the court therefore holds the appeal not moot. *Bank of Montreal v. Official Comm. of Unsecured Creditors (In re American HomePatient, Inc.)*, 420 F.3d 559 (6th Cir. 2005).

11.3.lll. Sale order appeal is not moot as to unexecuted portions of the sale order. The bankruptcy court authorized an asset sale, with a portion of the proceeds distributed to the first lien lenders and the balance to the second lien lenders. The first lien lenders challenged several aspects of the sale and the order, but stipulated to allow the sale to close, as long as the sale proceeds were held in escrow and not distributed to the second lien holders pending a decision of the appellate court. The appeal was moot as to issues relating to the validity of the sale but not as to the distribution of proceeds. Those issues were preserved by the stipulation and the escrow of the sale proceeds pending the appeal

outcome. *Contrarian Funds, LLC v. WestPoint Stevens, Inc. (In re WestPoint Stevens, Inc.)*, 333 B.R. 30 (S.D.N.Y. 2005).

11.3.mmm. Denial of mandatory abstention is reviewable, even in the context of a refusal to remand. Under section 1452(b), a district court's decision on a motion to remand is not reviewable, by appeal or otherwise. Under section 1334(d), a district court's decision on a motion to abstain is similarly not reviewable, except that an order denying mandatory abstention under section 1334(c)(2) is reviewable. What if the district court denies remand on the ground that mandatory abstention is not required? The Second Circuit rules that to give effect to both provisions, the order is reviewable. It reasons that after a reversal of a decision not to abstain, the district court might decide to remand. The appellate court's review would have been only of the abstention decision, not of the remand, so the appellate review does not violate section 1452(b). *Mt. McKinley Ins. Co. v. Corning Inc.*, 399 F.3d 436 (2d Cir. 2005).

11.3.nnn. Court of appeals has jurisdiction over district court's discretionary stay of Attorney General's enforcement action. The debtor in possession sought a stay of the State Attorney General's prepetition Clayton Act case, which sought to require the debtor to divest assets. Without ruling on whether the police or regulatory power exception of section 362(b)(4) applied, the district court granted a discretionary stay. The Attorney General appealed. The court of appeals has appellate jurisdiction because the order put the Attorney General "effectively out of court," as described in *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Co.*, 460 U.S. 1 (1983). If the bankruptcy court authorized or required divestiture of the assets, the issue might become moot, and the Attorney General would not have the opportunity to litigate the Clayton Act violation and might have to relitigate it with the asset's purchaser. If not, then in the meantime, any Clayton Act violation could harm consumers in the state. Accordingly, the court of appeals could hear the appeal. *Lockyer v. Mirant Corp.*, 398 F.3d 1098 (9th Cir. 2005).

11.3.ooo. Appeal of an order for relief in an involuntary case is not moot. The debtor appealed the chapter 7 order for relief. The appellees sought dismissal on the ground of mootness. The court concludes that the relief sought—return of the control of the business to the debtor, discharge of the trustee, and dismissal of the case—could be granted. Nor were the transactions so complex or difficult to unwind that the appeal should be dismissed as equitably moot. *Focus Media, Inc. v. National Broad. Co. (In re Focus Media, Inc.)*, 378 F.3d 916 (9th Cir. 2004).

11.3.ppp. Court of appeals lacks jurisdiction over order denying interlocutory review. The bankruptcy court issued a preliminary injunction. The defendant appealed. The district court concluded that the injunction was interlocutory and did not grant leave to appeal. The defendant appealed to the court of appeals, which ruled that it did not have jurisdiction. Although section 1292(a) of title 28 grants the court of appeals mandatory jurisdiction over any district court order granting or denying an injunction, the Second Circuit concludes that the district court was not required to act in this case, because of the discretion it has in granting leave to appeal under section 158(a)(3) of title 28. Since the district court did not act, the court of appeals was without jurisdiction to hear the appeal. *Gibson v. Kassover (In re Kassover)*, 343 F.3d 91 (2d Cir. 2003).

11.3.qqq. B.A.P. may not certify interlocutory appeal under 28 U.S.C. § 1292(b). The bankruptcy appellate panel reversed the bankruptcy court's decision and remanded for further specific findings. The appellee asked the B.A.P. to certify questions to the court of appeals for interlocutory appeal under section 1292(b). The B.A.P. rules that section 1292(b) authorizes a certified interlocutory appeal only from a district court (whether acting as a court of original jurisdiction or as a bankruptcy appellate court), but not from the decision of a bankruptcy appellate panel. *Watman v. Groman (In re Watman)*, 304 B.R. 553 (1st Cir. B.A.P. 2004).

11.3.rrr. Section 363(m) moots appeal from an order approving integral portions of a sale agreement. A pre-petition junior secured lender was the successful bidder at a bankruptcy sale. One of the terms of the sale required a release of any avoiding power actions against the buyer and against the senior secured lender. In fact, the buyer increased the purchase price to obtain the releases. Because the releases were integral to the sale, section 363(m) prevented review of those provisions. In addition,

section 363(m) does not exclude creditor purchasers from its protection. *Official Committee Of Unsecured Creditors v. Trism, Inc. (In re Trism)*, 328 F.3d 1003 (8th Cir. 2003).

11.3.sss. Rule 9021 requires a separate document for an effective order. The bankruptcy court dismissed a case in a memorandum opinion without a separate order. As a result, the time to appeal did not begin to run. The Ninth Circuit B.A.P. re-emphasizes the importance of the separate document rule, under which a judgment (including any order) must be set forth in a separate document. The B.A.P. notes the recent amendment to F.R.C.P. 58, under which a judgment is effective either when it is set forth on a separate document or when 150 days have run from entry on the docket of a non-conforming judgment. *Garland v. Estate of Maloney (In re Garland)*, 295 B.R. 347 (9th Cir. B.A.P. 2003).

11.3.ttt. Section 108(b) extends time to file notice of appeal. Federal Rule of Appellate Procedure 4(a) provides a 30-day deadline for filing a notice of appeal. The deadline is jurisdictional. If the appellant files a bankruptcy petition within the 30-day period, however, section 108(b) of the bankruptcy code extends the time period until 60 days after the order for relief. A notice of appeal is a document of the kind described in that section. The Rules Enabling Act for the appellate rules provides that the rules supercede all laws in conflict with the rules. But the court concludes that the enactment of section 108(b) after the promulgation of the rules renders that provision of the Rules Enabling Act inapplicable to this situation. *Local No. 38 v. Custom Air Systems, Inc.*, 333 F.3d 345 (2d Cir. 2003).

11.3.uuu. Creditor may not intervene to take over settled appeal. The committee appealed from an order of the bankruptcy court dismissing avoiding power claims that the committee had brought on behalf of the estate. During the appeal, the committee settled with the defendants. A creditor moved to intervene in the appeal to continue its prosecution. The district court rules that despite the creditor's absolute right to intervene under section 1109(b), intervention on these facts would amount to taking ownership of the cause of action, which is not authorized by section 1109. *Official Committee v. Morgan Stanley & Co., Inc. (In re Sunbeam Corp.)*, 287 B.R. 861 (S.D.N.Y. 2003).

11.3.vvv. Decision not to remand is reviewable on jurisdictional grounds. Where the bankruptcy court determines not to remand an action that has been removed from state court, the non-removing party may seek review of the order, despite the limitation on appellate review of a decision to remand or not to remand contained in 28 U.S.C. § 1452(b), if the sole ground for review is that the bankruptcy court does not have jurisdiction to hear the removed action. *Bissonnet Invs. LLC v. Quinlan (In re Bissonnet Invs. LLC)*, 320 F.3d 520 (5th Cir. 2003); *Mourad v. Farrell (In re V&M Mgmt., Inc.)*, 321 F.3d 6 (1st Cir. 2003).

11.3.www. Order dismissing non-final appeal is final and appealable. The bankruptcy appellate panel ruled that it did not have jurisdiction to hear an appeal because the underlying order was not final. On further appeal to the court of appeals, the Eighth Circuit rules that the B.A.P's order was a final order, that a motion to dismiss the appeal to the court of appeals should therefore be denied, but that because the underlying order was not final, the B.A.P.'s order should be affirmed. *Schwartz v. Kujawa*, 323 F.3d 628 (8th Cir. 2003).

11.3.xxx. Bankruptcy court did not have jurisdiction to issue order supplemental to appealed confirmation order. In the confirmation order, the bankruptcy court set the interest rate on state tax claims at 10%. The state appealed. Within 5 days thereafter, on the debtor's motion, the bankruptcy court issued an order confirming the 10% rate, apparently so that the state's appeal would not disrupt the implementation of the confirmation order. The state also appealed the supplemental order. After the district court dismissed the appeal from the confirmation order and affirmed the supplemental order, the state appealed the supplemental order to the Court of Appeals, which rules that the bankruptcy court did not have jurisdiction to issue the supplemental order, because the subject of the supplemental order was the subject of an appeal from the confirmation order, which divested the bankruptcy court of jurisdiction. *Texas Comptroller v. Trans Texas Gas Corp.*, 303 F.3d 571 (5th Cir. 2002).

11.3.yyy. Appeal from third party release is moot. The debtor's principal competitor was a successful plaintiff in a patent violation action against the debtor and was therefore also its principal creditor. It also sued the debtor's principals in a subsequent action. The debtor's plan provided for payment of all creditors

(including the competitor) in full, funded in large part by a contribution from the principals, who would receive the benefit of an injunction against prosecution of the action against them unless the debtor defaulted under the plan. The Fourth Circuit holds the creditor's plan confirmation appeal moot, because the plan had been substantially consummated, the debtor had incurred substantial new relationships and obligations in going back into business, and because it would be inequitable to vacate the injunction without at the same time refunding the principals contribution to the reorganization. *MAC Panel Co. v. Virginia Panel Corp.*, 283 F.3d 622 (4th Cir. 2002).

11.3.zzz. B.A.P.'s may issue writs of mandamus. The All Writs Act, 28 U.S.C. § 1651(a), authorizes "all courts established by Act of Congress [to] issue all writs necessary or appropriate in aid of their respective jurisdictions . . . ." Bankruptcy Appellate Panels are established under 28 U.S.C. § 158(b), which grants the judicial counsel of a circuit the authority to establish them. The Ninth Circuit B.A.P. rules that because Congress authorized the creation of the B.A.P.'s, Congress "established" the B.A.P.'s for purposes of the All Writs Act. Therefore, the B.A.P.'s have authority to issue writs of mandamus. *Salter v. United States Bankruptcy Court (In re Salter)*, 279 B.R. 278 (9th Cir. B.A.P. 2002).

11.3.aaaa. Appeal from confirmation order is held equitably moot. In a continuing expansive reading of the equitable mootness doctrine, the Third Circuit affirms, on an abuse of discretion standard, the district court's ruling that an appeal from the order confirming the reorganization plan of Zenith Electronics is moot. The plan provided for exchange of public bonds for new bonds in a lesser amount, conversion of insider debt to equity, refinancing of secured debt, and elimination of equity. The court applied the five part equitable mootness test it adopted in *Continental Airlines*, 91 F.3d 553 (3d Cir. 1996):
(1) Substantial consummation: the plan had been substantially consummated; (2) Absence of a stay: the plan was consummated within four days after entry of the order of confirmation, without notice to the appellants, but the exchange of bonds did not occur until ten days later, after the appellants had received notice of the confirmation order and the commencement of consummation. Nevertheless, the court faulted the appellants for neither seeking a stay nor providing an adequate explanation for their failure to do so. (3) Effect on rights of third parties: the effect to be measured is on parties before the appellate court, not those before the bankruptcy court. The court did not weigh the effect on the insider 58% stockholder heavily, or the effect on the secured lenders who refinanced their credit facility, departing from the Fifth Circuit's decision in *In re GWIPCS1, Inc.*, but finds that the effect on bondholders who were not before the court might be inequitable. (4) Effect on success of the plan: the appellants intended to dissolve the plan if they were successful on appeal, so the Third Circuit found this factor satisfied.
(5) Public policy of finality: despite the reliance of insiders, the court found this factor weighed in favor of mootness. *Nordhoff Investments, Inc. v. Zenith Electronics Corp.*, 258 F.3d 180 (3d Cir. 2001).

11.3.bbbb. Delayed interlocutory appeal is permitted. The appellant timely filed a notice of appeal from an interlocutory order of the bankruptcy court and a motion for leave to appeal to the district court. Thereafter, the appellant moved the bankruptcy court for an order altering the prior ruling. Because of the filing of that motion, the district court denied the motion for leave to appeal without prejudice. The bankruptcy court ultimately denied the motion to alter the prior ruling, and the appellant moved once again for leave to appeal, but more than ten days after the bankruptcy court denied the motion to amend the judgment. The court of appeals rules that the appeal was proper, because it was an appeal from the original ruling of the bankruptcy court, which had been timely. The subsequent motion for leave to appeal was simply renewal of a motion that had previously been denied without prejudice. Therefore, its tardiness did not affect the jurisdiction of the district court. *McGee v. Stumpf (In re O'Connor)*, 258 F.3d 392 (5th Cir. 2001).

11.3.cccc. Interlocutory bankruptcy court orders may not be reviewable by the court of appeals. The trustee brought an action against several defendants for recovery of fraudulent transfers and on other grounds. The bankruptcy court dismissed the fraudulent transfer claims. The orders were interlocutory, because they did not dispose of all claims against all of the defendants. Before trial on the remaining claims, the district court withdrew the reference and tried the remaining claims. The trustee never sought district court review of the bankruptcy court's interlocutory orders. When the trustee lost on the other claims at the district court and appealed to the court of appeals, the court of appeals dismissed the appeal of the bankruptcy court's interlocutory orders for lack of jurisdiction. The court of appeals reasoned

that it had jurisdiction only of appeals of orders of the district court and that the district court had never ruled on the matters that the bankruptcy court disposed of by the initial interlocutory order. *Brandt v. Wand Partners*, 242 F.3d 6 (1st Cir. 2001).

11.3.dddd. B.A.P. retains jurisdiction to issue stay pending appeal. Typically, the filing of a notice of appeal divests the lower court of jurisdiction. It does not, however, divest it of jurisdiction to consider ancillary matters, such as issuing a stay pending appeal. Accordingly, the B.A.P. has jurisdiction to issue a stay pending appeal even after the filing of the notice of appeal. Similarly, it may stay issuance of the mandate. But it may not do either once the mandate has issued, because issuance of the mandate returns the case to the bankruptcy court and divests the B.A.P. of jurisdiction. *Fross v. MJPB, Inc. (In re Fross)*, 258 B.R. 26 (10th Cir. B.A.P. 2001).

11.3.eeee. Appeal from contract assumption order is not moot. The bankruptcy court authorized the assumption and assignment of physicians' employment contracts. The physician-employees objected that the contracts could not be assigned. After the bankruptcy court approved the assignments, the physicians appealed. The court of appeals rules that section 363(m), which prevents an appeal from affecting the validity of a sale order, applies to an order approving assignment of executory contracts, as long as the order also contemplates a sale of the contracts under section 363. In this case, if the physicians' challenge to the assumption and assignment order was reversed, the physicians might have a claim for rejection damages and would be relieved of covenants not to compete contained in the contracts. Accordingly, the court could grant effective relief, and the appeal was not moot. *Cinicola v. Scharffenberger*, 248 F.3d 110 (3d Cir. 2001).

11.3.ffff. Appeal of an unstayed order is not moot. The IRS did not obtain a stay of the bankruptcy court's order approving the chapter 7 trustee's final accounts and closing the case, but appealed the order nevertheless. The IRS joined as an appellee a receiver in a federal district court case, who had received the chapter 7 estate's surplus. The First Circuit B.A.P. holds that the appeal is not moot by reason of the failure to obtain a stay, because it did not involve a sale of property or confirmation of a plan, because the distributee of the estate's property was a party to the appeal, and because the bankruptcy court could fashion effective relief. *United States v. Sterling Consulting Corp. (In re Indian Motorcycle Co., Inc.)*, 259 B.R. 458 (1st Cir. B.A.P. 2001).

11.3.gggg. Equitable mootness may be defeated by the appellee's inequitable conduct. On an appeal, the lender was required to return funds to the debtor after the dismissal of a chapter 13 case. The lender failed to do so but instead sought and obtained a judgment of the state court allowing it to apply the funds to the loan. The debtor sought to have the bankruptcy court order return of the funds, but the bankruptcy court denied the debtor's motion. On appeal from that denial, the lender argued equitable mootness on the grounds of a comprehensive change in circumstance as a result of the state court judgment. The B.A.P. rules that the lender's own conduct in disregarding the prior appellate decision was inequitable and defeated the lender's claim to equitable mootness. *Williams v. City Financial Mortgage Co. (In re Williams)*, 256 B.R. 885 (8th Cir. B.A.P. 2001).

11.3.hhhh. Finality for purposes of appeal may differ if the reference is withdrawn. The Second Circuit determines finality of a bankruptcy court order by determining "whether the underlying decision of the bankruptcy court was final or interlocutory," citing *Bowers v. Connecticut National Bank*, 847 F.2d 1019, 1022 (2d Cir. 1988). In this bankruptcy case, the district court was required to determine venue directly under section 157(b)(5) of title 28, in a proceeding that could not be referred to the bankruptcy court under section 157(a). Because the district court issued the initial order, the Bowers test could not be satisfied, suggesting that the rules for determining finality for purposes of an appeal from a bankruptcy court order do not apply where the reference has been withdrawn and the initial order is entered or is made by the district court. *Maritime Asbestosis Legal Clinic v. United States Lines, Inc. (In re United States Lines, Inc.)*, 216 F.3d 228 (2d Cir. 2000).

11.3.iiii. Only a person aggrieved by non-disclosure may appeal from confirmation on that ground. The creditor challenged the validity of the disclosure statement for failure to conduct a thorough preference recovery analysis, but would not have voted differently had it known the outcome of that

analysis. The creditor appealed the confirmation order under section 1129(a)(2) ("the proponent of the plan complies with the applicable provisions" of the Bankruptcy Code) on the ground that inadequate disclosure constituted noncompliance. Although the Third Circuit agreed with the general principle, it ruled that the creditor was not aggrieved by the possible violation and so did not have standing to appeal. *In re PWS Holding Corp*., 228 F.3d 224 (3d Cir. 2000).

11.3.jjjj. Time to file notice of appeal extended twice by weekends. The bankruptcy court entered its order on a Wednesday so that the 10-day period for filing any notice of appeal expired on Saturday and was automatically extended to Monday under Rule 9006(a). On that Monday, the appellant sought a 20-day extension under Rule 8000(2)(c). The court granted the extension so that the period would expire on a Sunday, which was automatically extended to the next business day by Rule 9006(a). The Court of Appeals held the notice of appeal timely, even though it was filed 33 days after the initial entry of judgment, because of the intervention of two weekend extensions. *Plotner v. AT&T Corp.*, 224 F.3d 1161 (10th Cir. 2000).

11.3.kkkk. Appeal from plan releases is not moot. Where the confirmed reorganization plan provided a release of equity holders from fraudulent transfer claims, an appeal from the confirmation order challenging only the release would not be held equitably moot. If the releases were struck, it would not require unraveling of the reorganization or reversal of the entire confirmation order. *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000).

11.3.llll. FCC appeal of plan confirmation order is equitably moot. The debtor avoided its obligations under the C-block license auction to the FCC and confirmed the plan based on the reduced obligation. The FCC appealed and obtained a temporary stay, but the stay was vacated before the appellate decision. The debtor obtained new investors (mostly insiders) and embarked on building out the PCS system. The appeal was equitably moot because a stay had not been obtained, the plan had been substantially consummated, and the relief requested would adversely affect the rights of third parties. Substantial consummation does not require complete consummation (some financing had still not been obtained), and the fact that insiders were involved does not detract from either substantial consummation or third party reliance. The reliance element is evaluated based upon whether the parties could be placed back in the position they were in before confirmation. *United States v. GWI PCS One, Inc. (In re GWI PCS One, Inc.)*, 230 F.3d 788 (5th Cir. 2000).

11.3.mmmm. Confirmation of chapter 13 plan moots appeal from order converting case. The trustee objected to the debtor's motion to convert her chapter 7 case to chapter 13. The objection was overruled, and the chapter 13 case proceeded to confirmation. Distributions under the chapter 13 began before the B.A.P. heard the appeal from the conversion order, which had not been stayed. Because the chapter 13 confirmation and distributions could not reasonably be unwound, the court held the appeal moot and dismissed. *Blackwell v. Little (In re Little)*, 253 B.R. 427 (8th Cir. B.A.P. 2000).

11.3.nnnn. Appeal divests lower court of jurisdiction. The bankruptcy court dismissed the petition for bad faith. The B.A.P. reversed and remanded. The trustee appealed to the Court of Appeals. While that appeal was pending, the bankruptcy court implemented the B.A.P.'s remand, reinstated the bankruptcy case, granted the discharge, and closed the case. Holding that the bankruptcy court did not have jurisdiction during the pendency of the appeal to the Court of Appeals, the Court of Appeals vacated the bankruptcy court's orders. *Neary v. Padilla (In re Padilla)*, 222 F.3d 1184 (9th Cir. 2000).

11.3.oooo. A B.A.P. decision is not binding precedent on bankruptcy courts. Based on the rationale that the decision of one district judge does not bind other district judges within the same district, the bankruptcy court concludes that the Article I B.A.P. should not be given any greater *stare decisis* authority than the district court and therefore cannot bind bankruptcy judges within the circuit. *Daly v. Deptula (In re Carrozzella & Richardson)*, 255 B.R. 267 (Bankr. D. Conn. 2000).

11.3.pppp. Equitable mootness argument rejected in appeal of confirmation order. Plaintiffs in a securities class action appealed from an order confirming a plan which contained a release of the debtor's directors and officers from the class action claims. Because the release was not integral to the plan, the

amounts involved were not large, and the reversal of the release would not necessitate the reversal or unraveling of the entire plan, the Third Circuit denies a motion to dismiss the appeal on grounds of equitable mootness. *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203 (3d Cir. 2000).

11.3.qqqq. Extension of ten-day period to appeal does not require "special circumstances." The appellant timely sought an extension of the ten-day period under Bankruptcy Rule 8002 to file its appeal to permit it to determine the outcome of a mediation. The bankruptcy court denied the motion on the ground that the appellant did not demonstrate special circumstances for the extension. The Ninth Circuit B.A.P. reversed, holding that in determining an extension motion, the court should apply a modified version of the standards for determining whether a continuance is appropriate, and refusing to follow the Tenth Circuit B.A.P.'s ruling requiring special circumstances set forth in *Lovelace v. Higgins (In re Higgins)*, 220 B.R. 1022 (10th Circuit B.A.P. 1998)). *Nugent v. Betacom of Phoenix, Inc. (In re Betacom of Phoenix, Inc.),* 250 B.R. 376 (9th Cir. B.A.P. 2000).

11.3.rrrr. Appeal from order denying section 1110 rights is moot. After the bankruptcy court authorized the assignment of leases that were protected by section 1110 as collateral for a post-petition financing, the lessor appealed. Because the appeal would have affected the financing, the court of appeals, in a very broad reading of section 364(e), holds the appeal moot. *Boullion Aircraft Holding Company, Inc. v. Smith Management (In re Western Pacific Airlines, Inc.)*, 1999 W.L. 459469 (10th Cir. 1999).

11.3.ssss. Repossession of aircraft moots appeal from order denying section 1110 rights. Although the bankruptcy court initially permitted an aircraft lessor to repossess aircraft under section 1110, the district court reversed. Nevertheless, the chapter 11 case converted to chapter 7 and the lessor repossessed all planes. Accordingly, the appeal of the District Court's order (*In re Western Pacific Airlines*, 219 B.R. 305 D. Colo. 1998) on rehearing, 221 B.R. 1 (D. Colo. 1991), was moot. Because the lessor/appellant caused the mootness, the court of appeals declined, on equitable grounds, the appellant's request to vacate the decision below. (*Boullion Aircraft Holding Company, Inc. v. Smith Management (In re Western Pacific Airlines, Inc.)*, 199 W.L. 459469 (10th Cir. 1999).

11.3.tttt. The bankruptcy court may not implement a B.A.P. reversal while it is on appeal. The bankruptcy court entered a non-dischargeability judgment against the debtor. The debtor appealed, and the B.A.P. reversed and remanded. The creditor timely appealed but after the B.A.P. issued its mandate. The bankruptcy court then denied the debtor's motion to vacate the judgment because of the B.A.P. reversal. The B.A.P. affirmed the denial, reasoning that the subsequent appeal divested the bankruptcy court of jurisdiction, even though it was filed after the B.A.P. had issued its mandate to the bankruptcy court. *Marino v. Classic Auto Refinishing, Inc. (in re Marino)*, 234 B.R. 767 (9th Cir. B.A.P. 1999). Because the appellant did not obtain a stay pending appeal, the court could enforce its original judgment, even though it had been reversed, although the B.A.P. would likely view a motion for a stay with favor. *Hill and Sanford LLP v. Mirzai (In re Mirzai)*, 236 B.R. 8 (9th Cir. B.A.P. 1999).

11.3.uuuu. Failure to specify an issue on an appeal results in waiver. Bankruptcy Rule 8006 requires an appellant to file a "statement of issues to be presented," and Rule 8010 requires a statement of the issues presented in the appellant's brief. Failure to raise an issue in these two places results in waiver, even if the issue is mentioned in the body of the brief. *Interface Group-Nevada, Inc. v. Trans World Airlines, Inc. (In re Trans World Airlines, Inc.)*, 145 F.3d 124 (3d Cir. 1998).

11.3.vvvv. A person aggrieved may piggyback on the appeal of a party without standing. A party before the district court filed a notice of appeal within 30 days after the district court's order. The trustee filed a notice of appeal within 14 days thereafter. The original appellant did not have standing to appeal, but the invalidity of its appeal did not effect the additional 14-day period in which the trustee could file its notice of appeal. *Marlow v. Rollins Cotton Co. (In re The Julien Co.)*, 146 F.3d 421 (6th Cir. 1998).

11.3.wwww. Appellate jurisdiction limited. A person who had objected to the bankruptcy court's ruling did not appeal the order to the district court, but filed a brief in support of the debtor, who did appeal.

After the district court affirmed, the person filed a notice of appeal to the court of appeals. The court of appeals ruled that because the person did not file a notice of appeal at the first appellate level, the court of appeals did not have jurisdiction to hear the second level appeal filed by that person. *Krebs Chrysler-Plymouth, Inc. v. Valley Motors, Inc.*, 141 F.3d 490 (3d Cir. 1998).

11.3.xxxx. Bankruptcy court contempt sanction is not a final order. The bankruptcy court issued a contempt order, to which the contemnor filed timely objection. The bankruptcy court overruled the objection, and the contemnor appealed to the B.A.P.. The B.A.P. holds that the contempt order and the order overruling the objections are not final orders, because Bankruptcy Rule 9033 requires district court *de novo* review of a contempt order. The order overruling the objection is vacated and remanded to the bankruptcy court to transmit to the district court for review. *In re Carrico*, 214 B.R. 842 (6th Cir. B.A.P. 1997).

11.3.yyyy. Mixed question of law and fact defined. "A mixed question of law and fact occurs when the historical facts are established; the rule of law is undisputed . . .; and the issue is whether the facts justify the legal rule. Mixed questions are presumptively reviewed by us *de novo* because they require consideration of legal concepts and the exercise of judgment about the values that animate legal principles," overruling prior Ninth Circuit precedent in the context of a determination that a debt was non-dischargeable because it was based on willful and malicious injury. *Murray v. Bammer (In re Bammer)*, 131 F.3d 788 (9th Cir. 1997) (*en banc*).

11.3.zzzz. Litigation target does not have standing to oppose assignment of a claim. The debtor's landlord sued the debtor for damage to the building and obtained relief from the stay on the grounds that the debtor's liability was insured. After conversion of the debtor's case to chapter 7 in the appointment of a trustee, the landlord obtained judgment outside the policy limits. The trustee settled with the landlord for the excess amount by assigning the debtor's insurance bad faith claim to the landlord in exchange for 5% of the landlord's recovery. The insurer attempted to intervene in the bankruptcy court to oppose the settlement. The court of appeals affirmed the denial of intervention on the grounds that the insured had no standing to challenge who owned the claim against it and dismissed the appeal because the insurer was not "aggrieved" by the bankruptcy court's order denying intervention. *In re New Era, Inc.*, 135 F.3d 1206 (7th Cir. 1998).

11.3.aaaaa. All bankruptcy judges in a district are bound by a district judge's decision. In a somewhat unusual personal description of the history of prior case law in the Western District of New York, Judge Kaplan concludes that all bankruptcy judges within a district are bound any reported decision of a single district judge in the district, for *stare decisis* purposes, even in a multi-judge district court. *IRR Supply Centers, Inc. v. Phipps (In re Phipps)*, 217 B.R. 427 (Bankr. W.D. N.Y. 1998).

11.3.bbbbb. Sale of property under plan renders appeal from confirmation order moot. The Sixth Circuit joins the Ninth and Eleventh Circuits in holding that sale of property under a plan (here, a single asset real estate case) renders moot an appeal from an order confirming the plan, even though the debtor's principal secured creditor, who was the plan proponent, is a party to the appeal. *255 Park Plaza Associates Ltd. Partnership v. Connecticut General Life Insurance Company (In re 255 Park Plaza Associates Ltd. Partnership)*, 100 F.3d 1214 (6th Cir. 1996).

11.3.ccccc. Abstention may be reviewable by mandamus. Section 1334(d) of title 28 provides that a decision to abstain or not to abstain "is not reviewable by appeal or otherwise." Nevertheless, the Sixth Circuit holds in the *Dow Corning Breast Implant* litigation that the district court's decision to abstain from multiple proceedings was reviewable by a petition for a writ of mandamus and ordered the district court to hear the cases. *Lindsey v. The Dow Chemical Company (In re Dow Corning Corporation)*, 113 F.3d 565 (6th Cir. 1997).

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. Equip. Acq. Res., Inc. (In re Equip. Acq. Res., Inc.)*, ___ B.R. ___, 2013 U.S. Dist. LEXIS 1286 (N.D. Ill. Jan. 4, 2013).

11.4.b. A request for payment of an administrative expense does not trigger a section 106(b) sovereign immunity waiver. The corporate debtor did not file a federal income tax return for a 2001 "stub period" between January 1 and the date of the filing of the petition, because of uncertainty over which other corporation was its parent and responsible for including it in the parent's return. After bankruptcy, it filed a return for the "short period" remainder of 2001 but did not seek a prompt determination under section 505(b) of the tax due for the short period. The debtor filed 2002 and 2003 returns with section 505(b) prompt determination requests. The IRS did not complete its examination of those returns before the section 505(b) deadlines. The debtor in possession also amended the debtor's 1998 return to seek a refund, based on net operating loss carrybacks and filed an unsigned return for the 2001 stub period. The IRS rejected the refund request. The IRS filed a request for payment of administrative expense for interest and penalties for the 2001 short period. The liquidating trustee under the debtor's confirmed plan objected to the request, sought to carry forward and carry back losses against the short period income, recover the disallowed 1998 refund and recover a refund of taxes paid with the 2001 short period return. Later, the trustee requested a refund from the IRS for 1998 and for the 2001 short period. Under section 106(b), a governmental unit that has filed a proof of claim waives sovereign immunity with respect to a claim that is property of the estate and arose out of the same transaction or occurrence. "Same transaction" does not require an absolute identity of factual background but only whether judicial economy and fairness require all issues to be tried together. Here, the trustee's short period refund claim is sufficiently related to the IRS's short period interest and penalty administrative expense requests as to qualify. However, a request for payment of an administrative expense is not the same as a proof of claim. Section 106(b) refers only to a proof of claim. Therefore, section 106(b) does not waive sovereign immunity for a counterclaim to an administrative expense request. *United States v. Bond*, ___ B.R. ___, 2012 WL 4086769 (E.D.N.Y. Sept. 17, 2012).

11.4.c. Section 106(a) does not abrogate Indian tribe's sovereign immunity. The debtor is a member of an Indian tribe. The trustee sought turnover from the tribe of tribal revenue payments to which the debtor was entitled. Under federal common law, Indian tribes have sovereign immunity, but Congress may abrogate immunity by explicit legislation. Section 106(a) abrogates sovereign immunity "as to a governmental unit" with respect to turnover proceedings. Section 101(27) defines "governmental unit" as the United States, a State, District or Territory or a foreign state, municipalities, instrumentalities and divisions, "and any other foreign or domestic government". Although case law has characterized Indian tribes as domestic nations, the general reference in the definition to foreign or domestic governments is not sufficiently explicit to cover Indian tribes for purposes of waiving their sovereign immunity. Therefore, section 106(a) does not abrogate the tribe's sovereign immunity, and the trustee may not get turnover from the tribe. *Bucher v. Dakota Fin. Corp. (In re Whitaker)*, 474 B.R. 687 (8th Cir. B.A.P. 2012).

11.4.d. An Indian tribe is a governmental unit for which the Bankruptcy Code waives sovereign immunity. The debtor in a prior case confirmed a plan that provided for assignment to a third party of a lease from an Indian tribe of mineral rights on Indian land. The plan specified the obligations under the lease for which the assignee would be liable. The Indian tribe was a party in the prior case. In the assignee's later chapter 11 case, the tribe objected to the lease's assumption on the ground that sovereign immunity protected it against the bankruptcy court's orders and the application of section 1141(d) in the prior case. An Indian tribe generally has sovereign immunity, subject to Congressional abrogation, which must be clear and unequivocal to be effective. Section 106(a) abrogates sovereign immunity "as to a governmental unit" with respect to section 1141, among other sections. A

"governmental unit" includes, in addition to a State and its municipalities, a foreign state and its municipalities, and "other foreign or domestic government". The latter phrase includes Indian tribes. Therefore, Congress has abrogated Indian tribes' sovereign immunity in bankruptcy cases, and the tribe is bound by the order in the prior case. *In re Platinum Oil Props., LLC*, 465 B.R. 621 (Bankr. D.N.M. 2011).

11.4.e. A state's consent by ratification to a sovereign immunity waiver permits an action to enforce the automatic stay and the discharge injunction. The chapter 13 debtor owed child support payments. The state collection agency filed a proof of claim. The debtor objected to the prepetition interest portion of the claim. The state did not respond, so the court sustained the objection. The debtor confirmed the plan and completed all payments, receiving a discharge. During the debtor's plan performance, the state contacted the debtor twice and threatened collection action for nonpayment of child support. The debtor's attorney responded each time, and the state dropped the matter. After the discharge, the state sought to collect unpaid prepetition and postpetition interest. The debtor then brought an action against the state for violation of the automatic stay and of the discharge injunction. A state generally has sovereign immunity, but there are three bases on which the bankruptcy court may entertain an action against a state. Under the litigation waiver theory, by filing a proof of claim and invoking the court's jurisdiction, a state waives immunity for adjudication of the claim. Under the congressional abrogation theory, Congress may abrogate the state's immunity under a valid exercise of power. Congress has done so in section 106, but the third theory has overtaken the abrogation theory, which retains little relevance. Under the "consent by ratification" theory, by ratifying the Constitution's Bankruptcy Clause, the states waived immunity in proceedings necessary to effectuate the bankruptcy courts' in rem jurisdiction. The courts' in rem jurisdiction involves, at a minimum, the court's exclusive jurisdiction over the debtor's property, the property's equitable distribution and the debtor's discharge. An action for a stay violation, even one seeking money damages, functions to protect the courts' in rem jurisdiction. Therefore, the states generally consented by ratification to a sovereign immunity waiver to permit enforcement actions for a stay violation. In this case, however, the debtor brought the action after distribution was completed, the court no longer had exclusive jurisdiction over the debtor's property and the discharge injunction replaced the stay. Therefore, the action was too late to vindicate the court's in rem jurisdiction, and the sovereign immunity waiver did not apply. An action for a discharge injunction violation similarly functions to protect the in rem discharge, and the sovereign immunity consent by ratification therefore applies to it. *State of Florida Dept. of Rev. v. Diaz (In re Diaz)*, 647 F.3d 1073 (11th Cir. 2011)

11.4.f. Sovereign immunity abrogation applies even where action only indirectly addresses state claims or liabilities. Before bankruptcy, the debtor purchased excess workers compensation insurance for itself and its subsidiaries that were self-insured under applicable state insurance law and workers compensation for subsidiaries that were ineligible to be self-insured. After bankruptcy, the debtor in possession assumed the insurance contracts and entered into new, similar contracts. The plan provided for the sale of all the debtor's assets and for the reorganized debtor simply to address claims and make distributions. After confirmation, the state workers compensation agency and insurance fund claimed that the debtor in possession had been self-insured during the case and asserted an administrative expense claim for workers compensation claims that it had paid. It also asserted that the insurer had provided coverage. The insurer commenced an adversary proceeding against the reorganized debtor and the state agency and fund seeking a declaration that it was not liable to the state under the policies. The Constitution abrogates state sovereign immunity to the extent of the bankruptcy court's *in rem* jurisdiction necessary to resolve a bankruptcy case. In addition, section 106(a)(2) abrogates state sovereign immunity to permit the court to "hear and determine any issue arising with respect to the application of [section 502 or 503] to governmental units". The determination of the insurer's and the fund's administrative expense claims, and the determination of the insurer's liability under the policy, which is an asset of the estate, are necessary for the administration of the estate. Therefore, the adversary proceeding does not exceed the Constitutional and statutory abrogation of sovereign immunity, even though it does not directly address the state's liability to the estate or the state's claims against the estate. *Ace Am. Ins. Co v. DPH Holdings Corp. (In re DPH Holdings Corp.)*, 437 B.R. 88 (S.D.N.Y. 2010).

11.4.g. 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).

11.4.h. Order against a state to enforce the automatic stay is not subject to a sovereign immunity claim. Florida sent collection letters and attempted to garnish wages of a chapter 13 debtor who had confirmed a repayment plan. Upon finding a stay violation, the bankruptcy court awarded damages, attorney's fees, and sanctions against the state and in favor of the debtor. The state's sovereign immunity does not prevent the court from doing so. *Central Va. Comm. College v. Katz*, 546 U.S. 356 (2006), held that the Constitution permits Congress to hold the states to the same rules as private parties, despite any sovereign immunity claim, in "proceedings necessary to effectuate the *in rem* jurisdiction of the bankruptcy court", which includes a proceeding to enforce the automatic stay. However, the court may not award punitive damages. Section 106(a)(3) expressly authorizes the bankruptcy court to issue an order under one of the sections enumerated in section 106(a)(1) against a governmental unit, "but not including an award of punitive damages". *Central Va.* held only that section 106(a)'s sovereign immunity abrogation was unnecessary, not unconstitutional. The punitive damage limitation therefore remains effective as within Congress' apparent intent when it enacted section 106(a), even under the mistaken impression that the section was necessary to abrogation. *Fla. Dept. of Rev. v. Omine (In re Omine)*, 485 F.3d 1305 (11th Cir. 2007).

11.4.i. State's refusal to consent to bankruptcy case does not prevent discharge of a bail bond forfeiture judgment. A bail bond issuer defaulted on surety bonds issued to the state to guarantee the appearance of criminal defendants. The state obtained a judgment against the issuer, who then filed bankruptcy. The state moved to dismiss the case on the ground that its refusal to consent deprived the court of jurisdiction over it. The Supreme Court's decisions in *Tenn. Student Assist. Corp. v. Hood*, 541 U.S. 446 (2004), and *Central Va. Comm. College v. Katz*, 546 U.S. 356 (2006), fully dispose of the state's claim. The proceeding is, in *Hood*'s words, *in rem*, brought to obtain a discharge, not to seek recovery against the state, and therefore does not infringe the state's immunity. In addition, despite a plea from concurring Judge Edith Jones, the court refuses to revisit its decision in *In re Hickman*, 260 F.3d 400 (5th Cir. 2001), that a bail bond forfeiture judgment is not nondischargeable under section 523(a)(7)'s exception to discharge for a "fine, penalty, or forfeiture". *Texas v. Soileau (In re Soileau)*, 488 F.3d 302 (5th Cir. 2007).

11.4.j. *Ex parte Young* permits a case ancillary to a foreign proceeding against a state banking superintendent. The Yugoslav banking supervisory agency took over a Yugoslav bank that had a New York branch. The New York banking superintendent seized the New York branch's assets to liquidate them under New York law for distribution to New York creditors. The Yugoslav agency commenced a case ancillary to a foreign proceeding under then-applicable section 304. The New York superintendent moved to dismiss on sovereign immunity grounds, arguing that sovereign immunity protected the superintendent, as an agency or instrumentality of New York state, from bankruptcy court jurisdiction to order turnover of the bank's assets from the superintendent. *Ex parte Young* permits an action that might otherwise be barred by sovereign immunity if the action is directed against an individual state officer, in his or her official capacity, alleges an ongoing violation of federal law, and seeks only prospective relief. Here, the petition alleges that the superintendent commits an ongoing violation of federal law by retaining assets that, as a matter of federal law under section 304, should be turned over to the bankruptcy court to

administer and is prospective in nature, because it does not seek to remedy past misconduct or compensate for a past violation. *Ex parte Young* does not permit a quiet title action against a state. This ancillary case, however, is not a quiet title action, because the state does not claim any beneficial interest in the seized assets but holds them only for distribution to the bank's creditors. *Deposit Ins. Agency v. Superintendent of Banks*, 482 F.3d 612 (2d Cir. 2007).

11.4.k. State supreme court is a governmental unit. The state supreme court, acting through its office of disciplinary counsel, disbarred an attorney and required restitution. The attorney filed a bankruptcy petition. The state bar disciplinary counsel sought enforcement of the restitution obligation. The supreme court is a governmental unit, because it exercises the state's sovereign judicial power. Therefore, section 362(b)(4)'s police or regulatory power automatic stay exception applies to the court's disciplinary counsel's action to enforce the disbarment and restitution order. *In re Arsi*, 354 B.R. 770 (Bankr. D.S.C. 2006).

11.4.l. State may not assert sovereign immunity against tax refund action. The debtor in possession sought a sales tax refund through ordinary state procedures. When it was unsuccessful, it brought an action under sections 505 and 542 for determination and turnover of the tax overpayment. The Supreme Court had ruled in *Tenn. Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004), that state sovereign immunity does not apply against the bankruptcy court's exercise of *in rem* jurisdiction and in *Central Va. Comm. College v. Katz*, 544 U.S. 960 (2005), that the Constitution's bankruptcy clause committed the states not to assert sovereign immunity against actions brought under the bankruptcy power. Those cases therefore do not reach the question of whether section 106(b) properly abrogated state sovereign immunity in bankruptcy. The Sixth Circuit, however, had so held in both those cases and in *In re Serv. Merch. Co.*, 333 F.3d 666 (6th Cir. 2003), and its rulings remain binding precedent, despite the Supreme Court's affirmance on other grounds. Therefore, the bankruptcy court has jurisdiction over the debtor in possession's action for a tax refund for overpayments. *In re Quality Stores, Inc.*, 354 B.R. 840 (W.D. Mich. 2006).

11.4.m. Section 106 does not override Federal Tort Claims Act exceptions. The Federal Tort Claims Act (FTCA) waives the United States' sovereign immunity to permit injured parties to bring certain claims. It excepts from the immunity waiver, however, claims arising out of discretionary functions or for "libel, slander, misrepresentation, deceit, or interference with contract rights." Section 106 waives the sovereign immunity of the United States in general. Section 106(c) permits offset against a governmental unit's proof of claim, notwithstanding any assertion of sovereign immunity, of "any claim against such governmental unit that is property of the estate." But section 106(a)(5) provides that, "Nothing in this section shall create any substantive claim for relief … not otherwise existing under … nonbankruptcy law." Section 106(c) does not override the FTCA's waiver exception for the listed claims. The exception to the sovereign immunity waiver for those claims prevents them from ever coming into existence (rather than just barring a remedy on underlying claims that exist independent of the waiver) and thereby from becoming property of the estate. Section 106(a)(5) makes clear that the section's sovereign immunity waiver does not create claims that do not exist outside bankruptcy. As such, they cannot form the basis for an offset claim against the government's proof of claim. A dissenting opinion argues that the FTCA bars the remedy but does not prevent the claim from coming into existence. *Zayler v. Dep't of Agric. (In re Supreme Beef Processors, Inc.)*, 468 F.3d 248 (5th Cir. 2006) (*en banc*).

11.4.n. *Ex parte Young* applies to an action to enforce an extension of time under section 108. The debtor in possession filed a claim against the State that was, under the State's administrative procedures, four days late. The debtor in possession argued that section 108(a) permitted the late filing, because it extends any such deadline for the first 60 days after the order for relief. When the State refused to recognize the claim, the debtor in possession sued the State officers to enjoin their continuing violation of Federal law. The officers argued that sovereign immunity barred the action, which ultimately sought monetary recovery from the State. However, monetary recovery was only a consequence of the action, not its purpose, which was to enjoin the officers' continued, prospective violation of section 108(a). Such a purpose falls within the requirements of *Ex parte Young*. *Dairy Mart Convenience Stores, Inc. v. Nickel (In re Dairy Mart Convenience Stores, Inc.)*, 411 F.3d 367 (2d Cir. 2005).

11.4.o. Section 106(b) does not impose a claim "maturity" requirement to qualify as a compulsory counterclaim for sovereign immunity waiver purposes. The debtor's non-debtor subsidiary contracted to build a steel mill. The debtor guaranteed completion, posted a letter of credit to secure the guarantee, and posted cash collateral with the letter of credit issuer to secure the reimbursement obligation under the letter of credit. A dispute arose over completion before the debtor's bankruptcy. Once the debtor filed chapter 11, the letter of credit issuer filed a proof of claim. Sometime later, the debtor's customer drew the letter of credit. The debtor in possession sued, based on the allegedly improper letter of credit draw, to recover the collateral. The issuer, International Finance Corp., an entity that is immune under the International Organizations Immunity Act, asserted sovereign immunity as a defense to the claim and claimed that the waiver effected by its earlier filing of a proof of claim related to this transaction did not meet the "compulsory counterclaim" requirement of section 106(b) for a waiver, because the debtor in possession's claim did not exist at the time IFC filed its proof of claim. Rule 13(b) of the Fed. R. Civ. P. requires the filing of any counterclaim "which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." However, section 106(b) does not impose a similar "maturity" requirement, so it applies even where, as here, the counterclaim arose after the filing of the proof of claim. *Int'l Fin. Corp. v. Kaiser Group Int'l, Inc. (In re Kaiser Group Int'l, Inc.)*, 399 F.3d 558 (3d Cir. 2005).

11.4.p. Sovereign immunity waiver is limited to matters logically related to a proof of claim. The State had filed a proof of claim against the debtor for environmental clean-up obligations. The chapter 11 plan provided for the establishment of a new corporation to undertake certain environmental remediation work. The State contracted with the new corporation to perform the work, and the debtor transferred funds to the corporation and the State to fund it. Within a few months after confirmation, disputes arose, and the State terminated the contract, directing the work to an unrelated company that hired many of the new corporation's employees. The new corporation and the chapter 11 liquidating trustee, which owned the stock of the new corporation, sued the State and the unrelated company for breach of contract, tortious interference, and fraud in the inducement and sought recovery of the transferred funds. The claim against the State did not arise out of the same transaction or occurrence as the original environmental claim. Although both matters related to environmental cleanup, the debtor did not have a counterclaim, compulsory or otherwise, against the State for the later events, at the time the State filed its proof of claim. Thus, the claims were not sufficiently related so that the proof of claim constituted a sovereign immunity waiver for the later lawsuit. *Montana v. Goldin (In re Pegasus Gold Corp.)*, 389 F.3d 1189 (9th Cir. 2005).

11.4.q. Sovereign immunity claim defeats section 544(b) action. The debtor in possession sued the state under section 544(b) to recover a fraudulent transfer, relying on the existence of a creditor holding a prepetition unsecured claim who could have pursued the action. Although the state had waived sovereign immunity in the case by filing multiple proofs of claim related to the same transactions, there was no creditor whose claim the debtor in possession could use under section 544(b). Because the state had not waived sovereign immunity, there was no cause of action before bankruptcy available to any creditor to avoid the transfer. The state's filing of the proofs of claim and the pursuit of the action by the debtor in possession does not avoid the sovereign immunity issue. *Grubbs Constr. Co. v. Florida Dep't of Revenue (In re Grubbs Constr. Co.)*, 321 B.R. 346 (Bankr. M.D. Fla. 2005).

11.4.r. State sovereign immunity does not prevent application of section 304 to a state supervised bank branch. The Superintendent of Banks argued that the bankruptcy court did not have jurisdiction to grant a foreign representative's petition under section 304 for the assets of a foreign bank's U.S. branch, which was regulated by the state Superintendent of Banks, because such a petition requires the state to appear in a federal court and is denied its rights under a mandatory bank supervision statute. The court rejects the argument out of hand. Section 304 is consistent with Congress' authority to enact uniform laws on the subject of bankruptcies and to regulate international commerce. A state official may not stand in the way of the enforcement of the bankruptcy laws. The court does not mention the recent Supreme Court's decision in *Tennessee Student Assistance Corp. v. Hood*, 124 S. Ct. 1905 (2004), which might have addressed this case as an issue of the bankruptcy court's *in rem* jurisdiction over the debtor's property. *Agency for Deposit Ins. v. Superintendent of Banks*, 313 B.R. 561 (S.D.N.Y. 2004).

11.4.s. Discharge complaint against a State does not implicate sovereign immunity. The debtor filed an adversary proceeding against the State for a determination that the undue hardship exception to student loan nondischargeability applied. The State objected to jurisdiction, claiming sovereign immunity from suit in the federal courts. The Supreme Court does not address the big question, whether the Eleventh Amendment and sovereign immunity apply in bankruptcy cases. Rather, it concludes that to the extent a bankruptcy case and any proceeding in the case are *in rem*, the bankruptcy court has complete jurisdiction to resolve the proceeding, even where a State is hailed into court as a party to the proceeding. It concludes that proceedings relating to the discharge are part of the bankruptcy court's *in rem* jurisdiction. Therefore, the bankruptcy court had jurisdiction to resolve this dischargeability complaint against the State, despite the State's claim of sovereign immunity. *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004).

11.4.t. Indian tribes do not have sovereign immunity in bankruptcy cases. An Indian tribe normally has sovereign immunity, which may be abrogated only by the tribe's consent or by explicit Congressional enactment. Section 106(a) of the Bankruptcy Code abrogates sovereign immunity as to "governmental units." The definition of "governmental unit" does not include explicit mention of Indian tribes but refers generally to "other foreign or domestic governments." Under Supreme Court precedents, Indian tribes are domestic governments. Therefore, even though Congress did not specifically list the Indian tribes in section 106(a), its abrogation of their sovereign immunity is sufficiently explicit to evidence Congress's unequivocal intent to abrogate. *Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055 (9th Cir. 2004).

11.4.u. Congress abrogated Indian tribes' sovereign immunity in bankruptcy. Section 106(a) abrogates sovereign immunity "as to a governmental unit." "Governmental unit" is defined to include "other foreign or domestic governments." Under Supreme Court precedents, Indian tribes are domestic governments. Therefore, even though Congress did not specifically list Indian tribes in section 106(a), its abrogation of their sovereign immunity is sufficiently explicit to evidence Congress's unequivocal intent to abrogate. *Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055 (9th Cir. 2004).

11.4.v. Government waives sovereign immunity for stay violation sanction by filing proof of claim. After the state taxing agency filed a proof of claim, it sought to collect the taxes from the debtor. The debtor sought an order enforcing the stay and sanctions. The parties agreed to an order prohibiting further collection efforts, which the state violated. By having filed the proof of claim, the state agency waived sovereign immunity under section 106(b). For these purposes, the stay violation arose out of the same transaction or occurrence as the taxes asserted in the proof of claim, because the state's violation related to the taxes. (The court rules, without discussion, that in this chapter 7 case, the claim against the taxing agency is property of the estate, a dubious proposition.) *Indiana Dept. of Revenue v. Williams*, 301 B.R. 871 (S.D. Ind. 2003).

11.4.w. United States trustee has sovereign and quasi-judicial immunity. When the United States trustee is sued for any of his official acts, he is acting on behalf of the United States, and the suit is effectively against the United States. He is therefore entitled to sovereign immunity. Section 106(a) does not waive sovereign immunity, because that section waives sovereign immunity only as to a "governmental unit." The definition of governmental unit excludes the United States trustee. In addition, because the United States Trustees perform many of the functions that had previously been assigned to bankruptcy judges and are part of the judicial function, when the United States Trustee is sued in his individual capacity, he is entitled to quasi-judicial immunity. *Balser v. Department of Justice*, 327 F.3d 903 (9th Cir. 2003).

11.4.x. Sovereign immunity waiver applies to Indian tribes. Section 106(a) abrogates sovereign immunity of a "governmental unit." The definition of "governmental unit" in section 101 includes "other foreign or domestic government." The court rules that the phrase "other domestic government" includes Indian tribes and that section 106(a) therefore abrogates sovereign immunity as to the tribes. *Russell v. Fort McDowell Yavapai Nation (In re Russell)*, 293 B.R. 34 (Bankr. D. Ariz. 2003).

11.4.y. Section 106(a) constitutionally abrogates state sovereign immunity. Breaking with five other circuits, the Sixth Circuit rules that section 106(a) is a constitutional abrogation of the states'

sovereign immunity. In this case, the debtor sued the Tennessee Student Assistance Corporation for a determination that her student loan debt was dischargeable. Reviewing the constitutional history, the Sixth Circuit determines that by authorizing "uniform" laws on the subject of bankruptcy, the Constitution abrogated the sovereign immunity of the states to suit in bankruptcy proceedings. *Hood v. Tennessee Student Assistance Corp.*, 319 F.3d 756 (6th Cir. 2003), *aff'd* 124 S. Ct. 1905 (2004).

11.4.z. Bankruptcy court may determine claim against state for purposes of set-off. The state filed a proof of tax claim in the bankruptcy court. The debtor asserted a tax refund state on unrelated matters. The filing of the proof of claim constituted a waiver of sovereign immunity sufficient to permit the bankruptcy court to determine the debtor's claim against the state for purposes of set-off under section 106(c). The matter need not be determined by the state court. *In re Microage Corp.*, 288 B.R. 842 (Bankr. D. Ariz. 2003).

11.4.aa. State participation in adversary proceeding may waive sovereign immunity. The debtor requested by motion a determination that its debt to the state was not discharged. The state opposed on the ground that the request required an adversary proceeding, which the debtor filed and the state answered. The state filed a motion for summary judgment and later, at the bankruptcy court's request, filed supplemental briefing. It also filed a motion to dismiss on sovereign immunity grounds. The Ninth Circuit rules that a state waives sovereign immunity by participating in litigation. Although the test to determine waiver is a stringent one, the state may not delay to see how the court might rule and only then assert sovereign immunity. Such tactical maneuvering undermines the integrity of the federal judicial system. *Arizona v. Bliemeister (In re Bliemeister)*, 296 F.3d 858 (9th Cir. 2002).

11.4.bb. Debtor's automatic stay motion does not violate sovereign immunity. The state initiated proceedings against the debtor and its officers for non-payment of pre-petition vacation pay. The debtor brought a motion before the bankruptcy court to determine the scope and applicability of the automatic stay. On appeal, the district court rules that the motion does not violate the state's sovereign immunity. First, the proceeding is not a suit against the state, because the state is not named as a defendant, is not served with process, and is not compelled to appear in federal court. Second, the motion asks the bankruptcy court to exercise its power to determine the scope of a provision based on its jurisdiction over the debtor and its estate, not jurisdiction over the state or other creditors. It is the bankruptcy law, not the court's order, that operates to stay the state's action. *In re Midway Airlines Corp.*, 283 B.R. 846 (E.D.N.C. 2002).

11.4.cc. Plan injunction implicates sovereign immunity. In 2001, the Bankruptcy Rules were amended to eliminate the requirement of an adversary proceeding to obtain an injunction as part of a plan in chapter 11. Although an adversary proceeding is no longer required, the court rules that a request for a plan injunction against a governmental unit implicates the same sovereign immunity issues that would be implicated by an adversary proceeding. *In re Pacific Gas & Electric Co.*, 273 B.R. 795 (Bankr. N.D. Cal. 2002).

11.4.dd. Sovereign immunity does not bar the trustee's use of an actual creditor's claim against a governmental unit under section 544(b). The trustee brought an action against the IRS under section 544(b) for recovery of tax payments that the trustee alleged constituted a fraudulent transfer. The IRS argued that the trustee could not maintain his action in the right of the creditor under section 544(b), because sovereign immunity would have prohibited the creditor from suing the IRS to recover the transfer. The bankruptcy court rules, however, that the express abrogation of sovereign immunity in section 106(b) with respect to section 544(b) should be construed to include the trustee's action here, despite the jurisdictional disability that the actual creditor would otherwise suffer. *Liebersohn v. Internal Revenue Service (In re C.F. Foods, L.P.)*, 265 B.R. 71 (Bankr. E.D. Pa. 2001).

11.4.ee. Sovereign immunity does not bar discharge of state taxes. The Ninth Circuit joins the Fourth and the Fifth in ruling that the discharge injunction of section 524(a) applies to claims of a state, including tax claims. Thus, the state as creditor is enjoined and, under the *Ex Parte Young* doctrine, the debtor may bring an action against the individual tax collector to enforce the discharge injunction, whether or not the state files a proof of claim in the case. What is more, the Tax Injunction Act, 28 U.S.C. § 1341, does not bar either the discharge injunction under section 524(a) or an action for an injunction to enforce the discharge injunction. *Goldberg v. Ellett (In re Ellett)*, 254 F.3d 1135 (9th Cir. 2001).

11.4.ff. Counterclaim sovereign immunity waiver under section 106(b) is unconstitutional. Section 106(b) provides for waiver of a state's sovereign immunity if the state files a claim in a bankruptcy case. *But College Savings Bank v. Florida Prepaid Post-Secondary Education Expense Board*, 527 U.S. 666 (1999), held that Congress could not imply a constructive waiver of sovereign immunity based on a state's conduct; the waiver must be voluntary and unequivocal. Applying *College Savings Bank* here, the First Circuit holds that section 106(b) is an unconstitutional waiver of sovereign immunity, because it provides for an implied waiver based on the state's conduct. *Arecibo Community Health Care, Inc. v. Puerto Rico*, 244 F.3d 241 (1st Cir. 2001).

11.4.gg. Filing of proof of claim waives sovereign immunity for same transaction or occurrence. The Ninth Circuit follows the Fourth and Tenth Circuits in holding that the filing by a state government or an arm of the state waives sovereign immunity for counterclaims against the state arising out of the same transaction or occurrence, differing from the Seventh Circuit rule under which the filing of the proof of claim waives immunity only to the extent of defeating the state's claim. In applying the rule, the Ninth Circuit follows the "logical relationship" test of Fed. R. Civ. P. 13(a) to determine what constitutes the same transaction or occurrence, noting that the concept "gets an increasingly liberal construction." In so ruling, the Ninth Circuit does not address whether the filing of a proof of claim might allow for a broader affirmative recovery from the state than for matters arising out of the same transaction or occurrence. *Schulman v. California (In re Lazar)*, 2001 U.S. App. Lexis 490 (9th Cir. 2001).

11.4.hh. Discharge of debt to state does not implicate 11th Amendment. Four years after bankruptcy, the state sued the debtor. The debtor moved to reopen the case, and the state appeared to challenge reopening and dischargeability. Holding that determinations of dischargeability arise from the court's jurisdiction over debtors, not its jurisdiction over states, and noting the absence of an adversary proceeding in this case in which the state was hailed into court, the Fourth Circuit holds that the bankruptcy court could determine dischargeability without violating the states sovereign immunity under the 11th Amendment. *Virginia v. Collins (In re Collins)* 173 F.3d 924 (4th Cir. 1999).

11.4.ii. A State's proof of claim waives sovereign immunity. Relying on *Gardner v. New Jersey*, 329 U.S. 565 (1947), the Tenth Circuit holds that Section 106(b) is constitutional, so that a state filing a proof of claim waives sovereign immunity with respect to actions against the state arising out of the same transaction or occurrence. In addition, the court holds that all agencies of the state of Wyoming are a single entity for purposes of the Section 106(b) waiver. *Wyoming Dept. of Transportation v. Straight (In re Straight)*, 143 F.3d 1387 (10th Cir. 1998).

11.4.jj. Discharge of a State's claim does not violate the Eleventh Amendment. In an action by a State that had been removed to federal district court, the debtor raised his discharge and bankruptcy as an affirmative defense. Rejecting the state's Eleventh Amendment argument, the Fifth Circuit holds that using the discharge as an affirmative defense does not violate the Eleventh Amendment. The court leaves open whether a debtor's attempt to enforce the discharge injunction against the state would violate the Eleventh Amendment, but concludes that the mere granting of the discharge does not. *State of Texas v. Walker*, 142 F.3d 813 (5th Cir. 1998).

11.4.kk. Dischargeability of a state's claim does not implicate the Eleventh Amendment. The state commenced an adversary proceeding under section 523 to declare a child support claim nondischargeable. Because the state commenced the action, the bankruptcy court was not prohibited from entering judgment against the state holding the claim dischargeable. The debtor did not hale the state into court; the state chose to participate in the bankruptcy case for the benefits it would bring. *Dekalb County Division of Family and Children's Services v. Platter (In re Platter)*, 140 F.3d 676 (7th Cir. 1998).

11.4.ll. Sovereign immunity assertion is limited. The debtor in possession brought an action against the State to avoid a lien on real property as a preference. Because the action was in rem, it did not bring the State personally before the court or create the risk of imposing personal liability on the State. Therefore, the principles of sovereign immunity enunciated in *Seminole Tribe v. Florida*, 516 U.S. 44 (1996), did not apply. *O'Brien v. Vermont (In re O'Brien)*, 216 B.R. 731 (Bankr. D. Vt. 1998).

11.4.mm. State's assertion of sovereign immunity upheld. The State of Maryland filed a proof of claim for sales and withholding taxes. The trustee counterclaimed for preference recovery for payment of income taxes. The Fourth Circuit permitted the State to assert Eleventh Amendment immunity for the first time on appeal, held unconstitutional the Bankruptcy Code's abrogation of State's sovereign immunity under section 106, permitted compulsory counterclaims against a state that files a proof of claim in a bankruptcy case, and did not reach the issue of whether permissive counterclaims (such as the preference action involved here) could be used to offset the liability of the estate on a proof of claim. *Schlossberg v. State of Maryland (In re Creative Goldsmiths of Washington, D.C., Inc.)*, 119 F.3d 1140 (4th Cir. 1997); *Accord, Grabscheid v. Michigan Employment Security Comm'n*, 212 B.R. 265 (E.D. Mich. 1997).

11.4.nn. Sovereign immunity prevents dischargeability determination. The bankruptcy court finds that sovereign immunity and the Eleventh Amendment protect a state educational institution form defending a complaint to determine the dischargeability of a student loan. *Rose v. U.S. Department of Education (In re Rose)*, 214 B.R. 372 (Bankr. W.D.M.O. 1997).

11.4.oo. Sovereign immunity does not vitiate binding effect of confirmation order. The plan provided for the transfer of all property to a liquidating trust, which was to sell the property for the creditors, free of any stamp or transfer tax. Though the State had notice of the plan, it did not object. It was bound by the plan, despite its later assertion of sovereign immunity. *State of Maryland v. Antonelli Creditors' Liquidating Trust*, 123 F.3d 777 (4th Cir. 1997).

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a. Property of the estate includes payments for postpetition violation of a prepetition employment contract. The debtor entered into a three-year employment contract, which guaranteed his compensation for the entire period. One year later, he filed bankruptcy. The next day, his employer terminated his employment. He sued to recover the remaining two years' compensation. Property of the estate includes all interests of the debtor in property as of the commencement of the case, including a contingent interest under a prepetition contract. However, it does not include earnings for services that the debtor actually performs postpetition. Here, the debtor did not perform any postpetition services; rather, his right to compensation existed as of the commencement of the case, independent of whether he performed services. Rather, the claim against the employer vests in the estate, which has the sole standing to assert it. A dissent argues that the employer prevented the debtor from performing the services, thereby injuring the debtor and giving him standing to assert the claim. *Longaker v. Boston Scientific Corp.*, 715 F.3d 658 (8th Cir. 2013).

12.1.b. Tracing fictions may not separate property from property of the estate if the trust fund contains only victims' funds. The statutes and regulations governing futures commission merchants and investment advisors require that they segregate customer funds. The debtor was both. It segregated funds in bulk. That is, its customer funds were invested in a common securities pool, rather than being segregated for each customer. As it sunk into financial trouble, it breached its segregation requirements and diverted segregated customer funds to its own lender. Shortly before bankruptcy, it transferred some of the remaining segregated funds to a customer. Property of the estate includes all of the debtor's interests in property as of the commencement of the case. It does not include property in which the debtor holds only bare legal title as trustee, such as segregated funds. Where the defendant has commingled or dissipated trust funds, a trust beneficiary is subject to common law tracing requirements as a condition to keeping funds from becoming property of the estate. Where a beneficiary cannot trace assets directly, it may apply a tracing fiction, such as the first in, first out or the lowest intermediate balance rule, to separate trust property from the wrongdoer's own property. However, the tracing fictions do not apply if the only funds in the trust account are beneficiary funds, because the issue is not allocation between the victims and the wrongdoer but between similarly situated victims. Therefore, unless the beneficiary can actually trace specific property, the remaining property in the trust is property of the estate. *Grede v. FCStone, LLC*, 485 B.R. 854 (N.D. Ill. 2013).

12.1.c. Claim retention under a plan requires express, specific reference. Two of the debtor's directors, who were also creditors, claimed during the case that the debtor in possession or the creditors committee should pursue state law claims against the other directors for breach of fiduciary duty and against the debtor's counsel. Neither did so. The debtor's chapter 11 plan provided that the reorganized debtor would retain "any claims … that the Debtors or the Estate may hold against any entity … under Chapter 5 of the Bankruptcy Code or any similar provisions of state law, or any other statute or legal theory." The disclosure statement said that the reorganized debtor "may be potential plaintiffs in other lawsuits, claims, and administrative proceedings" and would "continue to investigate potential claims". Neither specifically mentioned claims against the directors or the law firm. A reorganized debtor or a successor may retain a claim after confirmation only if the plan or the disclosure statement expressly, specifically and unequivocally provides for its retention and enforcement, so that creditors have notice and can determine whether the plan resolves matters to their satisfaction. Otherwise, the reorganized debtor or its successor loses standing to bring the claim. A general reference to all causes of actions or claims belonging to the debtor or the estate is inadequate. The reservation in this case was not specific. Therefore, the reorganized debtor lacked standing to bring the claim. *Wooley v. Haynes & Boone, L.L.P. (In re SI Restructuring Inc.)*, ___ F.3d ___, 2013 U.S. App. LEXIS 7828 (5th Cir. Apr. 18, 2013).

12.1.d. 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.e. 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).

12.1.f. Substantive consolidation should be used to ensure the equitable treatment of creditors. The parent debtor owned units in a condominium project; the subsidiary managed the project. The two debtors shared directors and officers. The parent has only four creditors, including the owners' condominium association, and was solvent by about $9.6 million. The subsidiary has only one creditor, the association, arising from a state court judgment for $450,000 for actual and punitive damages for conversion related to misappropriated management fees and was insolvent by about $450,000. The same individuals control both entities, represent themselves as acting on behalf of both and do not distinguish the capacity in which they were acting. The parent advanced over $900,000 to the subsidiary without proper documentation, and the parent later converted the intercompany loan to a capital contribution. However, the debtors maintain separate bank accounts and file separate tax returns. They are engaged in different businesses, and there is no evidence that any creditor (including the association) was confused

about the identity of the debtor with whom it was dealing. Substantive consolidation is an equitable doctrine that permits a bankruptcy court to disregard corporate forms so that they may not "be used to defeat public convenience, justify wrong or perpetrate fraud" and where necessary to ensure the equitable treatment of creditors. Here, there is only one active creditor, and no creditors would be harmed by consolidation, because the combined estates would be sufficient to pay all claims and leave a surplus for the debtor. Based on this record, the bankruptcy court should consider whether the factors favoring substantive consolidation apply and whether the equitable treatment of all creditors is served by consolidation. *First Owners Assoc. v. Gordon Props., LLC (In re Gordon Props., LLC)*, 478 B.R. 750 (E.D. Va. 2012).

12.1.g. Sections 541(c) and 524(g) permit transfer of insurance policies to an asbestos trust, despite antiassignment provisions. The debtor proposed a plan that provided for transfer to an asbestos trust of $600 million by settling liability insurers and of $500,000 in cash, a promissory note for $1.25 million and a claim against another asbestos trust by the reorganized debtor and for the debtor's assignment to the trust of liability insurance policies issued by nonsettling insurers, despite antiassignment provisions in the policies that are enforceable under applicable nonbankruptcy law. Congress may preempt state law expressly, through a statute's express language or through its structure and purpose, or by implication, where it is impossible to comply with both state and federal requirements or where compliance with state law requirements interferes with Congress's purpose in the federal statute. Section 541(c) provides that "an interest of the debtor in property becomes property of the estate … notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law … that restricts or conditions transfer of such interest by the debtor." The insurance policies thus became property of the estate. The plan appoints the asbestos trust as the estate's representative. Therefore, there is no separate transfer to the trust that the antiassignment provisions would implicate. In addition, enforcement of the antiassignment provisions would prevent accomplishment of Congress's purpose in enacting section 524(g) to deal with asbestos cases. Therefore, there is implied preemption as well. *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869 (9th Cir. 2012).

12.1.h. Only the trustee may pursue a successor liability claim. The debtor law firm filed bankruptcy. Most of its partners decamped to four other firms, taking their clients and business with them. The firm's partnership agreement provided for retirement pay for retired partners, payable only by the firm or by "a partnership which may fairly be considered a successor partnership of the Partnership by reason of continuity of personnel and clients". A group of retired partners sued the four firms on a successor liability theory. A claim against a third party on a successor liability theory that does not allege particularized harm to the plaintiff but could be brought by any creditor of the debtor belongs to the estate, not to any creditor. This principle is based on the policy of vesting the estate with exclusive standing to pursue certain kinds of claims to prevent a race to the courthouse among creditors. If the four other law firms were a successor to the debtor, they would be liable to all creditors for all claims against the debtor. Therefore, the claim belongs only to the estate, and the retired partners do not have standing to bring it. *Retired Partners of Coudert Bros. Trust v. Baker & McKenzie LLP (In re Coudert Bros. LLP)*, ___ B.R. ___, 2012 WL 1267827 (S.D.N.Y. Apr. 12, 2012).

12.1.i. *In pari delicto* bars trustee's action against the debtor's auditor. The trustee sued the debtor's auditor for negligence in failing to detect a Ponzi scheme in which the debtor participated. The trustee succeeds to the debtor's rights under section 541(a). Applicable nonbankruptcy law determines the extent of those rights; there is no bankruptcy public policy exception that permits expansion of the debtor's (and hence the trustee's) rights against third parties. Here, applicable nonbankruptcy law gave the auditor an *in pari delicto* defense to liability. The defense applies to the trustee's action, which must be dismissed. *Peterson v. McGladrey & Pullen, LLP*, 676 F.3d 594 (7th Cir. 2012).

12.1.j. Tax refunds payable to a subsidiary under a tax sharing agreement is property of the parent's estate. The debtor and its bank subsidiary had entered into a tax sharing agreement. The agreement provided that the debtor would act as the subsidiary's agent for purposes of filing tax returns and managing all procedural matters with the IRS and to prosecute and settle any refund claims. Shortly before bankruptcy, the debtor filed a refund claim for the consolidated group based on carryback of losses that the bank incurred in the most recent tax year. The IRS had not paid the refund as of the petition date.

The FDIC was appointed receiver for the bank on the same day as the petition date and later in the receivership repudiated the tax sharing agreement. IRS regulations provide that a parent is the sole agent for members of the consolidated group with authority to act on all tax matters for the group's members. However, the regulation is solely for the IRS's protection. It does not establish an agency relationship, nor determine the relative rights, among a tax group's members, which an agreement among the members may determine. A tax sharing agreement that does not require a refund to be held in trust or placed in escrow for the group members and that requires only that the subsidiary's "share" of a tax refund be paid to the subsidiary within a reasonable period after receipt does not create an ordinary agency relationship under which the parent acts at the subsidiary's direction and control and instead creates a debtor-creditor relationship between the parent and the subsidiary. The absence of any trust or escrow requirement or limitation on the parent's use of a tax refund leads to the conclusion that the agreement created a debtor-creditor relationship. The debtor had the right to the tax refund on the petition date. All of a debtor's interests in property as of the petition date are property of the estate. Therefore, the tax refund was property of the estate. The FDIC's repudiation of the tax sharing agreement after the petition date does not retroactively change the estate's ownership of the asset. Therefore, the FDIC, as the bank's receiver, had only an unsecured claim under the tax sharing agreement. *Zucker v. Fed. Deposit Ins. Corp. (In re Netbank, Inc.)*, 459 B.R. 801 (Bankr. M.D. Fla. 2010).

12.1.k. SIFMA's standard form repo agreement effects a sale, not a secured loan. A lender transferred its interest in a loan using the Securities Industry and Financial Market Association's standard form master repurchase agreement. The agreement characterizes the parties as seller and buyer, describes the transaction as a sale, and expresses the parties' intent that the transaction be treated as a sale. The agreement required the seller to repurchase and the buyer to sell the identical securities at the end of the agreement's term, required the seller as custodian to maintain the securities in a segregated account for the buyer and permitted the seller to retain all payments on the securities during the term. If the seller defaulted under the agreement, the buyer's only remedy was to sell the securities in a commercially reasonable manner, apply the sale proceeds to the repurchase price, and pay any surplus to the seller. The explanatory documentation accompanying the form agreement says that the agreement "reflects the understanding of the market as a whole that the repurchase agreements for insolvency law purposes are purchases and sales". A court must construe an agreement as a whole to determine its effect. Here, there is consistent express language of sale and purchase throughout the agreement. The provision permitting the seller to retain distributions included the operative word "sold", and the custodianship provision does not detract from the sale characterization. The limitations on the buyer's remedies upon default is a reasonable contractual provision setting forth the legal consequences of a breach, not something that requires recharacterization of the agreement as a secured loan. Therefore, the agreement effects a sale. *Palmdale Hills Prop., LLC v. Lehman Comm'l Paper, Inc. (In re Palmdale Hills Prop., LLC)*, 457 B.R. 29 (9th Cir. B.A. P. 2011).

12.1.l. Court upholds security interest in economic value of FCC license. The debtor granted a security interest to the indenture trustee for its bonds in "all FCC License Rights [including] the right to receive monies, proceeds, or other consideration in connection with the sale, assignment, transfer, or other disposition of any FCC licenses … or any goodwill or other intangible rights or benefits associated therewith", but excluding "any FCC License to the extent … the Collateral Agent may not validly possess a security interest directly in the FCC License pursuant to applicable federal law". Under the Federal Communications Act, FCC policy determines the extent to which a licensee may grant a security interest in a license. FCC policy prohibits a security interest in a license but not in the proceeds of the sale of a license or "in the private economic value of an FCC license to the extent that such lien does not violate the FCC's public right to regulate license transfers". A license's private economic value is a general intangible under the U.C.C. Therefore, a security interest may attach to that value. Section 552 does not permit a lien on property that the estate acquires after bankruptcy except to the extent the property is proceeds of prepetition collateral. License sale proceeds that the estate acquires after bankruptcy are proceeds of the license's private economic value and therefore are subject to a security interest in the value that the debtor granted before bankruptcy. The value is also subject to the security interest for plan purposes, even when the estate does not sell the license, because the lien on the underlying intangible—the license's value—is valid during the case. *Sprint Nextel Corp. v. U.S. Bank N.A. (In re TerreStar Networks, Inc.)*, 457 B.R. 254 (Bankr. S.D.N.Y. 2011).

12.1.m. A narrow D&O policy definition of "Loss" prevents a liquidating trust from recovering from the insurer on a claim against an "absolved" director. The plan vested claims against former directors in a liquidating trust but permitted the trust to collect only from the D&O insurer and prohibited it from collecting from the director. The trust obtained a judgment against the director and sued the insurer, who had refused coverage to the director on the ground that the policy definition of "Loss" did not include the judgment. "Loss" was the amount that "any Insured Person becomes legally obligated to pay on account of each Claim" but excludes "any amount not indemnified by the Insured Organization for which the Insured Person is absolved from payment by reason of any covenant, agreement, or court order." The plan provision absolved the director, so the policy did not cover the director's liability for the judgment. *U.S. Bank N.A. v. Fed. Ins. Co.*, 664 F.3d 693 (8th Cir. 2011).

12.1.n. SIPA trustee may not pursue claims belonging to customers. The debtor broker-dealer operated a Ponzi scheme. The debtor became subject to a SIPA liquidation proceeding. The SIPA trustee sued various third parties who had funneled money to the debtor for unjust enrichment, aiding and abetting fraud and aiding and abetting breach of fiduciary duty, based on their failure to adequately investigate the debtor despite being confronted with inidicia of fraud. To have standing, a federal plaintiff must show a concrete and particularized injury in fact that can fairly be traced to the defendant's conduct and that can be redressed by a favorable decision. A plaintiff must assert his own rights, not those of another. A SIPA proceeding is to be conducted in accordance with the Bankruptcy Code, to the extent it is consistent with SIPA's provisions, and a SIPA trustee is vested with the same powers as a bankruptcy trustee. Thus, a SIPA trustee succeeds to all causes of action that the debtor had as of the petition date. But under *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), a bankruptcy trustee does not have standing to assert claims against third parties on behalf of creditors. SIPA does not generally give a SIPA trustee the status of a bailee of customer property, and even if it did, it does so only with respect to customer property, which does not include claims against third parties. Nor does the trustee's duty to investigate and report on fraud confer a right to bring claims that the investigation uncovers. To the extent that SIPC advances funds to the trustee to satisfy customer claims, SIPA subrogates SIPC to customer net equity claims, but only to net equity claims. *Picard v. HSBC Bank PLC*, 454 B.R. 25 (S.D.N.Y. 2011).

12.1.o. Security interest in proceeds does not include interest in commercial tort claims that may have damaged the debtor's business. Before bankruptcy, the debtor granted a security interest in substantially all its assets to its lender. The security interest did not specifically cover commercial tort claims. After bankruptcy, a trustee operated the business. The court approved an adequate protection order for the lender, which granted the lender a replacement lien on all assets. When trustee concluded that reorganization was no longer possible, it engaged a competitor to service the debtor's accounts, to reduce damages from breach of the debtor's contracts. The court gave the lender stay relief. The lender foreclosed and sold its collateral to a third party buyer. The buyer later sued the competitor for conversion, interference with contractual relationships, and breach of fiduciary duty. Granting a security interest in a commercial tort claims requires that the claims be described with specificity in the security agreement, so the claim must exist when the parties enter into the security agreement. A security interest may include proceeds, which includes claims arising out of loss of the collateral, but only to the extent of the value derived from the collateral, such as a claim arising from negligence that resulted in destruction of the collateral. General commercial tort claims, however, are not proceeds of collateral. Here, the buyer's claims were all tort claims arising out of the business. Therefore, the lender did not have a security interest in them, and the buyer did not acquire them when it purchased the lender's collateral at the foreclosure sale. *City Sanitation, LLC v. Allied Wast Servs. of Mass., LLC (In re American Cartage, Inc.)*, 656 F.3d 82 (1st Cir. 2011).

12.1.p. Disclosure statement disclosure of post-confirmation claims preserves the reorganized debtor's right to bring them. The debtor's plan provided that the reorganized debtor would retain all claims and causes of action belonging to the estate. The disclosure statement provided more detail, specifying, among other things, that the reorganized debtor might pursue claims against various prepetition shareholders for fraudulent transfers and recovery of dividends. Section 1123(b)(3)(B) permits a reorganized debtor to retain claims after confirmation, but the reorganized debtor may pursue them only if the plan expressly, specifically and unequivocally preserves the right to do so, to put creditors on notice so that they have sufficient information to cast an intelligent vote on the plan. The disclosure statement is

the primary means of informing creditors about the plan, so disclosure of retained claims in the disclosure statement suffices. The disclosure need not identify the defendants, only the claims. Here, the disclosure of the existence of the claims against former shareholders, the possible amount of recovery, the basis for the actions and that the reorganized debtor intended to pursue the claims was sufficient to meet the disclosure requirements. *Spicer v. Laguna Madre Oil & Gas II, L.L.C. (In re Tex. Wyo. Drilling, Inc.)*, 647 F.3d 547 (5th Cir. 2011).

12.1.q. Judicial estoppel does not apply against a trustee based on the debtor's nondisclosure of assets. The individual debtor did not disclose a major judgment in his favor in his schedules. The trustee closed the case as a no-asset case. When the trustee learned of the judgment, she reopened the case. The debtor consented to denial of his discharge. After the trustee's notice that assets may become available, creditors holding only about 15% of the debtor's scheduled claims filed proofs of claim, but the debtor's attorney and the trustee asserted large attorneys' fees claims against the estate arising from the judgment and the subsequent proceedings. The trustee attempted to substitute in to the proceeding in which the debtor obtained the judgment. The defendant incurred substantial additional attorneys' fees as a result of the additional proceedings. Judicial estoppel arises when a party intentionally takes a position in later litigation that is inconsistent with a position that a court accepted in earlier litigation. Judicial estoppel therefore bars the debtor from pursuing the judgment or benefiting from it. But the trustee is in a different position. The trustee did not take a position in prior litigation, either in the debtor's schedules or in the nonbankruptcy litigation. As an equitable doctrine, judicial estoppel must be consistent with law. The trustee takes the debtor's assets as they exist as of the commencement of the case. At that time, the debtor had not yet failed to disclose the judgment, so the trustee took the judgment free of any judicial estoppel claim that arose upon the later nondisclosure. Applying judicial estoppel against the trustee would be inequitable, because it would grant a windfall to the defendant based on the debtor's misconduct and deprive the creditors of an asset to which they would clearly be entitled in the absence of the debtor's misconduct. Therefore, the court permits the trustee to pursue the judgment, but only to the extent necessary to pay claims, including administrative expenses, without any surplus being returned to the debtor. *Reed v. City of Arlington*, 650 F.3d 571 (5th Cir. *en banc* 2011).

12.1.r. Debtor's postpetition severance payment is property of his estate. The debtor had an employment contract with his employer as of the petition date. The contract entitled him to a severance payment, which did not increase over time, if the employer terminated his employment within two years after a change in control. To receive the severance, the debtor had to waive claims against the company and be subject to a two-year non-compete. Four months after his bankruptcy, his employer was acquired, triggering his right to severance. The trustee sought turnover of his severance payment. Property of the estate includes property that is rooted in the prebankruptcy past but does not include earnings for postpetition services. Courts construe the exclusion narrowly. The debtor had a contingent right to severance as of the petition date. Although the debtor had to continue working after bankruptcy to receive the payment, the employer's obligation was more an incentive for the debtor to enter into the employment agreement than to continue working. Therefore, the severance did not constitute postpetition earnings. The court, however, pro rates the severance payment between the debtor and the trustee based on the amount of time the debtor worked after bankruptcy relative to the entire time he worked under the contract. *In re Jokiel*, 447 B.R 868 (Bankr. N.D. Ill. 2011).

12.1.s. Section 108(a) extends adverse possession statute of limitations. A party may acquire title to land by adverse possession if the possession is, among other things, for at least a prescribed period without the true owner's commencement of an action to recover the land from the adverse possessor. In this case, the adverse possessor held a parcel for less than the 10-year period prescribed under applicable nonbankruptcy law. The debtor in possession objected in the bankruptcy court to the adverse possession more than 10 years after the adverse possession began and less than 2 years after the commencement of the chapter 11 case. Section 108(a) gives a trustee an additional two years to commence an action if applicable nonbankruptcy law fixes a period in which an action may be commenced and the period has not expired as of the commencement of the case. Section 108(a) extended the statute of limitations on commencing an action to defeat the adverse possession, and the DIP's objection in the bankruptcy court within two years after the petition date was timely. *Jake's Granite Supplies, L.L.C. v. Beaver (In re Jake's Granite Supplies, L.L.C.)*, 442 B.R. 694 (D. Ariz. 2010).

12.1.t. Judicial estoppel is a fact-specific, equitable inquiry that may apply against a trustee based on the debtor's nondisclosure of assets. The individual debtor did not disclose a major judgment in his favor as well as other assets in his schedules. The trustee closed the case as a no asset case. When the trustee learned of the judgment, she reopened the case. The debtor consented to denial of his discharge. After the trustee's notice that assets may become available, creditors holding only about 15% of the debtor's scheduled claims filed proofs of claim, but the debtor's attorney and the trustee asserted large attorneys' fees claims arising from the judgment and the subsequent proceedings. The trustee attempted to substitute in to the proceeding in which the debtor obtained the judgment. The defendant incurred substantial additional attorneys' fees as a result of the additional proceedings. Judicial estoppel arises when a party takes a position in later litigation that is inconsistent with a position that a court accepted in earlier litigation, giving the party an unfair advantage or imposing an unfair detriment on the opposing party. Attempting to harmonize three apparently inconsistent prior decisions, the Fifth Circuit applies judicial estoppel to the trustee based on a fact-intensive, equitable analysis. The trustee succeeds to the debtor's claim, with all its attributes, including the potential for judicial estoppel. The creditors are not materially disadvantaged by the application of the doctrine, because their claims would be subject to the payment of the administrative claims of the debtor's and the trustee's lawyers, which were increased only because of the nondisclosure. The defendant was victimized by its increased fees. Therefore, equity requires application of judicial estoppel against the trustee. *Reed v. City of Arlington*, 620 F.3d 477 (5th Cir. 2010).

12.1.u. Alter ego claim does not belong to the estate. The creditors sued the corporate debtor's shareholders, alleging breach of contract and alter ego. If the claim belonged to the debtor and thereby became property of the estate, only the trustee may bring it; individual creditors may not. But the trustee may not bring claims that belong only to creditors, not to the debtor. Under California law, an alter ego claim is strictly procedural, not substantive. An alter ego claim is not general to all creditors but specific to the particular creditor to prevent unfairness and promote justice and equity. A corporation may assert a claim against its shareholders for the benefit of all creditors, but only for injury to the corporation, such as for a stockholder's conversion of corporate assets. However, that is not an alter ego claim. Therefore, any claim that a creditor may have against the shareholders belongs only to the creditors, not to the estate. *Ahcom, Ltd. v. Smeding*, 623 F.3d 1248 (9th Cir. 2010).

12.1.v. Creditors do not have derivative standing as to a Delaware LLC. A lender to the parent company sued the managing members of an LLC for breach of fiduciary duty for failing to implement an adequate system of financial controls, for authorizing acquisitions without adequate financial information and for benefiting individually from the acquisitions. Delaware LLC Act section 18-1002 provides, "In a derivative action, the plaintiff must be a member or an assignee or a limited liability company interest at the time of bringing the action" and at the time of the challenged transaction. This phrasing precludes creditor derivative standing against managers of a Delaware LLC. Tracing the history of derivative standing in actions against directors, partners or managers of Delaware non-corporate entities, and the extensive rights that the Delaware LLC Act provides to creditors to allow them to protect themselves by contract and in an LLC agreement itself, the court concludes that the result is neither absurd nor at odds with the underlying policy of the LLC Act. *CML V, LLC v. Bax*, 6 A.3d 238 (Del. Ch. 2010).

12.1.w. Proceeds of a postpetition sale of an FCC license is not subject to a prepetition security interest. The Federal Communications Act does not permit transfer, even of a security interest in, a broadcast license. The debtor granted the bank a security interest in the proceeds of the debtor's FCC broadcast license. After bankruptcy, the trustee attempted to sell the debtor's license. Section 552 permits a prepetition security interest to attach to property acquired after bankruptcy only if the property is proceeds of property in which the creditor had a security interest as of the date of bankruptcy. Before bankruptcy, the debtor did not have sufficient rights in any future sale proceeds of the license in which it could grant a security interest, because it did not have a contract of sale nor FCC approval of a transfer of the license. Therefore, proceeds of a postpetition license sale are not subject to the bank's security interest. *Spectrum Scan LLC v. Valley Bank & Trust Co. (In re Tracy Broadcasting Corp.)*, 438 B.R. 323 (Bankr. D. Colo. 2010).

12.1.x. 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), *reh'g denied*, 437 B.R. 488 (Bankr. D. Del. 2010).

12.1.y. 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.z. 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).

12.1.aa. Directors and shareholder are not liable for approving shareholder loans to failing corporation and for sale of stock that eliminated corporation's NOL's. To avert a going concern qualification in its audited financial statements, the debtor refinanced its debt by borrowing $90 million

from its 100% shareholder on market terms. The debtor's independent directors negotiated and approved the transaction, without determining the debtor's solvency, hiring a restructuring professional, seek other financing or consider alternatives. Ten months later, the shareholder sold all its shares and loans for $100,000, taking a tax deduction for its losses and wiping out the debtor's ability to use $700 million in net operating losses. Ten months after that, it filed chapter 11. Directors owe a Delaware corporation a duty of care and of loyalty, which includes the duty to act in good faith and prohibits both self-dealing and failure of oversight. Delaware law gives great deference to management. It permits management of even an insolvent corporation to take steps to continue operations to improve creditor recoveries. Directors are not liable on a "deepening insolvency" theory, even when pleaded as a breach of duty of care. The transactions were fair and on market terms, and the independent directors did not profit personally. Therefore, claims for breach of the duty of care and of the duty of loyalty for approving the loans must be dismissed. A controlling shareholder does not have fiduciary duties to the corporation and may act in its self-interest, unless it causes the corporation to provide value to the shareholder to the exclusion of or detriment to minority shareholders or negates the corporation's independent board's judgment and dictates terms. Here, the stock and note sale did not require board approval, and the board was powerless to stop it. It did not affect other shareholders. It did not breach any duty the shareholder owed to the corporation. As the court notes, the shareholders "lost $90 million. They could have taken their tax losses without the additional losses of $90 million." *Official Comm. of Unsecured Creditors v. Nat'l Amusements Inc. (In re Midway Games Inc.)*, 428 B.R. 303 (Bankr. D. Del. 2010).

12.1.bb. Sections 541(a)(1) and 541(c)(2) determine the debtor's interest in property as of the petition date. The debtor was the beneficiary under a spendthrift trust, but the debtor was to receive the remainder interest in the trust when he reached a certain age, while his bankruptcy case was still open, free of any spendthrift restrictions. Applicable state law honored the trust's spendthrift clause and prevent the debtor from alienating any interest in the expected remainder interest. Under section 541(a)(1), property of the estate includes all interests of the debtor in property as of the commencement of the case. Section 541(c)(2) enforces a trust's spendthrift provision to the extent it is enforceable under applicable nonbankruptcy law. As of the commencement of the case, section 541(c)(2) protected the debtor's interest. Therefore, the remainder interest did not become property of the estate. *Wachovia Bank, N.A. v. Levin*, 419 B.R. 297 (E.D.N.C. 2009).

12.1.cc. Proceeds of prepetition letter of credit draw are not property of the estate. The debtor obtained insurance policies and secured reimbursement obligations in part by posting letters of credit in favor of the insurer. Before bankruptcy, the insurer drew the letters of credit, applied a portion of the proceeds both before and after bankruptcy to reimburse itself under the policies for claims that it had paid and held the balance to protect itself against claims that were yet to be asserted and paid. Property of the estate includes all interests of the debtor in property as of the commencement of the case. Even though the letter of credit proceeds served to secure the insurer/creditor's reimbursement claims against the debtor, the funds came from the issuing bank, not from the debtor. They did not become the debtor's property as of the commencement of the case because the insurer had drawn the letter of credit before bankruptcy. Therefore, the proceeds were not property of the estate. However, any proceeds in excess of the amount necessary to satisfy all reimbursement obligations would be owed to the estate. *S-Tran Holdings, Inc. v. Protective Ins. Co. (In re S-Tran Holdings, Inc.)*, 414 B.R. 28 (Bankr. D. Del. 2009).

12.1.dd. Property held in a resulting trust is not property of the estate. The debtor provided a royalty distribution service for an oil well operator. The operator directed all receipts from the sale of oil to the debtor, who commingled the funds in its general operating account. The debtor made distributions to the royalty and working interest holders. The debtor did not charge a fee for the service because the operator was a good customer in other parts of the business. The two people who negotiated the oral agreement always intended that the funds remain the property of the operator and agreed that interest earned on the funds would be used for the operator's benefit. A resulting trust arises when the parties intend, but do not document or otherwise express, a trust relationship under which legal title to property passes from the beneficiary to the trustee and the beneficiary retains beneficial ownership. The beneficiary carries a heavy burden to prove that the parties intended a resulting trust rather than a debtor-creditor relationship. Here, the parties' intention was clear: neither of the people who negotiated the agreement intended the debtor to become the owner of the funds. Therefore, the relationship established a resulting

trust. Property that the debtor holds subject to a trust is not property of the estate. Therefore, the debtor in possession must pay the operator the amount of the funds on deposit. *Vess Oil Corp. v. SemCrude, L.P. (In re SemCrude, L.P.)*, 418 B.R. 98 (Bankr. D. Del. 2009).

12.1.ee. Section 108(a) extension applies to statutes of repose as well as statutes of limitations. The trustee brought a legal malpractice claim against the debtor's lawyers within seven months after the petition date but 13 months after the debtor knew or should have known about the claim. Louisiana's peremptive statute terminates a legal malpractice claim 12 months after the plaintiff knew or should have known of the claim. It has the same effect as a statute of repose, in contrast to a statute of limitations, which simply bars the remedy. Property rights should be determined under applicable non-bankruptcy law, unless some federal interest requires a different result. Section 108(a) provides that if "applicable non-bankruptcy law … fixes a period within which the debtor may commence an action, and such period has not expired before the date of the filing of the petition, the trustee may commence such action" within two years after the order for relief. This section evidences a Congressional policy that the trustee have at least two years to assess and pursue actions that belonged to the debtor as of the petition date. Congress did not distinguish between statutes of limitations and statutes of repose. Section 108(a) reflects a federal interest that overrides non-bankruptcy law. It therefore preempts a statute of repose (or a peremptive statute) and permits the trustee to bring an action within two years after the order for relief. *Stanley v. Trinchard*, 579 F.3d 515 (5th Cir. 2009).

12.1.ff. A stockholder's failure to invest may breach the duty of loyalty. The corporate parent acquired the debtor as part of a deal with the parent's lender: the lender had exposure to the already troubled debtor, the parent sought financing for an unrelated acquisition and the lender agreed to finance the other acquisition if the parent would acquire the debtor and guarantee its debt to the lender. After the acquisition and the guarantee, the parent installed a restructuring officer at the debtor, who was unsuccessful in turning the business around. The restructuring officer took instructions from the parent's officers without any formal meeting of the debtor's board, which included those officers. The parent refused any investment in the debtor for needed working capital. After it became apparent that the debtor would not likely survive, the restructuring officer focused on getting the lender paid to minimize guarantee exposure, rather than on maximizing value for all creditors. Directors' fiduciary duties include the duties of care, loyalty and good faith, which is a subsidiary duty of the duty of loyalty. To prevail on a claim for breach of duty of loyalty, a plaintiff must establish a self-interested transaction that was unfair to the corporation. Here, the directors promoted their self-interest by acquiring the debtor and guaranteeing its debt to obtain financing for an unrelated acquisition. They acted unfairly while in control of the debtor by guaranteeing the debt and failing to invest any equity. A claim for breach of the duty of good faith requires a showing of conduct that is more culpable than lack of due care, such as intentionally acting with a purpose other than advancing the corporation's interests or violating positive law or failing to act in the face of a known duty to act. The restructuring officer's taking orders from the parent's officers and focusing on limiting the parent's guarantee exposure were intentional acts with a purpose to advance interests other than the corporation's and failure to act in the face of a known duty. *Miller v. Greystone Bus. Credit II, L.L.C. (In re USA Detergents, Inc.)*, 418 B.R. 533 (Bankr. D. Del. 2009).

12.1.gg. D&O policy insured vs. insured exclusion prevents recovery in an action initiated by the debtor in possession. The debtor in possession asserted claims for breach of fiduciary duty against its former directors. The D&O insurance carrier refused coverage under the "insured vs. insured" exclusion, which provides, "The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against the Directors … brought or maintained by or on behalf of an Insured in any capacity". The debtor confirmed a plan that assigned its claims against its former directors to a creditors trust. The trustee settled with the directors and took an assignment of and pursued their claims against the carrier. A D&O policy is a liability policy, rather than a casualty policy, which therefore protects against third party claims, not against the risks under the insured's control; the exclusion implements this concept. Although the creditors, through the creditors trust, are the claim's beneficiaries, the claim is not brought on their behalf. A corporation owns the claim for breach of fiduciary duty, and the corporation, as debtor in possession, brought the claim here. The bankruptcy does not change the result. For these purposes, the debtor in possession is not a different entity from the debtor. Although interests differ after the debtor files bankruptcy, the debtor corporation is the source of the claim, and an action that will benefit creditors is not the same as an action on behalf of creditors. The court leaves open the question of whether an action

by creditors or a committee through derivative standing would also be subject to the insured vs. insured exception. *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663 (9th Cir . 2009).

12.1.hh. Court may not grant derivative standing to an individual creditor in a chapter 7 case. The trustee discovered assets that the debtor had not disclosed and, jointly with an individual creditor, brought an action to recover them. The trustee ran out of funds to pursue the action and proposed to dismiss it. The creditor sought derivative standing to pursue the action on behalf of the estate. The statute supports derivative standing of a creditors committee in a chapter 11 case if a debtor in possession or trustee fails or refuses without justification to pursue an action that vests in the estate. Section 1103(c)(5) authorizes a committee to perform services in the interest of those it represents, section 1109(b) grants a committee (and an individual creditor) standing to appear and be heard on any issue and section 1123(b)(3)(B) permits a plan to vest causes of action in a representative of the estate. There are no comparable provisions in chapter 7. In addition, in chapter 7, there is always an independent fiduciary, while in chapter 11, the debtor in possession may be conflicted. “An experienced bankruptcy trustee, unlike a potentially angry and out-for-justice creditor, may have a better instinct for what is worth chasing and what is worth foregoing.” Finally, granting derivative standing would permit a creditor to “hijack” the case. Therefore, the court denies the motion for derivative standing. However, a creditor may fund the trustee’s pursuit of litigation if it wishes, as long as the trustee remains in control of all decision making. *Reed v. Cooper (In re Cooper)*, 405 B.R. 801 (Bankr. N.D. Tex. 2009).

12.1.ii. Trustee does not have standing to pursue assigned creditors’ claims. The debtor investment manager engaged in a fraudulent scheme by commingling and then leveraging customer assets. The debtor’s bank established an account structure that permitted commingling and did not require segregation. The debtor’s chapter 11 plan established a liquidating trust and provided that each customer creditor who accepted the plan assigned to the trustee its claim against the bank for aiding and abetting the fraud. The liquidating trust contained a subtrust for the assigned claims and any proceeds, which were to be distributed pro rata among the assigning customer creditors. The trustee and the bank settled the bank’s confirmation objections on grounds other than the trustee’s standing to sue on the customers’ claims. In the trustee’s postconfirmation action against the bank, the bank challenged the trustee’s standing to sue. *Res judicata* requires a final judgment on an identical action between the same parties. Although the bank objected to confirmation, plan confirmation is not *res judicata* of the trustee’s standing to sue the bank, because standing is jurisdictional and cannot be waived. Ordinarily, under sections 323 and 541, a trustee may not bring claims on behalf of creditors. A trustee must act for the benefit of the estate, and claims assignments cannot expand a trustee’s statutorily prescribed duties, as the plan provision here would do. In addition, the Code requires that any recovery be distributed in accordance with the Code’s priorities. Distribution to a subgroup of creditors, who assigned their claims, contravenes the Code distribution rules, even though the confirmed plan so provided. Therefore, the trustee does not have standing to sue the bank. *Grede v. Bank of N.Y. Mellon*, 409 B.R. 467 (N.D. Ill. 2009).

12.1.jj. Section 546(e) protection applies to nonavoiding power claims against selling shareholders in a leveraged buyout. The debtor’s shareholders sold the debtor in a leveraged buyout. The payments to the shareholders were made through an escrow arrangement at a bank. The debtor in possession sought to recover the payments under the Uniform Fraudulent Transfer Act and as illegal shareholder distributions under state corporate law. Section 546(e) prohibits avoidance of a “settlement payment … made by or to a … financial institution”. “Settlement payment” is defined broadly to include “any other similar payment commonly used in the securities trade”. Whether or not Congress intended to cover only securities trades that affect public markets and to exclude share purchases such as the one involved here, the statutory language is broad and clear and would not lead to an absurd result if interpreted to protect these payments. In addition, the statute does not require that the financial institution, the bank here, have a beneficial interest in the transferred funds for the statute to apply. The transfer was from the buyers “to” the bank and “by” the bank to the selling shareholders. Therefore, section 546(e) applies and the transfers are not avoidable. The state law claims also fail. The federal Bankruptcy Code preempts state law to the contrary where the state law stands as an obstacle to the accomplishment of the federal goal. Here, section 546(e)’s goal is to protect these payments. State corporate law may not be used to attack them, even though section 546(e) does not by its terms apply to claims not asserted under the trustee’s avoiding powers. *Contemp. Indus. Corp. v. Frost*, 564 F.3d 981 (10th Cir. 2009).

12.1.kk. Court recognizes finance subsidiary's separateness. The debtor financed its accounts receivables through a special purpose, wholly owned subsidiary, which acquired receivables from the debtor by contribution and borrowed against them from the lender, sending borrowing proceeds back to the debtor-parent. The subsidiary's organization documents had various separateness covenants, including requirements for separate bank accounts, stationery, and financial statements. It violated some of the covenants. It did not generate separate financial statements and did not file tax returns. It occasionally used the parent's stationery. The parent's financial statements characterized the borrowings as its own. Nevertheless, the debtor acknowledged the subsidiary's separateness, the subsidiary made all loan funding requests and submitted its own borrowing base certificates and the lender expressly relied on the subsidiary's separateness. The court recognizes the subsidiary's separate existence from the parent. By its organizational documents, it was not intended to be an operating company, so the fact that it did not operate does not require the court to ignore corporate form. Neither does the absence of separate bank accounts, stationery, tax returns or financial statements. The lenders relied on separateness in performing the function for which it was created, and the court should not disregard it. The court similarly rejects an alter ego or veil piercing rationale to reach the subsidiary's assets. *LaSalle Nat'l Bank Assoc. v. Paloian*, 406 B.R. 299 (N.D. Ill. 2009).

12.1.ll. Court recognizes the contribution (true sale) of debtor's receivables to finance subsidiary. The debtor financed its accounts receivables through a special purpose, wholly-owned subsidiary, which acquired receivables from the debtor by contribution and borrowed against them from the lender, sending borrowing proceeds back to the debtor-parent. The contribution documents expressed the intent that the debtor part with all interest in the receivables, and the subsidiary's law firm issued a "true sale" opinion. Whether a transfer is a sale depends on the totality of circumstances, but factors that courts consider include the parties' intent, the documents' language, recourse to the transferor, transferor's right to excess collections, ability to alter pricing and a transferor repurchase right. Here, the documents were clear in both language and intent, the parties complied with UCC requirements and the legal opinions, while not binding on the court, reflected the parties' intent. Therefore, the court determines the contribution to divest the debtor of all right, title and interest in the receivables. *LaSalle Nat'l Bank Assoc. v. Paloian*, 406 B.R. 299 (N.D. Ill. 2009).

12.1.mm. Chapter 7 trustee may bring derivative action for breach of fiduciary duty against debtor's directors. Most members of a corporate group filed chapter 11 and sought approval of debtor in possession financing. A nondebtor member of the group guaranteed the financing and granted a lien on its assets to secure the guarantee. The nondebtor member, which was a Delaware corporation, later became a chapter 7 debtor, in part because of the extra debt arising from the guarantee. The trustee sued the directors for breach of fiduciary duty for authorizing the guarantee and lien for no direct benefit to the chapter 7 corporation, alleging that they breached their duty of loyalty by authorizing the actions to perpetuate themselves in office at lucrative salaries and for the benefit of the chapter 11 debtors, for whom they also served as directors. Under *Trenwick Am. Litig. Trust v. Ernst & Young, LLP*, 931 A.2d 438 (Del. 2007), directors of a subsidiary may act in the interest of the parent, but only when the subsidiary is not insolvent or when the action would not render the subsidiary unable to meet its legal obligations. Here, the complaint adequately alleged this exception to the *Trenwick* rule and therefore survives a motion to dismiss. Under *N. Am. Catholic Educ. Prog. Found. v. Gheewalla*, 960 A.2d 92 (Del. 2007), creditors may have derivative standing to sue directors for breach of fiduciary duty if the corporation is insolvent. The chapter 7 trustee here may stand in the creditors' shoes to bring a derivative action against the directors. The court does not address the trustee's direct standing as successor to the debtor's claims against the directors or the limitation on a trustee's authority to bring claims against creditors under *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972). *Seidel v. Byron*, 405 B.R. 277 (N.D. Ill. 2009).

12.1.nn. The equities that apply to determining a constructive trust claim in bankruptcy differ from those that apply outside of bankruptcy. A creditor that the debtor had insured claimed proceeds of the debtor's reinsurance contract under a constructive trust. Constructive trusts are determined under applicable nonbankruptcy law. In this case, applicable law requires, among other things, unjust enrichment, which incorporates the concepts of equity and good conscience. Generally, creditors' rights in bankruptcy are determined under applicable nonbankruptcy law, unless some federal interest requires otherwise. The equities in bankruptcy differ from the equities outside of bankruptcy. A bankruptcy trustee must marshal assets under judicial supervision for distribution according to the Bankruptcy Code.

Therefore, refusing to apply a constructive trust in bankruptcy on facts under which it would be applied outside of bankruptcy is consistent with equity, and the estate's enrichment with the reinsurance policy proceeds is not unjust. The court therefore denies the creditor's constructive trust claim. *Ades and Berg Group Investors v. Breeden*, 550 F.3d 240 (2d Cir. 2008).

12.1.oo. Breach of fiduciary duty claim must allege damage to the debtor. The plan established a liquidating trust comprised of "all property of the Debtors' Estates which has not previously been transferred" and empowered the liquidating trustee to prosecute any claims transferred to the Trust, including claims against directors and officers. The liquidating trustee sued the debtor's directors alleging that the directors breached their fiduciary duty owed to the creditors when the debtor entered the zone of insolvency and after it became insolvent. The complaint alleged the directors' actions caused damages to creditors and shareholders, alleged that the action was derivative on behalf of creditors and shareholders and sought recovery on behalf of creditors and shareholders, with any recovery to become property of the trust. The debtor was a Delaware corporation. Under *No. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007), creditors may assert only derivative claims against directors for breach of fiduciary duty. The claims actually belong to the injured corporation, so a derivative action is actually by the shareholders (or creditors) on behalf of the corporation. Because the claim belongs to the corporation, it becomes property of the estate upon a bankruptcy filing. In this case, the claims were properly transferred from the estate to the liquidating trust, and the trustee had standing to bring them, but only as trustee of the trust that now owned the claims, not as a representative of creditors or stockholders. The complaint alleged only damages to creditors and shareholders, not to the debtor. Therefore, the complaint fails to allege a claim on which relief may be granted and must be dismissed. *The Torch Liquidating Trust v. Stocksill*, 561 F.3d 377 (5th Cir. 2009).

12.1.pp. A D&O insurance policy bankruptcy exclusion is not enforceable, but the policy limit on an action by the debtor is. The debtor's fully paid prepetition directors and officers liability insurance policy excluded coverage of any claims asserted by the debtor or any insured director or officer, except a derivative claim commenced without any involvement by the insureds. A policy endorsement denied coverage for any claim asserted by the debtor's bankruptcy estate or its representative. The trustee sued the carrier for coverage in his claim against the directors and officers for misconduct. Section 541(a)(1) includes as property of the estate any interest of the debtor in property as of the commencement of the case. Under section 541(c)(1), any provision that restricts or conditions transfer of an interest of the debtor in property based on a bankruptcy filing is ineffective to prevent the interest from becoming property of the estate. Here, the policy became property of the estate, and the trustee had the same coverage as the debtor had before bankruptcy, despite the endorsement. That coverage excluded any action by the debtor or the other insureds. The policy would cover a derivative action that creditors or shareholders could bring before bankruptcy, even though a derivative action seeks recovery for the benefit of the insured company. When bankruptcy intervenes, the derivative action belongs to the estate, and creditors and shareholders may no longer bring it. Thus, even though the policy excepts derivative actions from the coverage exclusion, the exception does not apply once the action belongs to the estate and may be brought only by the trustee, because the policy exclusion on claims the debtor may bring applies equally to the trustee. *Texas Atty. Gen'l v. Brown (In re Fort Worth Osteopathic Hosp., Inc.)*, 387 B.R. 706 (Bankr. N.D. Tex. 2008).

12.1.qq. "Equities of the case" exception to section 552(b) requires expenditure of unencumbered assets. Section 552(b) continues a prepetition security interest in proceeds of estate property if the security agreement extends to proceeds, except to the extent the court, "based on the equities of the case, orders otherwise". The "equities of the case" exception attempts to prevent a windfall to a secured lender where unencumbered estate assets are devoted to improving the collateral's value. Here, the debtor in possession expended substantial efforts to preserve and sell the estate's property, resulting in a higher sale price than could have been obtained if the debtor in possession had not undertaken the efforts and sought an order withholding $1,000,000 from the sale proceeds available for secured creditors for unsecured creditors, based on the efforts. The work was funded by a debtor in possession loan that was fully repaid from the sale proceeds. Therefore, the estate did not expend unencumbered assets, and the equities did not permit withholding of proceeds for the estate. *All Points Capital Corp. v. Laurel Hill Paper Co. (In re Laurel Hill Paper Co.)*, 393 B.R. 89 (Bankr. M.D.N.C. 2008).

12.1.rr. Judicial estoppel does not bar trustee from pursuing an action that the debtor did not disclose. The debtor had sued prepetition to recover for a personal injury. The debtor did not disclose the claim on his schedule of assets. The case was closed without the claim being administered. After discharge, the defendant moved for summary judgment arguing that the debtor's nondisclosure in the bankruptcy case judicially estopped the debtor from pursuing the action. The debtor moved to reopen the bankruptcy case, the defendant removed the action to the bankruptcy court and the trustee moved to be substituted as the real party in interest. Under section 541, the claim became property of the estate. Because it was not scheduled and therefore not administered, it was not abandoned to the debtor upon closing; the estate retained the right to the claim. Judicial estoppel prevents a party from assuming an inconsistent position in litigation to gain unfair advantage. Here, the debtor would not have gained an unfair advantage, because the claim belonged to the trustee, for the benefit of the debtor's creditors, not to the debtor. Therefore, judicial estoppel does not bar the trustee from proceeding. *Kane v. Nat'l Union Fire Ins. Co.*, 535 F.3d 380 (5th Cir. 2008).

12.1.ss. Debtor in possession retains LLC membership interest, despite bankruptcy filing. The debtor was an LLC member. The LLC operating agreement, when read with the applicable LLC statute, provided that a person ceases to be an LLC member upon filing a bankruptcy petition unless the LLC agreement provides otherwise. The LLC agreement here did not. The debtor in possession sought to dissolve the LLC. Section 541(c) invalidates any restriction on transfer of any interest of the debtor in property that is conditioned upon a bankruptcy filing. The LLC agreement and statute therefore cannot affect the debtor's LLC membership interest, either as to economic or non-economic matters, and the DIP had standing to seek dissolution. *Klingerman v. ExecuCorp, LLC (In re Klingerman)*, 388 B.R. 677 (Bankr. E.D.N.C. 2008).

12.1.tt. Complaint states claim against directors for good faith breach, but not against officers. The liquidating trustee's complaint alleged that the distressed debtor's directors abdicated their duties by selecting a restructuring advisor as COO and allowing him to sell the debtor's principal assets without supervision within three weeks after his selection without an investment banker, a search for strategic or financial buyers or any marketing or auction, resulting in a sale to a buyer with whom the debtor had already begun preliminary discussions at a price that was substantially below the assets' value, despite contemporary evidence that there was substantial market interest in the assets at a substantially higher price. The trustee also asserted breach of fiduciary duty claims against the officers, particularly the COO. A director's fiduciary duty of loyalty is not limited to preventing self-dealing. It also requires a duty to act in good faith. Failing to act when a director clearly should act violates the duty of loyalty by failing to discharge the duty in good faith. By abdicating decision-making authority to the COO and failing to supervise his activities, the directors here violated the duty of loyalty. A certificate of incorporation exculpation provision under Del. GCL section 102(b)(7) and the business judgment rule are effective to protect a director against liability for breach of the duty of due care only if the director acts in good faith and does not breach the duty of loyalty. Because the complaint adequately pleads that the directors breached the duty of loyalty, the trustee may pursue the due care claim as well, despite the exculpatory clause and the business judgment rule. An officer also owes fiduciary duties to the corporation, but the officer's duties are narrower, based on the function and duties of the office. The court dismisses the claims against the officers because the complaint does not allege what office each officer defendant held or how the officer's actions breached the duties of that office. *Bridgeport Holdings Inc. Liquidating Trust v. Boyer (In re Bridgeport Holdings Inc.)*, 388 B.R. 548 (Bankr. D. Del. 2008).

12.1.uu. Claim asserting direct injury to creditors in general does not belong to the estate. The amount of secured debt an oil and gas debtor could issue under its unsecured bond indenture depended on certified reserve estimates. Based on reserve estimates that later proved to be materially overstated, the debtor issued debt secured by substantially all of its assets. After the debtor entered chapter 11, its trustee sued the directors, who had purchased half the secured notes, and the purchaser of the other half of the notes, on various theories relating to the overstated reserve estimates. The action was settled as part of the plan by the secured creditors' reduction of their claims and the estate's release of its claims against the secured creditors. The unsecured bondholders participated in the case and approved the plan and the release. After confirmation, the bondholders sued the non-insider secured note purchaser in state court for fraud and aiding and abetting fraud in the issuance of the secured notes, alleging that the unsecured bondholders either purchased or refrained from selling their notes based on the fraudulent

reserve estimates. The secured creditor removed the action to the bankruptcy court. If the claims were property of the estate, the bankruptcy court would have post-confirmation jurisdiction and would properly dismiss them because the trustee, not the bondholders, has exclusive standing to bring them. The claims belong to the estate if the debtor could have asserted them as of the petition date. Claims that are common to a number of creditors belong to the estate if they allege injury to the estate, by way of fraudulent transfer, for example. Claims asserting specific injury directly to creditors, not derivatively through injury to the debtor, belong to creditors, not the estate. The bondholders assert here that the secured note purchaser aided in fraud that induced the bondholders to purchase or not to sell their bonds. Those claims belong to the creditors, not to the estate, so the bankruptcy court does not have jurisdiction and must remand the action to state court. That the bondholders participated in the chapter 11 case and consented to the estate's release of the secured note purchaser does not estop them from suing the purchaser. A contrary rule would inequitably penalize participation in the case. *Highland Cap. Mgmt. LP v. Chesapeake Energy Corp. (In re Seven Seas Petroleum, Inc.)*, 522 F.3d 575 (5th Cir. 2008).

12.1.vv. Estate representative has standing to sue auditor for losses resulting from undiscovered fraud. To receive his maximum annual bonus and remain in control, the debtor's CEO falsified the debtor's books over two years to hide the debtor's poor performance. The debtor's auditor did not detect the fraud until after it had issued clean audit opinions for the two years' financial statements. The estate representative sued the auditor for breach of contract, negligence, negligent misrepresentation, and fraud or recklessness in connection with the two years' audits. Under New York law, a claim for defrauding a corporation with management's cooperation accrues to creditors, not to the corporation, so the corporation, or a party pursuing the corporation's claims, does not have standing to sue. However, if management cooperated intending to benefit only itself, its cooperation is adverse to the corporation, even if it incidentally benefits the corporation, and is not imputed to the corporation, which then has standing. An auditor's breach of contract, negligence and fraud are a single form of wrongdoing, so the debtor in possession would not have standing even to bring the breach of contract or negligence claim if management cooperated in the fraud. Because the debtor's management here acted adversely to the corporation, for its own personal benefit, the debtor owned the claims against the auditor, and the claims properly vested in the estate representative, who had standing to sue the auditor on all the claims the disbursing agent brought. *Bankr. Servs., Inc. v. Ernst & Young (In re CBI Holding Co., Inc.)*, 2008 U.S. App. LEXIS 12767 (2d Cir. 2008).

12.1.ww. Estate representative may sue on a claim a creditor assigned to the estate. The debtor's CEO owned a 52% equity interest in the debtor. An independent investor owned the balance of the equity and was a substantial creditor as well. To receive his maximum annual bonus and remain in control, the CEO falsified the debtor's books over two years to hide the debtor's poor performance. The debtor's auditor did not detect the fraud until after it had issued clean audit opinions for the two years' financial statements. The estate representative objected to the auditor's claim for prepetition accounting fees and counterclaimed for breach of contract, negligence, negligent misrepresentation, and fraud or recklessness in connection with the two years' audits. As part of the plan settlement of the investor's claim, the investor assigned the estate representative its claims against the auditor for the same causes of action. Section 541(a)(7) includes in the estate any interest in property that the estate acquires after bankruptcy. Therefore, the estate may accept an assignment of a claim from a creditor. Here, the court-approved plan provided for the investor's assignment of its claim to the disbursing agent as representative of the estate, so the disbursing agent has standing to bring the claim against the auditor. *Bankruptcy Servs., Inc. v. Ernst & Young (In re CBI Holding Co., Inc.)*, 2008 U.S. App. LEXIS 12767 (2d Cir. 2008).

12.1.xx. A corporate officer owes fiduciary duties to the corporation. The Florida-incorporated debtor engaged in extensive fraudulent financial reporting over several fiscal quarters. The trustee sued the former vice president and general counsel for breaching his fiduciary duty of care to the corporation by failing to implement an adequate monitoring system or to use such a system to safeguard against corporate wrongdoing. The court reviews Delaware and Florida case law, which relies on Delaware law, without examining the reasoning underlying the case law, to determine that corporate officers owe fiduciary duties to a corporation. Therefore, the court denies the officer's motion to dismiss for failure to state a claim. *Miller v. McDonald (In re World Health Alternatives, Inc.),* 385 B.R. 576 (Bankr. D. Del. 2008).

12.1.yy. Property of the estate does not include real property held in the name of a mortgage servicer debtor. The debtor originated, sold, and serviced mortgages. The servicing agreement provided that the debtor would hold the mortgages in an express trust for the benefit of the buyer, who would be "the absolute record holder" and own "the entire equitable ownership" of the mortgages, that any property acquired upon a mortgage foreclosure would be acquired and held in the name of the buyer and that any deed would be issued to the buyer. However, foreclosure deeds were issued to the debtor, who held numerous properties on the petition date. Because the debtor held the properties in an express trust, section 541(d) prevents them from becoming property of the estate. Although section 541(d) provides that property in which the debtor holds only legal title becomes property of the estate under paragraphs (1) and (2) of section 541(a), it also prevents the equitable interest in the property from becoming property of the estate under paragraph (3), which includes as property of the estate any property the trustee recovers under the avoiding powers. Therefore, section 544(a)(3) does not permit the debtor in possession, as an ideal hypothetical bona fide purchaser of real property from the debtor as of the commencement of the case, to avoid the buyer's unrecorded interests in the foreclosed property. The court places particular emphasis on the facts that the debtor agreed not to assert an interest in the mortgages or foreclosed property and conducted itself prepetition in accordance with that agreement. *Mortgage Lenders Network, US, Inc. v. Wells Fargo Bank, N.A. (In re Mortgage Lenders Network, US, Inc.)*, 380 B.R. 131 (Bankr. D. Del. 2007).

12.1.zz. Money order company must trace trust funds in a bankruptcy estate, despite state statute creating a floating trust. The debtor issued money orders in exchange for cash. Under the contract with the money order company, the debtor was required to hold the cash in a separate, segregated account, in trust for the company. However, the debtor put the cash in its general operating account and transferred a sufficient sum to the segregated trust account every week except for two. When the debtor filed bankruptcy, the trust account actually held nearly the amount that should have been transferred during those two weeks. A state statute provided that the cash received constitutes trust funds and that if the cash is commingled, all commingled cash is impressed with a trust Funds held in trust are not property of the estate. State law determines what property is held in trust, absent a countervailing federal interest. Here, the countervailing federal interest is the Bankruptcy Code's policy of equality of treatment. To promote that policy, federal law requires tracing to show the property is actually held in trust, so state law cannot substitute a floating trust rule for the federal tracing requirement. *Callaway v. Memo Money Order Co.*, 381 B.R. 650 (E.D. N. Car. 2008).

12.1.aaa. Debtor is not entitled to unclaimed funds. A chapter 7 trustee administered a case, sent final distribution checks to creditors, and closed the case. Some of the creditors did not cash the checks; some creditors could not be found. The unclaimed funds were deposited with the court under section 347(a), which requires payment into court and disposition under chapter 129 of title 28. Chapter 129 provides for escheat to the U.S. Treasury and delivery to "any claimant entitled to such money." Many years later, the debtor's assignee sought payment of the unclaimed funds. Unclaimed funds differ from surplus funds, which are funds remaining after all creditors and administrative expenses have been paid in full. Only the unpaid creditor is entitled to unclaimed funds, not the debtor. *In re Ruch Hampton Indus., Inc.*, 379 B.R. 192 (Bankr. M.D. Fla. 2007).

12.1.bbb. Debtor is not entitled to unclaimed funds. A chapter 7 trustee administered a case, sent final distribution checks to creditors, and closed the case. Some of the creditors did not cash the checks; some creditors could not be found. The unclaimed funds were deposited with the court under section 347(a), which requires payment into court and disposition under chapter 129 of title 28. Chapter 129 provides for escheat to the U.S. Treasury and delivery to "any claimant entitled to such money." Many years later, a representative of the dissolved debtor sought payment of the unclaimed funds. Unclaimed funds differ from surplus funds, which are funds remaining after all creditors and administrative expenses have been paid in full. Only the unpaid creditor is entitled to unclaimed funds, not the debtor. *In re Bradford Prods., Inc.*, 375 B.R. 356 (Bankr. E.D. Mich. 2007).

12.1.ccc. Discharge of debtor's liability to judgment creditor does not deprive trustee of debtor's legal malpractice claim. The debtor suffered a large judgment, was placed into involuntary bankruptcy, and received a discharge, without ever having paid any of the judgment. Because of the discharge, the

debtor would never have to pay any of the judgment. The trustee brought a legal malpractice action against the debtor's former counsel for the representation leading up to the judgment. The legal malpractice claim vested in the estate upon the filing of the petition, before the discharge. It accrued no later than when the debtor suffered the injury of the judgment. It did not terminate just because the debtor would not suffer any loss from having to pay any of the judgment. Finally, state law prohibiting assignment of a legal malpractice claim does not prevent the claim from becoming property of the estate. Therefore, the trustee may pursue the claim. *Stanley v. Trinchard*, 500 F.3d 411 (5th Cir. 2007).

12.1.ddd. Section 542(a)'s turnover obligation applies only while the defendant has the subject property. The debtor issued checks prepetition, which his bank honored postpetition. Section 542(a) requires "an entity … in possession, custody, or control, during the case, of property [of the estate to] deliver to the trustee, and account for, such property or the value of such property". The trustee sought turnover from the debtor, on the theory that the debtor had control of the bank account funds *during the case*, before the bank honored the checks. However, section 542(a) applies only to property of which the defendant has possession, custody, or control at the time of the turnover demand. Section 549 permits the trustee to recover property that has been transferred postpetition; section 542 does not. *Brown v. Pyatt (In re Pyatt)*, 486 F.3d 423 (8th Cir. 2007).

12.1.eee. Creditors' breach of fiduciary duty claims are derivative claims. Several creditors had sued the debtor and some of its directors prepetition for breach of fiduciary duty. After bankruptcy, the trustee settled the claims on behalf of the estate. Even though directors owe creditors a fiduciary duty under Delaware law when the corporation is insolvent, any claims for breach are derivative claims that must be asserted on behalf of the corporation. The trustee succeeds to those claims under section 541(a) as property of the estate and may settle them, to the exclusion of the creditors who had previously sued. The court therefore overrules creditors' objection to the settlements. *Morley v. Ontos, Inc. (In re Ontos, Inc.)*, 478 F.3d 427 (1st Cir. 2007).

12.1.fff. Creditors may not assert a direct breach of fiduciary duty claim against directors. A corporation had agreed with plaintiff to develop a wireless network, using in part wireless spectrum licenses that the plaintiff transferred to the corporation. The corporation failed. The plaintiff sued the directors (the principal shareholder's employees) directly for breach of fiduciary duty, claiming that they owed their duties to the plaintiff as a substantial creditor because the corporation was either insolvent or in the "zone" of insolvency at the time of the alleged breach. Directors owe fiduciary obligations to the corporation, which shareholders may enforce for the benefit of the corporation in a derivative action. Creditors are afforded protection by contract and by fraud and fraudulent conveyance law, among other things, so directors do not in general owe creditors duties beyond these protections. Imposition on directors of direct fiduciary duties to creditors might inhibit a corporation's ability to engage in vigorous, good faith negotiations with its creditors at a time when it most needs that flexibility. Directors' duties do not change when the corporation is insolvent or even nearly so. However, because creditors may become the residual beneficiaries of the corporation's assets, they have standing to maintain a derivative claim against directors on behalf of the corporation for breach of fiduciary duty. But creditors do not have the right to assert direct claims for breach of fiduciary duty. *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007).

12.1.ggg. Plan confirmation does not resolve breach of fiduciary duty claim for decision to file bankruptcy. The directors breached their fiduciary duty by authorizing the filing of a bankruptcy petition. The corporation suffered damages as a result. The chapter 11 plan preserved any claims against the directors that existed immediately before the commencement of the case and vested them in a disbursing agent, who assigned them, with court approval, to the minority shareholders. The bankruptcy court does not have exclusive jurisdiction to resolve the claims, because they relate to the directors' pre-bankruptcy conduct, not to activities during the bankruptcy case. Nor does the Bankruptcy Code preempt the claims, because they arose before, not during, the bankruptcy case. And plan confirmation does not resolve the claims so that claim preclusion prevents their pursuit after the plan effective date, because the claims do not relate to any findings, such as the plan proponents' good faith or compliance with the terms of the Code, that must be determined as part of plan confirmation. Instead, the plan expressly preserves the

claims, which relate solely to prepetition conduct, the breach of fiduciary duty in authorizing the filing of the bankruptcy petition. *Davis v. Yageo Corp.*, 481 F.3d 661 (9th Cir. 2007).

12.1.hhh. An action on behalf of the estate that benefits only creditors does not belong to creditors. The debtor's law firm assisted it in transferring assets prepetition while the debtor was insolvent for less than reasonably equivalent value to a company that an insider controlled. A claim against the law firm for aiding and abetting the breach of fiduciary duty belongs to the debtor and therefore to the estate, and the trustee has standing to pursue it. A trustee may not bring an action that belongs only to creditors. Even though the debtor was insolvent at the time of the breach and the recovery will likely benefit only creditors, in that any recovery by the estate will be distributed on creditors' claims, this claim is brought on behalf of the estate, not of creditors, and the trustee therefore is not barred. *Moratzka v. Morris (In re Sr. Cottages of Am., LLC)*, 482 F.3d 997 (8th Cir. 2007).

12.1.iii. Participation agreement is not a loan. The debtor financed small businesses. It borrowed from a secured lender to support its operations and, separately, participated out to other financial institutions interests in its loans to its customers. The secured lender claimed a security interest in all of the debtor's assets, including the portion of customer loans that had been participated. Whether the security agreement, which was ambiguous, granted the secured lender a security interest in the participated portion of the customer loans may depend in part on whether the participation interests are loans to the debtor, because the characterization of the participation interests could determine whether they are property of the debtor in which it may grant a security interest. Although the court determines that the participation agreement meets the four requirements of a true participation (as distinguished from a loan)—advance of funds, right to repayment only from collections from the borrower, no legal recourse against the borrower, and parties' intentions—the court nevertheless analyzes whether the security agreement granted a security interest in the participation interests and concludes that it does not. *Acro Bus. Fin. Corp. v. M & I Marshall and Isley Bank (In re Acro Bus. Fin. Corp.)*, 357 B.R. 785 (Bankr. D. Minn. 2006).

12.1.jjj. Bankruptcy court may not substantively consolidate nondebtors. The bankruptcy court authorized the debtor in possession to purchase the assets of its two subsidiaries for nominal consideration. The purchase was not a substantive consolidation, because the subsidiaries were not in bankruptcy, and substantive consolidation is "impossible" with nondebtor entities. The court does not explain why this is so. *Peoples State Bank v. Gen. Elec. Cap. Corp. (In re Ark-La-Tex Timber Co.)*, 482 F.3d 319 (5th Cir. 2007).

12.1.kkk. Court recognizes finance subsidiary's separateness. The debtor financed its accounts receivables through a special purpose, wholly-owned subsidiary, which acquired receivables from the debtor by contribution and borrowed from the lender, sending borrowing proceeds back to the debtor-parent. The subsidiary's organization documents had various separateness covenants, including requirements for separate bank accounts, stationery, and financial statements. However, it violated those covenants, among others. Nevertheless, the subsidiary is not an alter ego of the parent. By its organization documents, it was not intended to be an operating company, so the fact that it did not operate does not require the court to ignore corporate form. Neither does the absence of separate bank accounts, stationery, tax returns or financial statements. The lenders relied on separateness in performing the function for which it was created, and the court should not disregard it. *Doctors Hosp. of Hyde Park, Inc. v. Desnick (In re Doctors Hosp. of Hyde Park, Inc.)*, 360 B.R. 787 (Bankr. N.D. Ill. 2007).

12.1.lll. Interpleaded funds from government contract are property of the estate. The debtor contracted with a ship owner, who operated the ship for the U.S. government, to repair the ship. The debtor filed bankruptcy before receiving final payment from the ship owner and before paying a subcontractor. The ship owner paid the money it received from the government into court and brought an interpleader action against the debtor in possession and the subcontractor. The funds are property of the estate. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962), does not require otherwise. In that case, the Supreme Court awarded government funds originally owing to the bankrupt contractor to a surety who completed the contract with another contractor and paid the subcontractor. The surety had the rights by subrogation of the bankrupt contractor as well as the rights of the subcontractor. Here, the debtor had not parted with those

interests as of the commencement of the case, so the funds remained property of the estate. *Grochal v. Ocean Tech. Servs. Corp. (In re Baltimore Marine Indus.)*, 476 F.3d 238 (4th Cir. 2007).

12.1.mmm. Prepetition income is not property of the estate. The debtor received income prepetition from a closely held business. He did not disclose the income in his bankruptcy filing. The government indicted him under 18 U.S.C. § 152(1) for concealing property of the estate. Income generated prepetition is not property of the estate under either section 541(a)(1), which includes all of the debtor interests in property as of the commencement of the case, or under section 541(a)(6), which includes proceeds of or from property of the estate. The income that arose prepetition could not derive of or from property of the estate, because the estate was created only when the petition is filed. Therefore, the debtor is not guilty of concealing property of the estate based on any concealment of income from the closely held business. *United States v. Mitchell*, 476 F.3d 539 (8th Cir. 2007).

12.1.nnn. *In pari delicto* defense defeats a trustee's claims arising from a stock-for-stock merger. An acquiring corporation defrauded a target corporation's shareholders into agreeing to a stock-for-stock merger, which was executed by the target merging into a newly formed subsidiary of the parent. Bankruptcy followed. The trustee sued the parent's officers, directors, and professionals for the damages their fraud caused the target. The court does not resolve whether the claim properly belongs to the target and therefore its trustee as successor or to the target's shareholders. It concludes, however, that the *in pari delicto* defense bars liability to the target and its trustee. The defense requires the defendant to show at least the plaintiff's substantially equal culpability and that application "would not interfere with the purposes of the underlying law or contravene public policy." The court imputes the fraud to the new subsidiary, under the principle that controlling actors' fraudulent conduct may be imputed to a corporation when they have used the corporation to facilitate the fraud. Thus, any claim the subsidiary asserts is subject to the *in pari delicto* defense. Because the target merged into the new subsidiary and the trustee asserts the claims on behalf of the surviving entity, which was the subsidiary, the trustee is similarly subject to the defense. The trustee does not gain the adverse interest exception benefit, because the perpetrators were actually acting *in* the interest of the subsidiary, not adverse to it, by allowing it to obtain assets for little or no consideration. *Nisselson v. Lernout*, 469 F.3d 143 (1st Cir. 2006).

12.1.ooo. Court permits lender to credit bid its secured claim, despite committee "wrongful lending" allegations. An investor loaned new funds, secured by all of the debtor's assets, and made a convertible preferred stock investment, to pay off existing secured debt and provide working capital for expansion at a time when the debtor's prospects looked strong. The investor got one board seat (out of four). The market shifted shortly thereafter, the debtor breached the investor's loan covenants, and the debtor needed fresh funds. The investor made an additional secured advance. The investor's board designee did not vote on the transaction. The debtor's condition still worsened. After the investor's board designee resigned, the debtor and the investor negotiated a stalking horse bid for the debtor's assets, using a credit bid of its secured claim. The debtor filed chapter 11 and conducted an auction, at which the investor sought to credit bid its secured claim. The creditors committee objected to the credit bid by objecting to the allowance of the investor's claim. The court concludes that the claim should be allowed in full. The claim should not be recharacterized as equity, because the parties' clear intent was that the loan portion of the investment be treated as debt. That the investor already held some convertible preferred and knew of the debtor's financial distress at the time of the new debt does not require recharacterization. New money from an existing equity holder need not be treated as equity when a new prudent lender would not lend, because it is legitimate for an existing lender or equity holder to lend to shore up an existing position. The claim should not be equitably subordinated, because the investor did not have sufficient control to be an insider—one board seat of four and the ability to call covenant defaults do not amount to control—and did not seek to benefit itself at the expense of others or mislead others. The investor did not breach any fiduciary duty or aid and abet the directors' breach of fiduciary duty by increasing the debtor's debts, because deepening the debtor's insolvency by itself is not a breach of the duty of care. *Official Comm. of Unsecured Creditors v. Tennenbaum Cap. P'ners, LLC (In re Radnor Holdings Corp.)*, 353 B.R. 820 (Bankr. D. Del. 2006).

12.1.ppp. Liquidating trust may not assert claims against the parent's directors. The parent had embarked on an acquisition strategy. In executing the strategy, the group increased its debt, which a

wholly-owned subsidiary guaranteed. When the strategy failed, the subsidiary filed chapter 11. The post-effective date liquidating trust sued the parent's and the subsidiary's directors in Delaware Chancery Court for breach of fiduciary duty to the subsidiary (which it claimed was insolvent at the time of the transaction) and its creditors and for deepening the subsidiary's insolvency. The court dismisses the complaint. First, under Delaware law, a parent does not owe any fiduciary duties to a wholly-owned subsidiary or its creditors. Such duties arise only in the context of protecting the subsidiary's minority shareholders. "Wholly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations; that is why they are created. Parent corporations do not owe such subsidiaries fiduciary duties." Second, "A subsidiary board is entitled to support a parent's business strategy unless it believes pursuit of that strategy will cause the subsidiary to violate its legal obligations. Nor does a subsidiary board have to replicate the deliberative process of its parent's board when taking action in aid of its parent's acquisition strategy." Third, the parent's directors do not owe fiduciary duties to the subsidiary. If the parent breached its duty as a shareholder, the directors are liable only if the plaintiff pierces the parent's corporate veil. Finally, Delaware does not recognize a cause of action for deepening insolvency "when a firm is insolvent [any more than] a cause of action for 'shallowing profitability' … when a firm is solvent." "Even when a firm is insolvent, its directors may, in the appropriate exercise of their business judgment, take action that might, if it does not pan out, result in the firm being painted in a deeper hue of red. The fact that the residual claimants of the firm at that time are creditors does not mean that the directors cannot choose to continue the firm's operations in the hope that they can expand the inadequate pie." The only recourse is under a traditional claim for breach of fiduciary duty. *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006).

12.1.qqq. Payments under postpetition crop disaster relief legislation for prepetition crop losses are not property of the estate. The debtor suffered weather-related crop losses before bankruptcy. After bankruptcy, Congress enacted legislation to provide disaster relief for the losses. The payments the debtor received are not property of the estate. Section 541(a)(1) speaks only as of the commencement of the case. The debtor had no rights to the payments as of the commencement of the case, because Congress had not yet enacted the relief legislation. The payments were not sufficiently "rooted in the prebankruptcy past," *Segal v. Rochelle*, 382 U.S. 375 (1966), to become property of the estate, because section 541(a)(1) strictly limits the property analysis to the time of the commencement of the case. The payments also do not become property of the estate under section 541(a)(6), which includes only "proceeds … of property of the estate." The prepetition crop losses are not property that can become property of the estate. *Bracewell v. Kelley (In re Bracewell)*, 454 F.3d 1234 (11th Cir. 2006). *Accord Burgess v. Sikes (In re Burgess)*, 438 F.3d 493 (5th Cir. 2006).

12.1.rrr. Lender's claim against controlling shareholder belongs to the estate. The debtor's controlling shareholder persuaded the lender to defer enforcement action and accept a restructuring proposal before bankruptcy by representing that there was a buyer for the debtor's assets. The sale never occurred. In the meantime, the controlling shareholder caused the debtor to transfer substantial assets to an affiliate. The lender soon filed an involuntary bankruptcy petition. The trustee settled claims against the controlling shareholder for fraudulent transfer and on a veil piercing theory. The court approves the settlement, because the claims belong to the estate, not the lender. The claim against the controlling shareholder arising from the transfer of the debtor's property to an affiliate asserts damage to the debtor and to all creditors alike, not to individual creditors. In addition, under Missouri law, a veil piercing claim related to a particular transaction belongs to the corporation, not to the individual creditors. Therefore, the trustee has authority to settle the claims against the controlling shareholder, and the lender does not have any rights in the claims. *Highland Cap. Mgmt., L.P. v. Welsh, Carson, Anderson & Stowe VI, L.P. (In re Bridge Info. Sys., Inc.)* 344 B.R. 587 (E.D. Mo. 2006).

12.1.sss. Corporate charter exculpatory provision does not protect against breach of duty of loyalty. Delaware law permits a corporate charter to exculpate directors for breach of the duty of care. Under such a provision, a director may not be held liable to the corporation in a derivative action that alleges poor decision-making that led to a bad result. The provision is enforceable against both shareholders and a bankruptcy estate representative who assert the corporate debtor's claims on behalf of creditors. However, where a complaint alleges specific facts that show that corporate directors acted at the direction of the controlling shareholder and without regard to the interest of the corporation, lacked independence because

they were also officers or directors of the shareholder, were beholden to the controlling shareholder, and engaged in a scheme to prefer the shareholder over all other creditors and siphon off the corporation's assets for the benefit of the shareholder, the complaint adequately states a claim for breach of the fiduciary duty of loyalty. An exculpatory charter provision does not protect directors against such claims. Officers may similarly be held liable if they act within their discretionary authority. Although the exculpatory provision specifically protects only directors, not officers, the court applies the same standard to officers and dismisses claims against them based on breach of the duty of care. *Official Comm. of Unsecured Creditors v. Am. Tower Corp. (In re Verestar, Inc.)*, 343 B.R. 444 (Bankr. S.D.N.Y. 2006).

12.1.ttt. Directors and officers dominated by the CEO lack independence and may be liable for breach of the duty of loyalty. The debtor's CEO, who was a director, repeatedly disregarded advice from his senior officers that an acquisition strategy would harm the company and hid that advice from the board and did so to maintain his position and compensation. Such conduct violates the CEO's duty of loyalty, because it was motivated by the "self-interest of entrenchment." The conduct caused harm to the debtor. Even though a majority of the board was not self-interested, the CEO's hiding of information on which the board could make an informed decision resulted in the harm. Similarly, the COO and CFO, who were also directors, breached their duty of loyalty. They had repeatedly warned the CEO of the likely problems but did not speak up at board meetings and voted to support the damaging transactions. They were dominated and controlled by the CEO and therefore lacked the independence to defeat a claim of a breach of the duty of loyalty. The general counsel was not a director but participated in board meetings. He failed to warn the board of the problems with the proposed transactions and participated in the formulation of information that would support a "business judgment" defense to any claim arising from the transactions, also because of the CEO's domination and control. Therefore, he too lacked independence and breached his duty of loyalty. Because of their lack of independence and their breaches of the duty of loyalty, the directors and officers were not entitled to a presumption that they acted with due care and in good faith or to rely on the business judgment rule defense or a due care exculpatory clause in the corporate charter. *Boles v. Filipowski (In re Enivid, Inc.)*, 3345 B.R. 426 (Bankr. D. Mass. 2006).

12.1.uuu. Reversion of residual upon payment of principal and interest creates a security interest, not a true sale. The debtor leased equipment to its customers. It financed the leases by assigning the leases to a bank. The agreement provided that the transaction was a sale, not a security interest grant, and that the debtor no longer had any interest in the leases, which "shall not be part of the estate of [the debtor] in the event of bankruptcy." It provided for a servicer to collect payments under the leases, remit them to the bank, and pay all taxes on the payments. It also permitted the debtor to act as subservicer. However, there was no servicing fee. In addition, the agreement frequently referred to payments owing from the debtor to the bank as "principal" and "interest." The agreement required that the transaction be characterized as a loan and security interest grant for tax purposes. The debtor could make "servicer advances" if a lessee failed to make a payment. Finally, upon the debtor's payment to the bank of all "principal" and "interest," the bank was required to transfer any remaining interest in the leases to the debtor. These documents create a loan and security interest, not a sale. *Netbank, FSB v. Kipperman (In re Commercial Money Ctr., Inc.)*, 2006 Bankr. LEXIS 1845 (9th Cir. B.A.P. Aug. 25, 2006).

12.1.vvv. Reversionary interest in workers' compensation fund belongs to the estate, not the funding bank. The debtor self-insured its workers' compensation liability. To do so, the state required it to obtain and post a letter of credit, which the state could draw if the debtor failed to pay claims. The state drew on the letter of credit and placed the drawn funds in a trust account for payment of claims. The trust agreement provided that when all claims had been paid, the debtor had a reversionary interest in the remaining trust funds. The letter of credit bank claimed the reversionary interest in the funds, arguing that the funds were proceeds of the letter of credit and the letter of credit was posted only to cover the debtor's workers' compensation liability, the excess should be returned to the bank, as though the excess had never been drawn. However, the independence principle and the terms of the trust agreement defeat the bank's claim. Under the independence principle, once the beneficiary draws the letter of credit, the bank's relationship to the beneficiary terminates, the bank cannot direct how the beneficiary uses the proceeds, and the bank has only a reimbursement claim against the debtor/account party. In addition, the trust agreement provided for a reversion of the trust funds to the debtor. Therefore, the excess became

property of the estate. *PNC Bank, N.A. v. Spring Ford Indus., Inc. (In re Spring Ford Indus., Inc.)*, 338 B.R 255 (E.D. Pa. 2006).

12.1.www. Interline trust doctrine does not exempt interline balances from bankruptcy. The debtor motor carrier owed substantial interline balances to a railroad for its portion of the charges the debtor received for intermodal goods transport. The railroad asserted the interline trust doctrine to argue that the carrier, and therefore its bankruptcy estate, held the customers' payments in trust for the railroad. The court declines to adopt the interline trust doctrine as a matter of federal common law. Neither the Bankruptcy Act nor the Interstate Transportation Act evidences a Congressional policy supporting creation and application of federal common law in this circumstance. Rather, the Bankruptcy Act policy is to apply state law "unless some federal interest requires a different result." *Butner v. United States*, 440 U.S. 48 (1979). The Transportation Act does not support the creation of federal common law in this area, because promotes free competition rather than government regulation. Therefore, the railroad's claim is a general unsecured claim. *Norfolk. S. Ry. Co. v. Consol. Freightways Corp. (In re Consol. Freightways Corp.)*, 443 F.3d 1160 (9th Cir. 2006).

12.1.xxx. Deepening insolvency does not create a theory of damages or an independent cause of action. The trustee sued the debtor's accountants for malpractice in preparing financial statements on which investors relied in buying equity in the debtor. The availability of the equity investment enabled the debtor to keep operating and incur substantial additional debt, which drove it into bankruptcy. The deepening insolvency was not the result of the investment, but of management's misuse of the investment and the squandering of the opportunity to use the funds to improve the business. Although a cause of action for deepening insolvency, "an injury to [a debtor's] corporate property from the fraudulent expansion of corporate debt and prolongation of corporate life," may lie, deepening insolvency does not create a theory or measure of damages that is independent of the damages arising from the malpractice claim itself. Therefore, the plaintiff cannot show harm necessary for liability if the only result of a defendant's action is the deepening insolvency of the debtor. In addition, a deepening insolvency claim requires proof of fraudulent conduct; negligence will not suffice. *Seitz v. Detweiler, Hershey & Assocs., P.C.*, 448 F.3d 672 (3d Cir. 2006).

12.1.yyy. Deepening insolvency claim requires fraud on the debtor. The liquidating trust plaintiff alleged that the defendant bank had acted as financial advisor to the debtor and as an advisor and holder of warrants to purchase 20% of the debtor's stock, had heavy influence over the debtor's decision making, persuaded the debtor to continue a business line and borrowings that were unsustainable and that the bank knew were unsustainable, resulting in the debtor's ultimate failure long after the debtor would have failed in the absence of the program, primarily for the purpose of generating fees for the bank. The complaint is sufficient to state a claim for breach of fiduciary duty, because it alleges that the bank was a person in control of the debtor. As an insider, the bank owed a duty to the corporation that it could breach by acting in its own self interest. In addition, although the courts are continuing to develop the theory of deepening insolvency as a cause of action, the Third Circuit has ruled that such a claim is viable under Pennsylvania law. New York, North Carolina, and Delaware law, which might apply here, adopt the same remedial purpose rationale as Pennsylvania, so the court concludes that such a claim exists under those states' laws. However, the claim is viable only if the plaintiff alleges and proves that the prolongation of corporate life and expansion of corporate debt was fraudulent and that the fraud was directed at the debtor, not at creditors, because the claim belongs to the debtor for injury to the corporation. This complaint sufficiently alleged such facts and would therefore not be dismissed. *OHC Liquidation Trust v. Credit Suisse First Boston (In re Oakwood Homes Corp.)*, 340 B.R. 510 (Bankr. D. Del. 2006).

12.1.zzz. Federal crop disaster relief payments are not property of the estate. The debtor suffered crop losses in 2001 and filed bankruptcy in 2002. In 2003, Congress enacted a crop disaster relief program that covered the crop losses, and the debtor became entitled to a payment under the program. Section 541(a)(1) creates an estate of property in which the debtor had an interest as of the commencement of the case. Although the losses occurred before bankruptcy, the debtor had no interest in the disaster relief payment until Congress enacted the relief program after the debtor's bankruptcy. The debtor did not have even a contingent interest, based on the contingency that Congress might enact such relief. It was a mere hope. Therefore, the payment is not property of the estate. The court notes that

section 541(a)(1) enacts the result but not the Supreme Court's reasoning in *Segal v. Rochelle*, 382 U.S. 375 (1966), by defining property of the estate as all of the debtor's interests in property as of the commencement of the case. In *Segal*, the Supreme Court reached the conclusion that tax refunds for prepetition losses were property of the estate by balancing the Bankruptcy Act's twin policies of securing for creditors everything of benefit that the bankrupt might possess and allowing the bankrupt to accumulate new wealth after bankruptcy to promote the fresh start. With the enactment of the express statutory standard in section 541(a)(1), courts no longer need to balance these policies to determine what interests are included in property of the estate. *Burgess v. Sikes (In re Burgess)*, 438 F.3d 493 (5th Cir. 2006), *en banc*.

12.1.aaaa. Tobacco transition payments under FETRA are property of the estate. Congress enacted the Fair and Equitable Tobacco Reform Act of 2004 (FETRA) to replace the prior system of tobacco quota and production support payments. The debtor was a recipient of both kinds of payments under prior law. Entitlement to quota payments under the old system was based on ownership of a farm and related quotas. FETRA transition payments that substitute for quota payments are proceeds of the farm and quotas, which became property of the estate when the debtor filed bankruptcy. Entitlement to production support payments under the old system was based on assuming the risk of tobacco production. FETRA transition payments that substitute for production support entitlements are based on production during the 2002, 2003, and 2004 crop years. The debtor filed bankruptcy before the 2004 crop year, so the estate assumed the risk of production for 2004. But when the debtor filed bankruptcy, before FETRA's enactment, any expectation of payments based on 2002 and 2003 crop year risks of production were not a readily discernable interest and therefore did not become property of the estate. The production-based transition payments for 2002 and 2003 also were not proceeds of property of the estate. The 2004 crop year risk of production and the transition payments based on 2004 were property that the estate acquired after bankruptcy and became property of the estate under section 541(a)(7). *In re Evans*, 337 B.R. 551 (Bankr. E.D.N.C. 2005).

12.1.bbbb. First Amendment does not require application of Canon Law to determine what is property of the estate. The Archbishop of Portland in Oregon (defined in Oregon law as a corporation sole) filed a chapter 11 case. It argued that much of its real property belonged to its parishes and schools as a matter of Canon Law and that the First Amendment deprived the bankruptcy court of subject matter jurisdiction to resolve disputes over the ownership of church assets. However, the First Amendment deprives a court of jurisdiction only with respect to matters of religious law, doctrine, or faith. Who owns property, which is regulated by civil law and authorities, is not a theological question and neither establishes religion nor interferes with its free exercise. Instead, the court must apply neutral secular principles to determine who owns the property and, therefore, whether it is property of the estate. In addition, such a determination does not violate the Religious Freedom Restoration Act, 42 U.S.C. § 2000bb–2000bb-4, because it does not impose a substantial burden on the free exercise of religion. *Tort Claimants Comm. v. Roman Catholic Archbishop of Portland in Oregon (In re Roman Catholic Archbishop of Portland in Oregon)*, 335 B.R. 842 (Bankr. D. Ore. 2005).

12.1.cccc. CEO may be liable for breach of fiduciary duty for accepting excess compensation. Consummating a particular merger was one of the CEO's principal goals for the year. He failed to achieve the goal. Nevertheless, the board voted him a substantial bonus for the year. The bonus was not required under any existing compensation agreement, and the corporation had no obligation to pay it. After bankruptcy, a liquidating trustee sued the board and the CEO for waste and breach of fiduciary duty. The court dismisses the complaint for breach of fiduciary duty against the directors, because there was no allegation that they acted out of self interest or in bad faith. Therefore, the business judgment rule and the corporation's by-laws exculpation provision protect them. However, the exculpation provision does not protect the CEO, as it applies only to directors, not officers. In addition, the CEO was self-interested in the transaction: he was receiving the bonus. Therefore, the court denies the motion to dismiss the complaint against the CEO for breach of fiduciary duty for accepting the bonus. *J.P. Morgan Trust Co. N.A. v. Cleberg (In re Farmland Indus., Inc.)*, 335 B.R. 398 (Bankr. W.D. Mo. 2005).

12.1.dddd. Texas would not recognize an independent tort of deepening insolvency. The trustee sued the debtor's lender, who had continued to extend the debtor's loans even after the debtor's financial

troubles became apparent, taking more collateral with each extension, under a deepening insolvency theory. The court traces the history of the theory and analyzes the cases that have applied it. It concludes that a claim for deepening insolvency involves the defendant's breach of a separate, already existing duty to the debtor, such as a fiduciary duty, or a claim for fraud, such as "fraudulent expansion of the corporation's debt or prolongation of its life." It also reviews the Texas Supreme Court's policy not to adopt new torts for actions that are already covered by existing tort liability. A tort under Texas law requires a duty, a breach of that duty, causation and damages. The deepening insolvency theory does not contain any duty that is independent of other torts. Therefore, the court concludes that the Texas Supreme Court would not recognize it as an independent tort and dismisses the claim for relief. *Official Comm. of Unsecured Creditors v. Rural Telephone Fin. Coop. (In re VarTec Telecom, Inc.)*, 335 B.R. 631 (Bankr. N.D. Tex. 2005).

12.1.eeee. Deepening insolvency claim under Pennsylvania law requires allegation of defrauding the debtor. The trustee sued the debtor's former lawyer under a deepening insolvency theory, alleging that the defendant "engaged in tortious conduct that caused injury to the debtor through the wrongful expansion of corporate debt and prolongation of corporate life beyond insolvency." The trustee has standing to bring the action under section 541(a), because the claim alleges harm to the debtor, not to creditors. However, under Pennsylvania law, the tort requires a showing of fraud. As the Third Circuit stated, it requires a showing of "the *fraudulent* expansion of corporate debt and prolongation of corporate life." *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 349 (3d Cir. 2001) (emphasis added). If the defendant's action defrauded only creditors, not the debtor, then whether or not creditors could maintain such a claim, the trustee does not have standing under section 541(a) to assert it. Because the trustee did not allege that the defendants defrauded the debtor, the court dismisses this claim for relief. *Stanziale v. Pepper Hamilton LLP (In re Student Fin. Corp.)*, 335 B.R. 539 (D. Del. 2005).

12.1.ffff. Deepening insolvency claim under Pennsylvania law is subject to the *in pari delicto* defense. The trustee sued the corporate directors and officers under a deepening insolvency theory under Pennsylvania law, based on a series of transactions by which the debtor's assets were transferred to a new corporation. The old entity was allowed to continue to operate the new corporation and incur debt. Because the trustee brings this kind of action as a successor to the debtor under section 541(a), the trustee is subject to the same defenses that the defendants could assert against the debtor. In an action for harm to the corporation, the defendants may assert an *in pari delicto* defense, arguing that the corporation caused its own harm, for which the defendants should not be held liable. That defense is available against a deepening insolvency claim. *Miller v. Dutil (In re Total Containment, Inc.)*, 335 B.R. 589 (Bankr. E.D. Pa. 2005).

12.1.gggg. *In pari delicto* defense is available against a trustee bringing RICO claim. The debtor operated a Ponzi scheme. Some of the debtor's major investors were IRA custodians, who were responsible for managing IRA funds of individuals. The trustee sued the IRA custodians under RICO alleging active participation in the Ponzi scheme by making the individual IRA's funds available for use in the scheme. The trustee's claim was subject to the *in pari delicto* defense. The trustee takes such a RICO claim as a successor to the debtor under section 541(a), subject to all of the defenses that would have been available to the debtor, including the *in pari delicto* defense. The fact that an innocent trustee has succeeded to the claim does not vitiate the defense. The *in pari delicto* defense is available against a RICO claim because the policy of RICO is to deter racketeering and related wrongdoing. Rewarding one of the racketeers at the expense of the others would not further that policy. *Official Comm. of Unsecured Creditors v. Edwards*, 437 F.3d 1145 (11th Cir. 2006).

12.1.hhhh. Deepening insolvency claim belongs to the estate. The liquidating trustee brought claims against former directors, underwriters, and professionals, alleging that they breached their duty to the corporation by falsely representing the debtor's solvency and prolonging its life so that they could continue to receive compensation. The trustee has standing to bring the action, because the claims belong to the trustee as successor to the debtor, not to the creditors. Even though the conduct resulted in nonpayment of creditors and the recovery benefits creditors under the plan, the action belongs to the estate. Moreover, the principle that directors of an insolvent debtor may owe fiduciary duties to creditors goes only to the standing of creditors outside of bankruptcy to bring a derivative action, not to the ownership of the claim.

The court does not address the merits of a deepening insolvency claim but holds only that the trustee has sufficient standing to establish the court's jurisdiction to hear the claim. *Smith v. Arthur Andersen LLP*, 421 F.3d 990 (9th Cir. 2005).

12.1.iiii. Committee may not pursue breach of duty and aiding and abetting claims against controlling buyer. While the debtor was insolvent, its president and sole shareholder agreed to sell the business. The president caused the debtor to enter into a sale agreement, and he entered into consulting agreements with the buyer, the net effect of which was to pay the president substantial sums, to turn control of the debtor over to the buyer during the sale process, and to prevent meaningful alternative bids. During the process, the debtor continued to lose money so that when it ultimately sold, it was worth substantially less than it would have been in a timely and properly conducted sale process. The creditors committee brought an action on behalf of the estate against the buyer for breach of fiduciary duty and for aiding and abetting the president's breach of duty. The court dismisses the action. The claim for breach of duty fails under the rule of *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991), because such a claim belongs only to creditors, not to the debtor or the estate. "A claim against a third party for defrauding a corporation with the cooperation of management accrues to creditors, not to the guilty corporation." (The *Wagoner* rule is a standing rule based on ownership of the claim and should not be confused with the *in pari delicto* rule, which provides an equitable defense.) Similarly, the aiding and abetting claim also fails. One insider (the buyer) cannot aid and abet another insider (the president). Here, the buyer took effective control under the sale agreement and therefore was an insider, even though it did not hold any equity interest, board seat, or office. *Official Comm. of Unsecured Creditors v. McConnell (In re Grumman Olson Indus., Inc.)*, 329 B.R. 411 (Bankr. S.D.N.Y. 2005).

12.1.jjjj. Third Circuit narrows grounds for substantive consolidation. The parent operating company and its operating company subsidiaries were borrowers and guarantors under a bank credit line. The parent managed and controlled all the subsidiaries and their finances on a product line basis and provided funding for all the subsidiaries. The companies, not the banks, determined which entities would borrow funds. Financial reporting was done on a consolidated basis, and the banks obtained guaranties based on the book values of subsidiaries' assets, not their net worth. The debtors and asbestos plaintiffs, who had claims only against the parent, sought substantive consolidation only for chapter 11 plan voting and distribution purposes, preserving the corporate structure unchanged for all other purposes. To support substantive consolidation, the moving party must prove that "(i) prepetition [the debtor entities] disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." In this case, the banks (as well as the debtors) treated the entities as separate by negotiating for subsidiary guaranties specifically to give themselves structural seniority, and eliminating this bargained-for right requires a heavy showing that is not present here. The alternative test, that assets and liabilities were not hopelessly scrambled, requires that the cost of unscrambling will reduce recoveries for all creditors, not just that administration will be simplified. Finally, the "deemed" consolidation proposed here acts as a sword to gain strategic advantage in plan negotiations, rather than as a shield to remedy harm that the debtors imposed prepetition on creditors. *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005).

12.1.kkkk. Court approves substantive consolidation under a plan. The three debtors operated a wholesale food distribution company, with separate locations in New Jersey, Texas, and Arizona. After the debtors' assets were sold, the chapter 11 trustee and the creditors committee proposed a liquidating plan that consolidated the three estates. Over objection, the court approved the consolidation. It found that the three debtors shared common directors and officers and conducted similar business operations under similar names Intercompany transactions were done without compliance with formalities, and there were no promissory notes for intercompany transfers. In addition, there would be a substantial cost savings in not having to administer three separate estates, and separating the financial affairs of the three companies would be difficult and expensive. Costs and recoveries in adversary proceedings would have to be allocated among the three debtors. Therefore, there was a substantial identity among the three estates, and a benefit would be gained from consolidation. In addition, the creditors testified that they viewed the three entities as one for purposes of extending credit, so there was no material reliance of the separate credit of the debtors. Finally, there was no material harm to the objectors, because the evidence

showed that the entity against which they claimed was insolvent, as were the others. Therefore, consolidation was proper. *Lisanti v. Lubetkin (In re Lisanti Foods, Inc.)*, 329 B.R. 491 (D.N.J. 2005).

12.1.llll. Court substantively consolidates owned golf course and related non-debtor tavern. The debtor acquired a golf course and tavern under a single purchase agreement, which allocated the purchase price among golf course and tavern assets. After the acquisition, the debtor transferred the tavern assets to a new entity, owned by the same family members that owned the debtor, for no consideration. The debtor charged the tavern nominal rent. The debtor and the tavern were under the same management, used a single bank account for both entities, did not follow any particular method in allocating expenses between the two entities, did not keep separate financial records, and did not observe corporate formalities in the dealings between the two entities. The tavern was the alter ego of the debtor and, as a separate matter, should be substantively consolidated with the debtor under either the *Auto-Train* or *Augie-Restivo* test, even though it was not itself a debtor. *Simon v. Brentwood Tavern, LLC (In re Brentwood Golf Club, LLC)*, 329 B.R. 802 (Bankr. E.D. Mich. 2005).

12.1.mmmm. Nominee trust property is property of the estate. Fourteen years before bankruptcy, the debtor's parents transferred their houses to a Massachusetts nominee trust, with their daughter as trustee and their three children as equal co-beneficiaries. Section 365(h), permitting sale of interests of the debtor and of co-tenants in real property, applies to the houses. A nominee trustee differs from an express trust in that it creates more of an agent/principal relationship than a trustee/beneficiary relationship. The beneficiaries may direct the actions of the trustee, and the Massachusetts courts have treated a beneficiary's ownership interest in the trust as an ownership interest in the trust assets. The relationship among beneficiaries may be characterized as tenants in common or as partners, but will be characterized as partners only if the trust was formed for business purposes. Therefore, the debtor's interest in the trust's real property was as a co-tenant, to which section 365(h) applies. *Genova v. ESM Realty Trust (In re Stoll)*, 330 B.R. 470 (Bankr. S.D.N.Y. 2005).

12.1.nnnn. Delaware district court adopts *Production Resources* analysis of fiduciary duty to creditors. A liquidating trustee sued the debtor's former director for breach of fiduciary duty in approving a merger that ultimately led to the debtor's financial troubles. The court adopts the Delaware Chancery Court's analysis in *Prod. Res. Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004), to determine that the directors' fiduciary duty does not change upon approaching insolvency, but only affects a different constituency, the creditors. Whether a debtor is in the vicinity of insolvency is determined by the Bankruptcy Code's definition of "insolvent"—liabilities exceeding assets "at a fair valuation." If the debtor was operating and satisfying its obligations following the questioned transaction, "fair valuation" should be determined on a going concern basis. Finally, directors are entitled to the benefit of the business judgment rule in defending against a claim of breach of fiduciary duty, even when the corporation is in the vicinity of insolvency. The plaintiff therefore must show that the directors breached one of their duties, of care, candor, and loyalty, that is, the duty to refrain from self-dealing or benefiting from the proposed transaction, to get past the business judgment rule and hold a director liable. *Liquidation Trust v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537 (D. Del. 2005).

12.1.oooo. Trustee may not bring breach of duty claim against directors where the corporate charter exculpates. The debtor's corporate charter contained the provision, authorized by Delaware law, that exculpates directors from liability to the corporation for the breach of the duty of care. The trustee nevertheless sued the directors for breach of their fiduciary duty of care, arguing that the debtor was in the vicinity of insolvency at the time of the breach, the directors therefore owed a fiduciary duty to creditors, and that the charter provision only exculpated the directors from liability to the corporation, not to creditors. The Second Circuit rejects the trustee's argument. Under section 541, the trustee may assert only the debtor's claims, not claims that creditors might have against third parties. Since the charter provision precludes the debtor corporation from bringing the claims, the trustee is similarly precluded. In reaching its conclusion, the court notes the Delaware Chancery Court's decision in *Prod. Res. Group, LLC v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004), which held that a breach of fiduciary duty claim belongs to the corporation and not the individual creditors, who could raise the claim only derivatively. *Pereira v. Farace*, 413 F.3d 330 (2d Cir. 2005).

12.1.pppp. Parent company debt issuance that imposes restrictions on subsidiary may breach parent's fiduciary duty. Holdco I owned Holdco II, which owned Holdco III, which owned about 70% of the debtor's publicly traded common stock. Three of the debtor's four directors were also the Holdcos' directors. The Holdcos issued debt with covenants that required them to prevent the debtor from issuing debt under certain financial conditions. The Holdco debt proceeds were upstreamed to Holdco I's parent entity, also controlled by the same directors. The trustee sued the directors for breach of fiduciary duty. The directors argued that the debt at the Holdco levels did not harm the debtor, because the debtor was not a party to the debt instruments and was not in a position to issue any debt anyway, because of restrictions in the debtor's own loan agreements. The court concludes that the debt issuance may have constituted a breach of the duty of loyalty. A director's exploitation of his position for personal gain breaches the duty of loyalty and may justify an unjust enrichment award, even if there was no damage or detriment to the debtor. The fiduciary rules requiring loyalty are prophylactic, so any act of disloyalty, such as use of information or misuse of control that results in a personal profit, may be actionable. *Cantor v. Perelman*, 414 F.3d 430 (3d Cir. 2005).

12.1.qqqq. Fraud against the debtor and veil piercing claims are property of the estate, which a creditor may not pursue. Before bankruptcy, the debtor's shareholders lied to a major creditor about a possible sale of the debtor. Believing the shareholders, the creditor did not file an involuntary petition against the debtor, but it did so once it learned the statement was untrue. In the meantime, the shareholders caused the debtor to transfer substantial sums to an affiliate. The creditor sued the shareholders after bankruptcy in state court claiming damages from the fraud; the shareholders removed to the bankruptcy court, where the trustee brought a separate action against the shareholders for recovery of the amounts transferred. The actions were consolidated. When the trustee sought to settle the actions, the creditor argued that the settlement should not bind the creditor, who should be free to pursue the state law action against the shareholders. The court disagrees. Although the creditor was indirectly harmed by the resulting loss in value of the debtor corporation, the primary harm was to the debtor, who was the sole owner of the claim against the shareholders. The claim became property of the estate under section 541, and the trustee had the exclusive right to pursue it. Therefore, the creditor could not pursue the claim that the trustee settled. In addition, the creditor's veil piercing claim against the shareholders belonged to the debtor as a matter of state law, so it vested solely in the trustee under section 541. The court notes that the question is solely one of state law, but reviews the numerous bankruptcy court decisions that have ruled on the issue. *In re Bridge Info. Sys., Inc.*, 325 B.R. 824 (Bankr. E D. Mo. 2005).

12.1.rrrr. Claim against directors for issuing false financial statements is not property of the estate. The liquidation trust trustee sued the debtor's former directors, relying on a plan provision that granted him standing to pursue the debtor's claims against the former directors. One claim sought recovery for damages arising from the directors causing the debtor to issue false financial statements, in violation of the securities laws. However, the trustee could not allege how the issuance harmed the debtor (as opposed to shareholders or other third parties who may have relied on the financial statements). Therefore, the debtor did not have a claim that the trustee could pursue. *Rahl v. Bande*, 328 B.R. 387 (S.D.N.Y. 2005).

12.1.ssss. Trustee may pursue claims assigned by creditors. With the aid of numerous appraisers, brokers, title insurance companies and others, the debtor conducted a real estate fraud scheme against mortgage lenders by obtaining under-collateralized mortgage loans to purchase properties. After bankruptcy, the lenders assigned their claims outright to the trustee, intending that the trustee pursue the accomplices for recovery. The mortgage lenders retained no interest in the claims, agreeing to share only as general unsecured creditors in the assets of the estate, which would be augmented by the trustee's recovery on the assigned claims. The trustee has standing to pursue the claims on the unique facts of this case. Because of the outright assignments, the claims belonged to the estate, so the trustee was not pursuing creditors' claims. The claims became property of the estate, and the trustee was authorized to take the assignments, because of section 541(a)(7), which includes property acquired after the commencement of the case. The transaction did not violate *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), because the lenders had decided for themselves how they wished to dispose of the claim and the defendants did not suffer the risk of inconsistent adjudications on the trustee's and the lenders' claims. Finally, the trustee is not subject to the *in pari delicto* defense, because he is pursuing the

claims of creditors, not of the debtor under section 541(a)(1). *Logan v. JKV Real Estate Servs. (In re Bogdan)*, 414 F.3d 507 (4th Cir. 2005).

12.1.tttt. Breach of duty claim against directors need not be pleaded with specificity in federal court. The bankruptcy trustee brought a claim against the directors in the bankruptcy court in Delaware. Under Delaware corporate law, a director has the benefit of the business judgment rule, which is a "presumption that directors making a business decision, not involving self-interest, act on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interest." Under Delaware Chancery Rules, which read the same as the Federal Rules of Civil Procedure but are construed differently, a plaintiff must plead with specificity the facts that would enable it to overcome that presumption. However, that pleading rule does not apply in federal court, in which notice pleading is adequate. The plaintiff need plead only enough to give the defendant fair notice of the general factual background of the claim. Even so, pleading only that the directors made a bad business decision is not enough to withstand a motion to dismiss. The plaintiff must also plead enough facts to show that the decision was irrational, in bad faith, or a product of self-dealing. *Stanziale v. Nachtomi (In re Tower Air, Inc.)*, 416 F.3d 229 (3d Cir. 2005).

12.1.uuuu. Claim related to improper letter of credit draw may be property of the estate. The debtor's non-debtor subsidiary contracted to build a steel mill. The debtor guaranteed completion, posted a letter of credit to secure the guarantee, and posted cash collateral with the letter of credit issuer to secure the reimbursement obligation under the letter of credit. A dispute arose over completion, the customer drew the letter of credit, and the issuer applied the collateral to the debtor's reimbursement obligation. The debtor in possession sued to recover the collateral. The claim is property of the estate. Although the letter of credit and its proceeds are not property of the estate, the collateral, which the debtor posted, and the claim to recover it based on the improper draw are property of the estate over which the bankruptcy court has jurisdiction. *Int'l Fin. Corp. v. Kaiser Group Int'l, Inc. (In re Kaiser Group Int'l, Inc.)*, 399 F.3d 558 (3d Cir. 2005).

12.1.vvvv. Funds were not property of the debtor where the debtor had only possession, not dominion or control. The debtor provided a service for freight shippers. It accumulated bills from their carriers each week, allowing its customer the shipper to make only one payment each week to the debtor, who would issue separate checks to each of the carriers. Under the debtor's contract with the shipper, the shipper would wire transfer the funds to the debtor each Monday, and the debtor would issue and mail checks to the carriers Monday evening. The debtor was not prohibited under the contracts from commingling shippers' funds. Shortly before bankruptcy, the debtor started taking advantage of the float and not issuing or mailing checks for up to 3 weeks, unless the shipper complained. One shipper did so, and the debtor issued and mailed $4.5 million of checks for this shipper within 90 days before bankruptcy. The payments were not a preference to the shipper, however, because the funds that the shipper advanced were never "property of the debtor," as section 547(b) requires for preference liability. Although the debtor could (and did) divert shippers' funds to its own uses, it did so without authority. It did not properly have dominion and control over the funds but was more like a bailee, who has only a possessory interest. In a footnote, the court questions whether the shipper is even a creditor, musing that because the debtor had used the shipper's funds to pay the carriers on time, a debt (which arises only when an obligation is part due) had not arisen. *Lyon v. Contech Constr. Prods., Inc. (In re Computrex, Inc.)*, 403 F.3d 807 (6th Cir. 2005).

12.1.wwww. Controlling customers may be liable for breach of fiduciary duty and related claims. The debtor supplied parts to the automotive industry. When its costs of goods rose and its customer contracts became unprofitable, its three major customers asserted substantial control over its operations, brought in a turnaround management firm, which operated the debtor's business for the benefit of the customers, caused the debtor to enter into an Accommodation Agreement with the debtor's lender that resulted in the reduction of the lender's exposure, the lender's forbearance from exercising remedies, and a substantial increase in the customers' own accounts receivable from the debtor. The debtor's sole shareholder cooperated in the process and before the debtor's bankruptcy established a new corporation that subsequently took over the debtor's assets and customers. Within about 6 months, the debtor filed a chapter 7 case. After bankruptcy, the new corporation sold its assets to an unrelated third party in a

transaction that the customers arranged, and the proceeds were used to pay the customers' accounts receivable from the debtor. The debtor's trustee sued the controlling customers, the debtor's sole shareholder, and the turnaround firm on numerous theories. In ruling on the defendants' motions to dismiss the complaint, the court made the following rulings. Being an "insider" under the Bankruptcy Code does not impose any fiduciary duties. However, under Tennessee law, a defendant that actually exercises domination and control over a corporation may owe fiduciary duties to the corporation the same as the directors or a majority shareholder. A defendant who owes a fiduciary duty to a corporation may be liable for the tort of deepening insolvency under Tennessee law, which is an actionable breach of fiduciary duty when it results in dissipation of assets that would otherwise be available for creditors, when debts are inflated without regard to the best interest of the corporation, and when the controlling defendants' debts are selectively paid. A claim for breach of fiduciary duty belongs to the corporation, so the trustee has standing under section 541 to bring the claim, to the exclusion of creditors. The *in pari delicto* defense is not available where the defendants so dominated and controlled the debtor that the debtor was not the principal wrongdoer but the controlling defendants caused the wrongs that the debtor may have perpetrated. The debtor's payment of its law firm's fees in connection with the Accommodation Agreement was for the benefit of the customers and so was potentially recoverable as a preference from the customers. Finally, under Tennessee law, a corporation may not assert a claim against its shareholder under an alter ego theory, so the trustee may not assert such a claim under section 541, nor is it a claim sufficiently common to all creditors that the trustee may assert it under section 544(a). *Limor v. Buerger (In re Del-Met Corp.)*, 322 B.R. 781 (Bankr. M.D. Tenn. 2005).

12.1.xxxx. *In pari delicto* defense does not apply where only two of three directors participated in the breach of duty. The closely held debtor had three directors. Two of them formed a new corporation and diverted corporate opportunities and allowed the new corporation to use the debtor's assets for less than reasonably equivalent value. The trustee sued the two directors and the new corporation, who pleaded an *in pari delicto* defense, arguing that the debtor had caused the transfer of opportunities and assets. However, because fewer than all of the directors were involved in the breach of duty, the adverse interest exception applies, rebutting the presumption that the action of the debtor's agent should be imputed to the debtor. *O'Neil v. New England Road, Inc. (In re NERI Bros. Constr.)*, 323 B.R. 540 (Bankr. D. Conn. 2005).

12.1.yyyy. The *in pari delicto* defense is available against a bankruptcy trustee. All of the debtor's principals were convicted for operating a fraudulent business scheme. The trustee alleged that a stockbroker assisted in the scheme and thereby harmed creditors. The trustee sued and sought damages. The stockbroker moved to dismiss based on an *in pari delicto* defense. On appeal, the district court concluded that the First Circuit would allow that defense against a trustee in bankruptcy, who was not involved in the fraud, because the action against the stockbroker was property of the debtor that vested in the estate under section 541. It was therefore subject to all of the defenses that would be available if the debtor had brought the action before bankruptcy. The action was therefore dismissed. Creditors were not precluded, however, from pursuing individual actions against the stockbroker for any damages that they may have suffered. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Nickless (In re Advanced RISC Corp.)*, 324 B.R. 10 (D. Mass. 2005).

12.1.zzzz. The *in pari delicto* defense and its exceptions apply in a partnership case. Where the plaintiff participated in the wrongdoing of which it complains, the defendant may assert the *in pari delicto* defense against liability. When the defendant was an agent of the plaintiff, the adverse interest exception may apply: when the agent is acting in a manner adverse to the interests of the principal, the normal rule that an agent's knowledge is imputed to the principal might not apply. The Revised Uniform Partnership Act codifies this rule in section 102(f). The sole actor doctrine is an exception to the adverse interest exception: when the agent and the principal are one and the same, the agent's knowledge is imputed to the principal, despite the adverse interest exception. RUPA does not codify the sole actor doctrine, but it applies under RUPA section 104, which permits supplementing of RUPA's provisions with "principles of law and equity." In this case, the sole individual who controlled the sole general partner in numerous investment limited partnerships defrauded the limited partners and their partnerships. In their bankruptcy case, the general partner and the investment partnerships were substantively consolidated. When the trustee sued a third party who had facilitated the fraud, the third party successfully argued that the *in pari*

delicto doctrine applied, because the general partner masterminded the fraud. He also successfully argued that the sole actor doctrine applied, because, among other things, the individual in control of the general partner was the sole actor on behalf of the general partner and the investment limited partnerships, as the bankruptcy court had underscored by ordering substantive consolidation of the estates. *Grassmueck v. Am. Shorthorn Ass'n.*, 402 F.3d 833 (8th Cir. 2005).

12.1.aaaaa. Secured creditor receives both repaired collateral and insurance proceeds. The lender took cross-collateralized security interests in various aircraft engines and any insurance proceeds to secure several different loans. One engine was damaged. The debtor repaired it prepetition but did not seek insurance proceeds. After the chapter 11 case was filed, the lender repossessed the repaired engine. After the case converted to chapter 7, the trustee recovered the insurance proceeds. The lender claimed a security interest in the funds. The lender was entitled to both the engine and the insurance proceeds. Under UCC section 9-306(A), insurance proceeds are "proceeds" of collateral, even when the collateral has been repaired and has not been disposed of or otherwise transformed. Although UCC section 9-306 limits the creditor to only one satisfaction, on the facts of this case, the creditor was not receiving more. The creditor's other collateral had also been damaged, and overall, the creditor was undersecured. Therefore, receiving both the repaired engine and its proceeds did not amount to a double recovery. *Stanziale v. Finova Capital Corp. (In re Tower Air, Inc.)*, 397 F.3d 191 (3d Cir. 2005).

12.1.bbbbb. A postpetition crop disaster relief payment is not property of the estate. After the debtor filed bankruptcy, Congress enacted a crop disaster relief program for a prepetition crop year. The payment under the program was not property of the estate. The debtor's interest in the payment at the petition date was at most a "mere hope" that legislation would be enacted and therefore did not qualify under section 541(a)(1) as an interest of the debtor in property as of the commencement of the case. Moreover, because the payment was not made from proceeds of the non-existent crop, it did not qualify as property of the estate under section 541(a)(6), which "cannot retroactively create a property interest that did not exist at the commencement of the case." *Burgess v. Sikes (In re Burgess)*, 392 F.3d 782 (5th Cir. 2004).

12.1.ccccc. Court denies substantive consolidation of related debtors for lack of reliance. The debtors operated convenience store chains. Their principal also owned a nondebtor fuel supply company that supplied gasoline to the debtors. After the debtors' petition date, to secure its own obligations to Amoco Oil Co., the fuel supply company transferred to Amoco a lien that the fuel supply company had on the debtors' fuel inventory. Amoco then allowed the fuel supply company to provide the debtors in possession postpetition financing from funds otherwise payable to Amoco. When the debtors' business failed, Amoco asserted that its claim against the fuel supply company should be allowed as an administrative expense against the estate or that the debtors and the fuel supply company should be substantively consolidated, because Amoco dealt with them as a single economic unit. The court denies substantive consolidation, because consolidation should be used sparingly, especially to consolidate a nondebtor company with a debtor, which should be done only under the most unusual and compelling circumstances. Because Amoco dealt separately with the debtors and the fuel supply company, the affairs of the debtors and the fuel supply company were not entangled, and consolidation would harm the debtors' creditors, the court denies consolidation. *In re FAS Mart Convenience Stores, Inc.*, 320 B.R. 587 (Bankr. E.D. Va. 2004).

12.1.ddddd. Plan disbursing agent's claim against accountant is limited by debtor's fraud and creditor's privity with accountant. The debtor's management falsified the debtor's financial statements. The auditor performed its audits negligently and did not uncover the fraud. A minority creditor/stockholder was entitled to remove management based on financial statement triggers, but the fraudulent financial statements prevented the creditor from exercising its right to do so. Upon plan confirmation, the estate and the creditor each assigned their claims against the auditor to the plan disbursing agent to pursue on behalf of the general unsecured creditors. The disbursing agent's claims received from the estate, which received them under section 541 from the debtor, were limited by the *in pari delicto* doctrine. The court provides a thorough and detailed explanation of the operation of the doctrine, of the adverse interest exception to the doctrine, of the (so-called) innocent insider exception to the adverse interest exception, and of the sole actor rule. Similarly, the disbursing agent's claims received from the creditor may not be

pursued unless the creditor was in privity with the auditor or the auditor knew, and showed that it knew, the creditor would rely on its work for a particular purpose. *Ernst & Young v. Bankruptcy Servs., Inc. (In re CBI Holding Co.)*, 311 B.R. 350 (S.D.N.Y. 2004); *rehearing granted, bankruptcy court's opinion vacated, judgment for defendants*. The trustee did not prove the abandonment of the adverse interest exception necessary to claim in the right of the debtor against a third party. *Ernst & Young v. Bankruptcy Servs., Inc. (In re CBI Holding Co.)*, 318 B.R. 761 (S.D.N.Y.2004).

12.1.eeeee. Bill of sale recharacterized as secured financing. The debtor leased equipment to a third party lessee. It later assigned the lease to CIT, granted CIT a security interest in the equipment, executed a bill of sale purportedly transferring the equipment to CIT, and agreed to repurchase the equipment as is, where is, from CIT at the end of the lease term for the remaining loan balance on the equipment if the lessee did not exercise the lease's purchase option. CIT did not file a financing statement for the transaction. The debtor's bank, however, had filed a financing statement to perfect its security interest in all of the debtor's equipment. After the lease expired, the lessee did not purchase the equipment, and the debtor filed bankruptcy, CIT and the bank each claimed the proceeds of the later sale of the equipment. Despite the bill of sale, the debtor's transaction with CIT was a secured financing, not a sale, as evidenced in part by the grant of a security interest but more importantly by the back-end repurchase obligation. Because the bank's security interest was perfected and CIT's was not, the bank was entitled to the proceeds. *Stillwater Nat'l Bank & Trust Co. v. CIT Group/Equipment Fin., Inc.*, ___ F.3d ___ (10th Cir. 2004).

12.1.fffff. Asset non-disclosure results in judicial estoppel. The debtor was injured in a maritime accident one year before bankruptcy but did not disclose the claim in its schedules. He disclosed it at the 341 meeting, but said that it was barred by the statute of limitations. The trustee therefore did not pursue it and filed a no-asset report, which the bankruptcy court accepted. When the debtor pursued the action in state court, the defendant moved to dismiss on judicial estoppel grounds. Because judicial estoppel is designed to protect the court's integrity, it does not require the defendant's reliance. In this case, the claim is dismissed under judicial estoppel, because the debtor took clearly inconsistent positions, the bankruptcy court accepted the debtor's statute of limitations position, and the non-disclosure was not inadvertent. Even though the case was pending in state court, the federal (bankruptcy) judicial estoppel principles apply, because the debtor took the prior inconsistent position before the bankruptcy court. Without explanation, the court does not preserve the asset for the trustee or the debtor's creditors. *Superior Crewboats Inc. v. Primary P & I Underwriters*, 374 F.3d 330 (5th Cir. 2004).

12.1.ggggg. Debtor's malpractice claim arose postpetition and was not property of the estate. Before bankruptcy, the debtor sought alimony in state court. After bankruptcy, the state court ruled against the alimony request. The trustee sought to include the debtor's malpractice action against his divorce attorney as property of the estate. State law determines what interests in property the debtor has and when they arise; federal law determines what constitutes property of the estate. Under applicable state law, a legal malpractice claim does not accrue until the plaintiff suffers loss. In this case, that occurred after bankruptcy, so the asset is not property of the estate. *Witko v. Menotte (In re Witko)*, 374 F.3d 1040 (11th Cir. 2004).

12.1.hhhhh. Court refuses to impose constructive trust on tax refund. Before bankruptcy, the debtor and its subsidiaries entered into a tax sharing agreement, under which the debtor would pay taxes for the consolidated group, income producing subsidiaries would pay their share to the debtor, and the debtor would pay tax savings or refunds to the subsidiaries that produced the losses that gave rise to the savings or refunds. After bankruptcy, the trustee received a tax refund largely attributable to the debtor's insurance company subsidiary, which was in liquidation. The insurance company's receiver sought to impose a constructive trust on the refund. The court, construing New York law, concludes that the presence of a written agreement precludes the imposition of a constructive trust, that there was no fraud or inequitable conduct that would justify its imposition, and that the interposition of bankruptcy requires courts to act cautiously before imposing a constructive trust, especially in this context. Although the estate was enriched, it was not enriched unjustly. "[T]he short—and conclusive—answer is that this is not injustice, it is bankruptcy." That is, bankruptcy defeats most contractual expectations, and that does not

give rise to a right to a constructive trust. *Superintendent of Ins. v. Ochs (In re First Central Fin. Corp.)*, 377 F.3d 209 (2d Cir. 2004).

12.1.iiiii. Trustee does not succeed to breach of fiduciary duty claims as an avoiding power. The reorganization plan appointed a liquidating trustee as an estate representative to succeed to all causes of action under the avoiding powers in chapter 5 of title 11, but not to actions that were property of the estate under section 541. The liquidating trustee brought an action under section 544 against a former officer and director of the debtor. The trustee asserted the director breached his fiduciary duty by orchestrating a payment to a joint venture, where the director was also a director of one of the companies in the joint venture. The trustee did not have standing to pursue the action, because section 544(b) grants the trustee only the power to "avoid any transfer" of the debtor's property. Because the action for breach of fiduciary duty belongs to the corporation as a matter of state law, it did not vest in the liquidating trustee. Moreover, section 550 provides the sole remedy for an action avoiding a transfer. Because the defendant here was neither the initial transferee or a person for whose benefit the transfer was made, the trustee did not have a remedy and therefore did not have an avoiding power of claim. *Savage & Associates, P.C. v. BLR Services SAS (In re Teligent, Inc.)*, 307 B.R. 744 (Bankr. S.D.N.Y. 2004).

12.1.jjjjj. Debtor's pension interest that is subject to IRS lien is not property of the estate. Under ERISA and the Supreme Court's decision in *Patterson v. Shumate*, 504 U.S. 753 (1992), the debtor's interest in an ERISA qualified pension plan does not become property of the estate, because the plan contains anti-alienation language and section 541(c)(2) excludes from property of the estate the debtor's interest in any property if it is subject to an enforceable non-bankruptcy law restriction on transfer. However, the IRS tax lien takes precedence over the ERISA transfer limitation, and the IRS tax lien attaches to the debtor's interest in the pension plan. When the debtor files a chapter 13 case, if the pension interest becomes property of the estate, the IRS has a secured claim under section 506(a) and must be paid in full over the term of the plan. Otherwise, the IRS has only an unsecured claim in the case (though its lien will survive against the pension plan outside of bankruptcy), and its claim may be paid in part and discharged. The Ninth Circuit rules that the debtor's interest in the pension plan is not property of the estate. The ERISA restriction on transfer is generally enforceable. Even though it is not enforceable against the IRS, the unenforceability against a single creditor does not cause the property to become property of the estate. *United States v. Snyder*, 343 F.3d 1171 (9th Cir. 2003).

12.1.kkkkk. A breach of fiduciary duty claim against directors is property of the estate. Minority shareholders brought claims against preferred shareholders and individual directors for breach of fiduciary duty in rejecting valuable offers to purchase the company and for imposing a refinancing that was expensive and not market tested. Because the damage from the alleged actions was to the corporation, rather than only to the minority shareholders, the action is a derivative action, which is an asset of the corporation and therefore an asset of its bankruptcy estate. Any recovery would be distributed in accordance with the Bankruptcy Code, first to creditors before payment to shareholders. Therefore, the district court properly dismissed the complaint. *Kennedy v. Venrock Assocs.*, 348 F.3d 584 (7th Cir. 2003).

12.1.lllll. Creditors' trust succeeds to debtor's actions against directors. The debtor in possession brought adversary proceedings against its directors and shareholders for a variety of claims, including breach of fiduciary duty to the corporation. Upon confirmation of the plan, the claims transferred to a creditors' trust. The alleged breach of duty occurred while the corporation was solvent, so the defendants argued that the creditors' trust, acting on behalf of creditors, could not maintain the action. The First Circuit holds, however, that the creditors' trust succeeds to the rights of the debtor in possession, who sues in the name of the debtor. As such, recoveries are for the benefit of the corporation, which are paid first to creditors because the breached obligation was owed to the corporation. *Liston v. Gottsegen (In re Mi-Lor Corp.)*, 348 F.3d 294 (1st Cir. 2003).

12.1.mmmmm. Court denies substantive consolidation because of prejudice to creditors. The parent holding company and two subsidiaries shared some officers and directors, guaranteed loans, and made intercompany loans without adequate documentation. The creditors' committee moved for substantive consolidation, which would have substantially decreased the recovery of creditors of two of the

entities. In the Eighth Circuit, substantive consolidation requires a showing of necessity due to the inter-relationship among the debtors, that the benefits of consolidation outweigh the harms to creditors, and prejudice resulting from not consolidating. *In re Giller*, 962 F.2d 796 (8th Cir. 1992). This case did not meet that standard, because of the substantial prejudice to creditors from consolidating and the absence of prejudice from not consolidating to creditors who relied on the true relationship. *In re Huntco Inc.*, 302 B.R. 35 (Bankr. E.D. Mo. 2003).

12.1.nnnnn. Funds from a provisionally honored check funded into a trust account is property of the estate. The debtor was a title company, which maintained trust accounts for receipt and disbursement of funds. One of its customers tendered an NSF check, which the bank provisionally honored. The debtor issued a check to the party entitled to the funds, and that check cleared the debtor's trust account bank account before the deposited check was returned NSF. The court construes the provisional honoring of the deposited check as a provisional loan from the bank to the debtor, relying on *In re Cannon*, 277 F.3d 838 (6th Cir. 2002). It concludes that the funds were not held in trust, even though they were deposited in the trust account, because they were proceeds of a loan from the bank rather than a deposit by the customer. Accordingly, the check to the payee was paid from property of the debtor, and the trustee may recover the transfer if the other elements of the avoiding power cause of action are met. *Dayton Title Agency, Inc. v. The White Family Companies (In re Dayton Title Agency, Inc.)*, 292 B.R. 857 (Bankr. S.D. Ohio 2003).

12.1.ooooo. Specially designated funds do not become property of the estate. The debtor installed and maintained advanced telecommunications services for the public schools. Under the 1996 Telecommunications Act, the government reimburses a school for installation and maintenance costs that it had paid to the debtor by paying the debtor. Under federal regulations, the debtor is required to forward the payment to the school within ten days. Upon bankruptcy, the trustee sought to recover the payment from the government and not pay it to the school. The First Circuit directs that the payment go to the school. First, the court looks to the role that the debtor was intended to play, which was merely a vehicle for delivering reimbursement to the school. Second, the regulatory controls in place required immediate pay over of the funds and prohibited the debtor from making use of any of the funds. Third, recognizing a greater ownership interest in the debtor would defeat the regulatory purpose. Finally, the court recognized that the debtor could not sue the government directly for the payment, because it had already been paid. The court eschewed the use of any trust language in reaching its conclusion, as possibly confusing. *Springfield v. Ostrander (In re LAN Tamers, Inc.)*, 329 F.3d 204 (1st Cir. 2003).

12.1.ppppp. Interest of debtor as sole member of LLC passes to the trustee. The debtor was the sole member of a limited liability company. The debtor argued that upon bankruptcy, the trustee was entitled to a charging order on the LLC interest but not the interest itself. The court disagrees, holding that the trustee takes all of the debtor's interest. Although the applicable Colorado statute provides for a charging order in the case of the bankruptcy of an LLC member, the court rules that the provision is intended only to protect other LLC members. In this case, where there are none, the trustee is entitled to the interest and may then manage and dissolve the LLC as the trustee chooses. *In re Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003).

12.1.qqqqq. Property held by Qualified Like-kind Exchange Intermediary must be conveyed to the buyer. The debtor was a Qualified Intermediary for like-kind exchange transactions under section 1031 of the Internal Revenue Code. Its client had completed all of its obligations under the like-kind exchange agreement. The only remaining performance at the time of the debtors bankruptcy was for the debtor to convey the purchased real property to the client. On the client's complaint for specific performance, the court rules that the like kind exchange contract is no longer an executory contract, because the only remaining performance is the transfer of title and because the trustee held only bare legal title to the property. Accordingly, the court orders specific performance. *Manty v. Miller & Holmes, Inc. (In re Nation-wide Exchange Services)*, 291 B.R. 131 (Bankr. D. Minn. 2003).

12.1.rrrrr. Substantive consolidation survives *Grupo Mexicano*. In *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund*, 527 U.S. 308 (1999), the Supreme Court ruled that without statutory authorization, the equity power of a federal court does not extend beyond remedies that were historically

available from a court of equity in 1789. Because substantive consolidation is an equitable remedy that the bankruptcy court imposes, the equity committee objected to a plan providing for substantive consolidation. The bankruptcy court rules that the *Grupo Mexicano* rationale does not apply to substantive consolidation. The remedy was recognized by the Supreme Court in 1941 in *Sampsell v. Imperial Paper and Color Corp.*, 313 U.S. 215 (1941). Moreover, the power to order substantive consolidation is to insure equitable treatment of all creditors as consistent with the bankruptcy court's general equitable powers. It is also contemplated under section 1123(a)(5)(C), which permits a plan to provide for "merger or consolidation of the debtor with one or more persons." *In re Stone & Webster, Inc.*, 286 B.R. 532 (Bankr. D. Del. 2002).

12.1.sssss. Escrowed funds are not property of the debtor. The debtor lawyer maintained a client trust account for real estate closings. He misappropriated funds to invest in commodity futures. After his scheme collapsed and he filed for bankruptcy, the trustee sued the commodity brokerage for fraudulent transfer and for damages relating to fraud in connection with the commodity investments. The Sixth Circuit rules that the escrowed funds were not property of the debtor, because the debtor held bare legal title and no equitable interest. Even though the debtor converted the funds to his personal use by reason of the misappropriation, the debtor did not thereby obtain title to the property. What is more, the trustee did not have standing to claim damages from the commodity broker, because the damages were suffered by the beneficiaries of the escrow account, not by the debtor. *Stevenson v. J.C. Bradford & Co. (In re Cannon)*, 277 F.3d 838 (6th Cir. 2002).

12.1.ttttt. Pre-petition security interest continues in post-petition fees. The debtor was a member of a law partnership which had done substantial work on a contingent fee matter. The law firm had granted a security interest in the contingent fee to the bank. During the litigation, the attorney filed a personal bankruptcy, dissolving the partnership. He reached an agreement with his former partners to take over the litigation in exchange for two-thirds of the contingent fee. The litigation was subsequently resolved. The bank claimed its security interest in the entire fee. The court of appeals upholds the bank's position on the ground that the transfer of the contingent fee receivable from the law firm, which had granted the security interest, to the individual lawyer did not extinguish the bank's interest, under former U.C.C. section 9-306. Although the attorney had performed substantial work on the matter after bankruptcy, the court found that the funds had been received before bankruptcy and the commitment of the security interest did not indicate that the receipt of the funds was contingent on the performance of substantial further legal services, so the assignment of the potential receivable did not prevent the bank from receiving the entire contingent fee. *Cadle Company v. Schlichtmann*, 267 F.3d 14 (1st Cir. 2001).

12.1.uuuuu. Third Circuit recognizes claim for "deepening insolvency." Standing in the shoes of the debtor, the creditors' committee sued the debtor's accountant for its participation in a Ponzi scheme that resulted in substantially deepening the insolvency of the debtor and unnecessarily prolonging the debtor's business life. Attempting to apply Pennsylvania law, the Third Circuit rules that a tort cause of action for deepening insolvency can be pursued by the corporation if it was harmed by the actions of others. In this case, however, the court concludes that the debtor was in *pari delicto* with the accounting firm and therefore cannot pursue the claim. *Official Committee of Unsecured Creditors v. R. F. Lafferty & Co., Inc.*, 267 F.3d 340 (3d Cir. 2001).

12.1.vvvvv. Assets re-vest in estate after post-confirmation conversion. The confirmed plan provided for the establishment of a liquidating corporation, which would liquidate assets and distribute them to creditors pro rata based on their claims. The plan did not specifically provide what would happen to the assets remaining in the liquidating corporation if the case were converted to chapter 7 after confirmation. The Ninth Circuit rules that the assets re-vest in the chapter 7 estate, even though plan confirmation typically terminates the existence of the estate under section 1141. *Pioneer Liquidating Corp. v. United States Trustee (In re Consolidated Pioneer Mortgage Entities)*, 264 F.3d 803 (9th Cir. 2001).

12.1.wwwww. State choice of law rules apply. A New York liquidator in a New York bankruptcy case of a Boston-based law firm filed an action against Idaho clients to collect fees earned by Boston partners in the law firm. The court of appeals rules that the New York bankruptcy court that heard the suit should

apply the same choice of law rules that a New York state court would apply, unless there was a compelling federal interest in the action. Because the action was based solely on state law and found its way to federal court only because the law firm had filed bankruptcy, the choice of law rules of the forum state apply *Bianco v. Erkins (In re Gaston & Snow)*, 243 F.3d 599 (2d Cir. 2001).

12.1.xxxxx. Ninth Circuit adopts broad substantive consolidation rules. Raejean Bonham operated a Ponzi scheme in her own name and through two wholly-owned corporations, whose separate existence was never preserved and which did not file bankruptcy petitions. The trustee sought substantive consolidation to bring preference and fraudulent transfer claims against investors who had been repaid by the corporations in the Ponzi scheme. In approving the bankruptcy court's substantive consolidation order, the Ninth Circuit (1) adopts the Second Circuit's *Augie/Restivo*, 860 F.2d 515 (2d Cir. 1988), test of whether the creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit <u>or</u> whether the affairs of the debtor are so entangled that consolidation will benefit all creditors; (2) measures "harm" as harm to the entity being consolidated, not to investors, so that inability to recover fraudulent transfers and thereby equitably distribute assets would constitute harm; (3) adopts the more restrictive and sparing view of consolidation, contrary to the Eleventh Circuit's view permitting more frequent consolidation; (4) authorizes substantive consolidation for the sole purpose of preserving the trustee's avoiding powers; (5) permits *nunc pro tunc* consolidation, effective as of the date of the petition; and (6) permits consolidation between the debtor and non-debtor affiliates. *Alexander v. Compton (In re Bonham)*, 229 F.3d 750 (9th Cir. 2000).

12.1.yyyyy. A trust cannot have an "alter ego." The debtor's wife had created an irrevocable trust under which she was the sole trustee and the debtor was one of the beneficiaries. The court rejected a theory that the debtor was the alter ego of the trust on the grounds that the trust "is fundamentally a relationship" and does not have a separate existence as a legal entity. *Babitt v. Vebeliunas (In re Vebeliunas)*, 252 B.R. 878 (Bankr. S.D.N.Y. 2000).

12.1.zzzzz. Property of the reorganized debtor does not vest in the post-confirmation chapter 7 estate. Several years after confirmation of the plan, the court converted the chapter 11 case of the debtor to a case under chapter 7. The trustee sought recovery of property that had been property of the chapter 11 estate. Holding that the property of the chapter 11 estate had fully revested in the reorganized debtor, the B.A.P. concludes that the reorganized debtor's property did not become property of the chapter 7 estate upon conversion. As an alternative, the B.A.P. suggests an involuntary petition against the reorganized debtor, rather than conversion, as a means of bringing property into the chapter 7 estate. *Harker v. Troutman (In re Troutman Ents., Inc.)*, 253 B.R. 1 (6th Cir. B.A.P. 2000).

12.1.aaaaaa. Partner's interest in partnership became property of the estate even though partner continued in the partnership. A partner in a law firm filed a voluntary chapter 7 petition but continued as a partner in the firm thereafter. The partner's interest in the partnership became property of the estate as of the date of the petition, and the partnership was liable to the chapter 7 trustee for the value of that interest even though the trustee did not pursue the partnership until after year-end distributions had been made. *Beaman v. Shearin (In re Shearin)*, 224 F.3d 346 (4th Cir. 2000); *Beaman v. VanDebenter Black, L.L.P. (In re Shearin)*, 224 F.3d 353 (4th Cir. 2000).

12.1.bbbbbb. Malpractice claim for filing the wrong petition is property of the estate. The debtor's attorney was supposed file a chapter 11 petition but mistakenly filed a chapter 7 petition instead. The debtor sued the attorney for malpractice. The Court of Appeals rules that the malpractice claim became property of the estate, because the malpractice claim accrued upon the filing of the petition. Section 541(a)(1) includes in the estate an interest of the debtor in property "as of" the commencement of the case. Because the malpractice claim arose as of the commencement of the case, it belonged to the estate, not the debtor. *Johnson, Blakely, Pope, Bokor, Ruppel & Burns, P.A. v. Alvarez (In re Alvarez)*, 224 F.3d 1273 (11th Cir. 2000).

12.1.cccccc. Embezzled funds do not become property of the estate. The debtor embezzled funds from a corporation in which he was a 50% shareholder. The embezzled funds did not become property of his estate, because a thief does not take title to stolen property. The court contrasts embezzlement (a

form of larceny) with false pretenses, on the grounds that the victim of larceny never intends to part with title to the property. However, goods that the debtor purchased with the embezzled funds become property of the estate, because the debtor actually obtained legal title to the goods, even though the debtor obtained no equitable interest in them. *Kitchen v. Boyd (In re Newpower)*, 233 F.3d 922 (6th Cir. 2000).

12.1.dddddd. Property obtained as an agent does not become property of the estate. The creditor gave the debtor a check, which the debtor was supposed to loan to a corporation jointly owned by the debtor and the creditor. The debtor instead embezzled the funds. The court held that the creditor was entitled to a return of the money because the debtor was the creditor's agent for the purpose of making the loan to the corporation, and property that the debtor holds as an agent never becomes property of the state, because an agent never takes title as against his principal. *Kitchen v. Boyd (In re Newpower)*, 233 F.3d 922 (6th Cir. 2000).

12.1.eeeeee. Former community property is not property of the estate. The debtor and his former spouse partitioned their community property in a divorce action before the debtor filed bankruptcy. The trustee argued that because the partitioned property remained liable for community debts incurred before the divorce, the now-separate property of the former spouse became property of the estate under section 541(a)(2)(B), which makes interest of the "debtor's spouse and community property as of the commencement of the case that is liable for an allowable [community] claim." The Fifth Circuit rejects the trustee's argument, holding that because the property was already the separate property of the former spouse before bankruptcy, it did not become property of the estate. *Andersen v. Conine (In re Robertson)*, 203 F.3d 855 (5th Cir. 2000).

12.1.ffffff. Court registry funds are not property of the estate. The Ninth Circuit rules that funds deposited by the debtor prepetition into the registry of the district court to secure the debtor's obligation to pay a potential future judgment in a civil action did not become property of the estate upon the filing of the bankruptcy, because the prepetition jury verdict and judgment, as well as the court's unentered order releasing the funds to the plaintiff, all occurred prepetition, divesting the debtor of any interest in the funds before the bankruptcy petition was filed. *McCarthy, Johnson & Miller v. North Bay Plumbing, Inc. (In re Pettit)*, 217 F.3d 1072 (9th Cir. 2000).

12.1.gggggg. A restaurant debtor may be subject to PACA claims. Under the Perishable Agricultural Commodities Act, certain purchasers of perishable agricultural commodities such as brokers and dealers are subject to a floating trust on all of their assets in favor of unpaid produce suppliers. In a case of first impression at the court of appeals level, the Third Circuit holds that a restaurant that purchases products in wholesale or jobber quantities is a "dealer" within the meaning of the act. *Magic Restaurants, Inc. v. Bowie Produce Co., Inc. (In re Magic Restaurants, Inc.)*, 205 F.3d 108 (3d Cir. 2000).

12.1.hhhhhh. Technical abandonment under section 554(c) may be revoked under Rule 60(b). Reviewing the various approaches to the effect of reopening a case under section 350(b) on a technical abandonment under section 554(c), the Tenth Circuit rejects all reported rationales (discretionary, automatic, or irrevocable) in favor of a rule that permits revocation under Rule 60(b) for a mistake or inadvertence. *Woods v. Kenan (In re Woods)*, 173 F.3d 770 (10th Cir. 1999).

12.1.iiiiii. Inadvertent failure to disclose claim may create judicial estoppel. The debtor did not disclose a potential claim against an unsecured creditor in its schedules or in a list of assets attached to a stipulation for relief from the stay with a secured creditor. The failure to disclose, though perhaps inadvertent, created a judicial estoppel against the debtor, preventing it from taking a position inconsistent with the absence (that is, nondisclosure) of the claim. The claim against the unsecured creditor was therefore dismissed. *Browning Manufacturing v. Mims (In re Coastal Plains, Inc.)*, 179 F.3d 197 (5th Cir. 1999).

12.1.jjjjjj. Bankruptcy trustee is first in line in claims against defrauding principals. Where a numerous individual creditors of the debtor asserted claims against the former principals of the debtor for claims arising out of their fraud and the trustee on behalf of the estate asserted "claims to the same limited pool of money, in the possession of the same defendants, as a result of the same act, performed

by the same individuals, as part of the same conspiracy," the bankruptcy court properly enjoined the creditors' action to allow the trustee to proceed first. Although the claims by the individual creditors were not property of the estate, their pursuit would interfere with the trustee's claim and could be enjoined. *Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998).

12.1.kkkkkk. Trustee may pursue assigned claims. A trustee may pursue, for the benefit of all creditors, claims assigned to the trustee postpetition by fewer than all of the general unsecured creditors. The property comes into the estate under section 541(a)(7), and the recovery is for the benefit of all creditors, not just the assignors. *Steinberg v. Kendig (In re Ben Franklin Retail Stores, Inc.)*, 225 B.R. 646 (Bankr. N.D. Ill. 1998).

12.1.llllll. Court limits assignability of avoiding power claims. The debtor's liquidating plan assigned the right to bring all avoiding power actions to the debtor's sole secured creditor, for no additional consideration. The court rules that because there is no benefit to the estate or unsecured creditors, the assignment is invalid and the creditor does not have standing to bring the action. *SouthTrust Bank, N.A. v. WCI Outdoor Products, Inc. (In re Huntsville Small Engines, Inc.)*, 228 B.R. 9 (Bankr. N.D. Ala. 1998).

12.1.mmmmmm. Collected sales taxes constitute a trust fund. The debtor collected Texas sales taxes from its customers before bankruptcy but failed to pay the taxes to the state once the petition was filed. The Ninth Circuit holds that under Texas law, the funds collected before bankruptcy constitute trust funds, using the lowest intermediate balance test as a tracing rule, and rejecting the debtors argument that only voluntary payment of commingled funds identifies the trust res. Nevertheless, even though the funds were property of the state, the debtor was liable to the state for the statutory rate of interest on the unpaid taxes, not just the interest earned on the state's funds, and the interest would be allowed as an administrative expense. *Texas Comptroller of Public Accounts v. Megafood Stores, Inc. (In re Megafood Stores, Inc.)*, 163 F.3d 1063 (9th Cir. 1998).

12.1.nnnnnn. Post-petition contingent fee payment may be property of the estate. The debtor, an attorney, entered into a contingent fee agreement before bankruptcy. Seventy-five percent of the services were performed before bankruptcy. Based on the conclusion of the services after bankruptcy, a large fee was awarded. The Bankruptcy Appellate Panel awarded 75% of the fee to the trustee. Even though post-petition services were required to obtain the contingent fee, the B.A.P. split the proceeds based on the percentage of work performed pre-petition and post-petition. *Jess v. Carey (In re Jess)*, 215 B.R. 618 (9th Cir. B.A.P. 1997).

12.1.oooooo. Malpractice claim arises pre-petition and is property of the estate. The debtor was indicted and convicted for nondisclosure of significant assets in his bankruptcy filing, giving rise to a malpractice claim against his attorney. Rejecting the analysis of *In re M. Frenville, Co.*, 744 F.2d 332 (3d Cir. 1984), the Fifth Circuit rules that the malpractice claim against the attorney arose pre-petition, when the debtor should have discovered the malpractice, rather than upon the occurrence of the injury, which under Mississippi law was at the time of the indictment. As a result, the claim is property of the estate. Only the trustee, not the debtor, may pursue it. *Wheeler v. Magdovitz (In re Wheeler)* 137 F.3d 299 (5th Cir. 1998).

12.1.pppppp. Post-petition, prejudgment tort claims are property of the estate, but may not be sold. Employees of the debtor committed business torts against the debtor-in-possession. Another company bought all of the assets of the estate from a subsequently appointed bankruptcy trustee and sued the former employees for the torts. In a confused reading of the bankruptcy law, the Third Circuit holds that notwithstanding state law restrictions on transferability of prejudgment tort claims, the tort claims became property of the estate. The Third Circuit saw no purpose in distinguishing between pre- and post-petition tort claims in this case. The court went on to hold that although section 541 makes the claims property of the estate, the trustee may not sell the claims contrary to New Jersey state law. A simpler solution would have been to compare section 541(c), which pre-empts state anti-assignment law, with section 363(l), which does not. *Integrated Solutions, Inc. v. Serv. Support Specialties, Inc.*, 124 F.3d 487 (3d Cir. 1997).

12.1.qqqqqq. Proceeds of letter of credit may constitute property of the estate. Prepetition, the debtor's potential long-term lender drew on a letter of credit issued by the debtor's bank to fund a commitment fee for the potential loan. The loan never closed, and the bankruptcy trustee sought recovery of the commitment fee from the potential lender as property of the estate. Holding first that the doctrine of independence does not apply because the action was against the recipient of the draw, the Sixth Circuit concludes that the trustee may seek recovery from the potential lender under section 542 (turnover of property of the estate) to the extent that the commitment fee was unearned. *Demczyk v. Mut. Life Ins. Co. of New York (In re Graham Square, Inc.)*, 126 F.3d 823 (6th Cir. 1997).

12.2 Turnover

12.2.a. Turnover under section 542 does not apply to an action to collect a debt for unjust enrichment. The trustee sued the defendants under section 542(a) for turnover under an unjust enrichment theory. Section 542(a) requires an entity "in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 … [to] deliver to the trustee, and account for, such property". By contrast, section 542(b) requires "an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order [to] pay such debtor to, or on the order of, the trustee". A third party's debt to the debtor for unjust enrichment becomes property of the estate under section 541(a)(1). Such a claim is not matured, payable on demand or payable on order, so section 542(b) does not apply. Section 542(a) does not apply to an action to collect a debt. Therefore, the trustee may not recover against the defendants in a turnover proceeding. *Lovald v. Falzerano (In re Falzerano)*, 454 B.R. 81 (8th Cir. B.A.P. 2011).

12.2.b. 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).

12.2.c. Court orders turnover of letter of credit proceeds to the estate. The debtor sold and leased back property to its lessor. The lessor financed the purchase price with a lender. The lease required that the debtor obtain a standby letter of credit to secure damages payable upon breach of the lease. The lessor assigned the letter of credit to the lender. When the debtor filed bankruptcy and breached the lease, the lessor's lender drew on the letter of credit. The amount drawn exceeded the lessor's conceded damages arising from the debtor's breach of the lease. The debtor in possession may obtain turnover from the lender of the excess as property of the estate. The letter of credit was to secure only the debtor's obligation to the lessor under the lease, not the lessor's obligation to the lender. Therefore, neither the lessor nor the lender is entitled to the benefit of a letter of credit draw in excess of the amount the debtor owes as damages under the lease. The turnover order does not implicate the independence principle,

because it does not interfere with the bank's payment on the draw. The court does not address, however, how letter of credit proceeds the bank paid to the lender are property of the debtor and therefore of the estate. *Two Trees v. Builders Transport, Inc. (In re Builders Transport, Inc.)*, 471 F.3d 1178 (11th Cir. 2006).

12.2.d. Trustee may not use turnover action to recover a disputed unsecured claim. The trustee brought a turnover action against the debtor's credit card processor for amounts that the processor had collected but not paid over to the debtor or the estate. The processor claimed various recoupments and offsets arising out of fees and chargebacks. The court dismisses the trustee's complaint, because the processor does not hold property of the estate. When a customer uses a credit card to pay for the debtor's goods or services, the customer's credit card bank pays the processor, who becomes liable to the debtor for the amount charged, subject to any charges or chargebacks allowable under the processing agreement. The processor does not thereby receive any property of the debtor. Accordingly, the trustee may not assert a turnover claim under section 542(a). The trustee may not assert a turnover claim under section 542(b) in this case either. That section requires "an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order" to pay the debt to the trustee. Where, however, there is a material dispute about the third party's debt or its amount, the debt does not qualify as "matured, payable on demand, or payable on order," and the trustee may purse the claim against the third party only under a breach of contract theory. *Leonard v. Optimal Payments Ltd. (In re Nat'l Audit Defense Network)*, 332 B.R. 896 (Bankr. D. Nev. 2005).

12.2.e. Attorney's files are subject to turn-over. The buyer of the debtor's assets joined the debtor in seeking turn-over from the debtor's lawyers of their papers relating to litigation against the buyer's affiliate. The Purchase Agreement provided for the buyer to have access to the documents. Rejecting the lawyers' arguments, the court rules that section 542(e) applies to the files, even though all of the debtor's assets have been sold to the buyer, because section 542(e) applies regardless of whether the documents are property of the estate. In addition, the lawyers did not have liens on the files and were required by state bar rules to turn over client files upon termination of an engagement. Therefore, the court ordered turn-over without payment of any of the lawyers claims. *American Metrocomm Corp. v. Duane Morris & Heckscher LLP (In re American Metrocomm Corp.)*, 274 B.R. 641 (Bankr. D. Del. 2002).

12.2.f. Use of subpoenaed documents turned over under Rule 2004 is limited. A receiver had seized all of the debtor's documents before the filing of an involuntary bankruptcy petition. The trustee sought turnover of the documents under Rule 2004 from the receiver. The court overruled the debtor's Fourth Amendment and Fifth Amendment objections to the request, holding that Fifth Amendment protection ended when the debtor turned the documents over to the receiver. But the court limited the trustee's ability to share the documents with any third party without prior approval of the court or in response to a search warrant or subpoena issued by another court. *In re Lufkin*, 255 B.R. 204 (Bankr. E.D. Tenn. 2000).

12.2.g. Trustee may use turnover power of section 542 to obtain property after avoiding a transfer. The trustee avoided an unrecorded leasehold under section 544(a), which merged with the estate's fee interest in the property, so that the estate had unencumbered title to the property. The trustee may seek turnover under section 542 instead of recovery of the property transferred under section 550(a), because the automatic preservation of section 551 had already rendered the entire property as property of the estate. *Dunes Hotel Assocs. v. Hyatt Corp.*, 245 B.R. 492 (D.S.C. 2000).

12.2.h. Debtor held in contempt for failure to revoke asset protection trust. The bankruptcy court found it incredible that the debtor would irrevocably transfer 90% of his net worth to an off shore asset protection trust with no ability to recover the trust res, and thus held the debtor in civil contempt with a fine of $10,000 per day plus incarceration until the debtor complied with the bankruptcy court's turnover order. *In re Lawrence*, 238 B.R. 498 (Bankr. S.D. Fla. 1999).

12.2.i. Turnover power may not be used to recover property transferred pre-petition. A fifty percent shareholder used $40,000 of the corporation's funds and $90,000 of his own to purchase the corporation's note to the bank. The debtor later filed a bankruptcy. The trustee could not recover the

$40,000 from the shareholder because he was no longer in possession of the debtor's funds when the adversary proceeding was brought. *Hager v. Gibson*, 109 F.3d 201 (4th Cir. 1997).

12.2.j. Lack of knowledge of source of funds is not a defense to a turnover proceeding. A law firm received a deposit from a corporation, which filed bankruptcy four days later. The corporation's principal asked for a return of the money, advising the law firm (who knew about the bankruptcy) that the money had come from the individual. The law firm returned the funds to the individual, but was later required to account for the value of the funds to the bankruptcy trustee because the law firm had enough knowledge to place a reasonable person on notice that the property might have belonged to the debtor. *Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (In re U.S.A. Diversified Products, Inc.)*, 100 F.3d 53 (7th Cir. 1996).

12.3 Sales

12.3.a. Sale contract actual damages clause invalidates liquidated damages clause. The debtor in possession contracted with a bidder for a sale of substantially all of the property of the estate. The sale procedures provided that if the successful bidder failed to close, its good faith deposit "shall be retained by the Debtors … without prejudice to the Debtors' ability to seek to recover additional damages". The bidder breached the contract and failed to close. The debtor in possession quickly sold the assets to another bidder for a higher price. The breaching bidder claimed for return of its deposit; the liquidating trustee sued for breach of contract and a declaration that it was entitled to retain the deposit. A contract for the sale of property may contain a liquidated damages provision, but New York law disregards a liquidated damages provision where a contract contains both that and an actual damages provision. The bid procedures provision permitting the debtor in possession to seek to recover additional damages is an actual damages provision, because it does not limit damages to the good-faith deposit. Therefore, the court disregards the liquidated damages and requires the estate to prove actual damages to retain any portion of the good-faith deposit. *Brown Publishing Co. Liquidating Trust v. Brown Media Corp. (In re Brown Publishing Co.)*, 486 B.R. 46 (Bankr. E.D.N.Y. 2013).

12.3.b. Section 363(b)'s business judgment rule applies to an order authorizing reimbursement of a bidder's expenses. The debtor in possession proposed to sell assets that were difficult to evaluate. To encourage potential second round bidders, it sought court approval to reimburse their due diligence expenses. Section 363(b) authorizes a debtor in possession to use property of the estate outside the ordinary course of business, subject to court approval under a business judgment standard. By contrast, section 503(b) allows as an administrative expense only actual costs and expenses that are necessary to preserving the estate. Section 363(b) applies where the debtor in possession seeks to make discretionary use of the estate's assets. Section 503(b) applies to third parties who have already incurred expenses without prior court authorization. Therefore, in this case where the debtor in possession sought prior approval, the section 363(b) standard applies. *ASARCO, Inc. v. Elliott Mgmt. (In re ASARCO, L.L.C.)*, 650 F.3d 593 (5th Cir. 2011).

12.3.c. A land swap is not a sale. The debtor owned two parcels of land, both of which were subject to the bank's security interest. The debtor in possession proposed to exchange one parcel for another parcel that was owned by the city. Section 363(b) authorizes the use, sale or lease of property of the estate outside of the ordinary course of business. Any such use, sale or lease is subject, under section 363(e), to a secured lender's right to adequate protection. The Code does not define "sale". It defines "transfer" as any mode of disposing of an interest in property. Section 1123 authorizes a plan to provide for the transfer of property. The difference suggests that "transfer" is broader than "sale". In addition, the debtor in possession here did not provide adequate protection of the lender's interest. Therefore, the court denies authorization for the land swap. *In re EQK Bridgeview Plaza, Inc.*, 447 B.R. 775 (Bankr. N.D. Tex. 2011).

12.3.d. Court refuses to reopen regularly conducted auction for higher bid. The court approved bid procedures involving an out-of-court auction of an assets of the estate. The bid procedures provided that bids would not be accepted after the auction was closed but that the DIP would be deemed to have accepted a bid only upon court approval. The debtor in possession's counsel conducted the auction at his office. The bidding proceeded for nearly 12 hours, and all bidders rested after being given an opportunity

to increase their bids. There were no irregularities at the auction. The DIP filed a notice of winning bidder two days later, as required by the bid procedures order, and the court held a hearing on the sale five days after that. At the hearing, a disappointed bidder offered more than the winning bid, based on new information that the disappointed bidder could have learned before but did not learn until after the auction. A court may reopen an auction where there are irregularities in the auction procedures, where the price is grossly inadequate, where complexity prevented a clear winner from emerging or where the bid procedures expressly authorize it. Otherwise, a court should not reopen bidding even to obtain a higher price for the estate, because doing so undermines bidder expectations, encourages bidders to hold their best bids until the court approval hearing after the auction and undercuts confidence and faith in the integrity of the judicial system. The court therefore refuses to reopen the bidding. It suggests that problems could be averted by holding all auctions before the court, where the judge would act as auctioneer. *In re Bigler, LP*, 443 B.R. 101 (Bankr. S.D. Tex. 2010).

12.3.e. A proposed compromise of a litigation claim is a sale to which section 363 applies. The trustee pursued the debtor's wife and two corporations owned by the wife under fraudulent transfer, reverse veil-piercing and constructive trust theories. The trustee sought court approval under Rule 9019 of a settlement with the defendants. The creditor who held over 85% of the unsecured claims objected and offered substantially more to buy the claims from the estate. Section 363(b) permits the trustee to sell property of the estate. The proposed compromise would have effected a disposition of property of the estate, in effect, a sale of the claim to the defendants. Therefore, section 363(b) applies, in addition to Rule 9019. If a potential buyer offers more than the proposed settlement amount, the must court consider the higher offer. *The Cadle Co. v. Mims (In re Moore)*, 608 F.3d 253 (5th Cir. 2010).

12.3.f. Court prohibits sale because of inability to provide adequate protection of non-economic interests. The debtor National Hockey League team proposed to sell the team at an auction. The NHL By-Laws permit a team sale only with consent from three-quarters of the other teams, permit a team to veto team relocation to its home territory and require that a buyer have "good character and integrity". The high bidder at the auction proposed to move the team to a different city. The NHL had prior dealings with the buyer that caused the NHL to question its character and integrity. The bidder's bid was contingent on the court authorizing a sale free and clear of the NHL By-law provisions. The debtor in possession and the NHL disputed the enforceability of the By-Law provisions, both under bankruptcy and non-bankruptcy law. Section 363(f)(4) permits sale of property of the estate free and clear of any interest that is subject to bona fide dispute. Section 363(e) requires the court to prohibit or condition a sale to the extent necessary to provide adequate protection of the adverse party's interest in property of the estate. These provisions permit a sale pending dispute resolution by transferring parties' rights from the assets to its proceeds. They are most often and most easily invoked when the disputed interest is a lien or other economic interest. Where the disputed interest is a non-economic right to admit only new members who meet the NHL's written requirements and to control where teams play their home games, it would not be possible to provide adequate protection of the interest by, for example, impounding the sale proceeds. If the court later holds the NHL By-Law provisions enforceable, it would not be able to protect the NHL's interest after the sale and the move. Therefore, the court prohibits the sale. *In re Dewey Ranch Hockey, LLC*, 414 B.R. 577 (Bankr. D. Ariz. 2009).

12.3.g. Buyer may not exclude disputed claims from payment of general unsecured claims under a sale. The debtor in possession proposed to sell its operations at a section 363 auction. The DIP and the debtor's principals favored the stalking horse bidder, whose bid was the highest but failed because it was contingent on a condition that could not be fulfilled. The next bidder's bid proposed to pay "all legitimate creditors", but specifically excluded the disputed claims of the debtor's principals. A section 363 sale risks depriving parties of the protections provided by the plan confirmation process, so the court should reject attempts to determine plan issues in connection with a sale. Equality of distribution is a fundamental bankruptcy policy. Therefore, a buyer must support with compelling evidence a proposal to pay some trade creditors if commercial factors and good will require. It may not select creditors not to pay based on disputes about the allowability of their claims. The court therefore denies approval of the sale. *In re Dewey Ranch Hockey, LLC*, 414 B.R. 577 (Bankr. D. Ariz. 2009).

12.3.h. Court sets limits on debtor in possession's business judgment in approving a section 363 sale. The debtor's $35 million secured debt exceeded the debtor's value, and the debtor was in default. The debtor began a sale process, which resulted in a competitor's acquiring the secured debt and later entering into a $28 million asset purchase agreement (APA) and a $40 million debtor in possession loan facility with the debtor. The APA preserved the buyer's/secured lender's deficiency claim and proposed a break-up fee. The DIP loan facility provided for a roll-up of the lender's prepetition claim, a lending fee of 0.75%, a lien on all chapter 5 causes of action, super-priority administrative expense status for any deficiency (which was nearly certain, since the DIP loan amount exceeded the APA sale price), limited fee and expense carve-outs, a 90-day maturity and immediate automatic stay relief upon a default. The debtor filed a chapter 11 petition and sought prompt approval of the DIP facility and the sale. The Committee objected and sought discovery. After negotiation, the debtor, buyer and committee agreed to modify the sale to waive the buyer's/lender's deficiency claim, increase the carve-out and expense allowance, waive any interest in certain chapter 5 causes of action, limit insider releases to three individuals to be employed by the buyer and fund a trust for the sole benefit of unsecured creditors. The court succinctly summarizes the standards for authorizing a section 363 sale: a sale of all assets is not per se prohibited, but debtor in possession must consider its fiduciary duties and state a business justification. The sale may not evade chapter 11 plan protections, release claims against the estate, determine a plan's structure or obligate parties in interest to vote for or against a plan. A party in interest opposing a sale must articulate the specific chapter 11 rights or protections denied by the sale. Here, the court approves the sale, excluding the creditors' trust and releases, because they are unsupported by a business justification, noting that the debtor in possession had no interest in either, that the trust evaded protections of administrative and priority creditors and that the provisions resulted from the committee's "spoiler's argument" rather than a sound business reason. As such, they compromise the debtor in possession's fiduciary duties, so the court does not defer to the debtor's business judgment on these provisions. *In re On-Site Sourcing, Inc.*, 412 B.R. 817 (Bankr. E.D. Va. 2009).

12.3.i. Court denies a break-up fee where unnecessary to promote a bid. The debtor in possession conducted an extensive marketing effort to sell its principal asset. It received only one noncontingent bid and entered into an asset purchase agreement (APA) with the bidder. The APA required the debtor to seek approval of the sale without a further auction, but if the court ordered an auction, then the debtor was to seek approval of bid protections of a minimum overbid amount, expense reimbursement and a break-up fee. At the hearing, a previously contingent bidder objected to the bid protections. The court approved only the minimum overbid and expense reimbursement. The original bidder did not participate in the auction, and the objector won. A break-up fee is an administrative expense and therefore should be approved only if necessary to preserve the value of the estate. A break-up fee may be necessary to preserve the estate's value if it induces the bidder to bid before the court orders an auction or to adhere to its bid after the court orders an auction, thus providing a floor for the auction. Here, the bidder did not condition its bid on approval of the break-up fee, rather, only on the DIP's agreement to seek approval. Therefore, the break-up fee was not necessary to obtain or preserve the bid. *In re Reliant Energy Channelview LP*, 594 F.3d 200 (3d Cir. 2010).

12.3.j. Court may authorize sale of substantially all assets for a "good business reason". The debtor in possession manufacturing company sold substantially all its assets under section 363(b) for $2.0 billion within 30 days after the petition date. The buyer, a newly formed entity, assumed most trade claims and miscellaneous other general unsecured claims and would operate essentially the same business as the debtor, but with new technology, new management, a new union agreement and new access to dealerships. Equity ownership in the buyer was distributed 20% to an independent company that was providing new technology and a distribution network for the debtor's product, 55% to an employee health care trust and 10% to the debtor in possession lender, who provided $5 billion in DIP financing and $6 billion financing for the buyer. Senior secured lenders with claims totaling $6.9 billion would receive the $2.0 billion cash purchase price. A liquidation of the assets, which was the only alternative to the sale, would have yielded no more than $800 million, and the estate was losing up to $100 million a day while operations were shuttered pending the closing of the sale. Section 363(b)'s purpose is to permit an asset sale quickly to preserve and maximize value. The court must find a good business reason for the sale, so as to prevent a powerful, bullying creditor from forcing a sale to cash out quickly, leaving other creditors without chapter 11's protections. Section 363(b) does not give the court carte blanche to approve all sales. The court must balance which sales to approve, not by a rigid rule or prescription, but rather by the

"good business reason" standard that *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983), set forth. A sale of substantially all assets is not necessarily an impermissible reorganization plan, but the extent to which the sale terms effect distributions is one consideration. Based on the debtor's desperate situation, its continuing losses and the alternative to the sale, the bankruptcy court properly approved the sale. *In re Chrysler LLC*, 576 F.3d 108 (2d Cir. 2009).

12.3.k. Court may authorize sale of substantially all assets for a "good business reason". The debtor had obtained debtor in possession financing under terms that required the sale under section 363(b) within 40 days after the petition date of substantially all its assets to a new entity principally owned by the DIP lender. The sale price was enough cash to pay the debtor's pre-existing secured lenders, assumption of most operating executory contracts and certain liabilities, including most trade supplier claims, all customer warranty claims and some personal injury claims arising from the debtor's products, and 10% of the stock of the new entity. Under the sale terms, the lender would also provide financing to the new entity and additional DIP financing to the debtor in possession to fund wind down expenses. The lender would distribute stock in the new entity to a Voluntary Employee Benefits Association (VEBA), which was sponsored by the debtor's principal union and had substantial unsecured claims against the debtor. In addition, the new entity would assume the obligations to the VEBA not paid by the stock ownership. The debtor was losing substantial sums and could not remain in business without the DIP financing that the lender was providing. No other buyers expressed any interest in purchasing the business or assets, and without the sale, the business would close and liquidate. Liquidation would result in realization of substantially lower value for all creditors. Section 363(b) authorizes a sale of assets out of the ordinary course of business. It does not limit the nature or amount of assets that may be sold. However, it does not permit all sales. A sale of substantially all assets outside of a chapter 11 plan must be supported by a good business reason, as *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983) set forth. Here, the absence of any alternatives to maintaining business operations and the substantially higher recovery to creditors overall provided a good business reason for the sale. Section 363(b) also requires the buyer's good faith, which is shown by the integrity of the buyer's conduct in the sale process. Here, there was no allegation of fraud, collusion or an attempt to take grossly unfair advantage of other bidders. The buyer's exercise of its negotiating leverage as DIP lender does not constitute bad faith or overreaching. A section 363(b) sale become an impermissible *sub rosa* plan if it short circuits plan confirmation requirements, dictates plan terms, constrains parties in exercising confirmation rights or allocates proceeds among creditors. The treatment of executory contract counterparties, the new entity's assumption of liabilities it needed to maintain operations and the lender's distribution of some of the new entity's stock to the VEBA are things the purchaser required to preserve an operating business and did not turn the sale into a *sub rosa* plan. The purchaser's allocation of ownership interests in the new enterprise does not affect the estate or its economic interests. Therefore, the court approves the sale. *In re Gen. Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009).

12.3.l. Court may authorize sale free and clear of product liability claims. The debtor in possession manufacturing company sold substantially all its assets under section 363(b). The sale order authorized the sale free and clear of interests and extinguished the right to pursue claims "on any theory of successor or transferee liability, … whether known or unknown as of the Closing, now existing or hereafter arising, asserted or unasserted …". Among the debtor's general unsecured prepetition claims were personal injury product liability claims arising out of the debtor's production, which used the assets that were sold. Section 363(f) authorizes a sale of property "free and clear of any interest in such property". The trend is toward a more expansive reading of this provision's scope. It is not limited only to *in rem* interests such as liens. It encompasses claims that "arise from the property being sold", which includes claims that are grounded on the use to which the property was put, such as the manufacturing operation here. Under section 1141(c), property dealt with by the plan is "free and clear of all claims and interests of creditors [and] equity security holders". The inclusion of "claims" in section 1141(c) does not narrow the scope of section 363(f), which does not include "claims". Section 363's expanded role in bankruptcy cases, substituting to some degree for plans, suggests that the effects of the two procedures should be harmonized. Therefore, the sale is free and clear of the personal injury claims. By authorizing the sale free and clear of personal injury claims, the court precludes successor liability. The court leaves for another day, however, whether the free and clear order protects the buyer from successor liability for future claims. *In re Chrysler LLC*, 576 F.3d 108 (2d Cir. 2009).

12.3.m. Agent in secured credit facility may credit bid without unanimous consent of all lenders. The debtor in possession auctioned its assets with court approval. On the direction of over 90% of the lenders, the agent under the debtor's secured credit facility credit bid at the sale. One of the lenders objected. The credit agreement appoints the administrative agent and authorizes the agent to take such actions on the lenders' behalf as are delegated under the loan documents. and provides that the credit agreement could not be amended to "release all or substantially all of the Collateral from the Liens of the Security Documents, without the written consent of each Lender". The security agreement includes the collateral agent as a secured party and authorizes any secured party to credit bid. The credit bid does not amend the credit agreement but implements the loan document's terms to permit majority decision-making. *In re Metaldyne Corp.*, 409 B.R. 671 (Bankr. S.D.N.Y. 2009).

12.3.n. Court disapproves section 363(b) sale to secured lender as violating chapter 11 reorganization scheme. The debtor was an oil and gas exploration and production company. Oil price declines had made its business unprofitable. Its sole secured lender was substantially undersecured. Both before and after bankruptcy, the debtor had attempted to market its business but received offers of only about 20% of the secured claim. The debtor in possession and the lender had entered into a cash collateral stipulation that gave the lender stay relief if the debtor did not confirm a plan by a specified deadline. After the deadline, the debtor in possession moved for approval of a section 363(b) sale of all its assets. Although it proposed bidding procedures, the marketing and due diligence period's shortness, the prior failed marketing efforts and the secured claim's size made it very unlikely that anyone other than the secured lender would bid. The proposed sale provided for assumption and assignment of some but not all contracts but did not provide for any payment to administrative or general unsecured prepetition claims. The sale hearing proceeded on uncontested evidence. Under Fifth Circuit case law, a section 363(b) sale may not circumvent the requirement for plan confirmation and must be based on a sound business reason, and an objecting party must specify what confirmation protections a sale would deny. Going further, based on an extensive review of academic literature on the expanding role of section 363(b) sales in chapter 11 cases and on its evaluation that a properly conducted plan process need not be materially more cumbersome than a section 363(b) sale process, the court imposes a list of at least 12 considerations for approval of a sale of substantially all of an estate's assets. The court concludes, "the movant must show that there is a need to sell prior to the plan confirmation hearing … not merely a showing that it doesn't matter" whether the sale proceeds under section 363 or a plan. "[T]he proposed transaction is a foreclosure supplemented materially by a release, by assignment of executory contracts (but only the contracts chosen by the secured lender), by a federal court order eliminating any successor liability, and by preservation of the going concern. Congress provided a process by which these benefits could be obtained. That scheme requires bargaining, voting, and a determination by the Court that Bankruptcy Code § 1129 requirements are met." The court denies authority to sell. *In re Gulf Coast Oil Corp.*, 404 B.R. 407 (Bankr. S.D. Tex. 2009).

12.3.o. Trustee may sell free and clear of junior lien under section 363(f)(5). The trustee sought to sell personal property free and clear of junior liens for a price less than necessary to pay all liens on the property. Section 363(f)(5) permits a sale free and clear of an entity's liens if the "entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest". Under Washington law, a junior lienor may be compelled to accept a money satisfaction, or indeed no satisfaction at all, if the property's value is not adequate to cover the junior creditor's lien, in a senior secured creditor's foreclosure sale under Article 9, in a receivership action, in the liquidation of a probate estate, in a personal property tax sale or in a federal tax lien sale. Therefore, the trustee may sell the property free and clear of the junior lienor's interest. *In re Jolan, Inc.*, 403 B.R. 866 (Bankr. W.D. Wash. 2009).

12.3.p. Trustee may not abandon property that the estate has contracted to sell. The debtor in possession obtained court authorization to auction real property. The auction was successful. Before the sale closed, the case converted to chapter 7. The trustee sought to abandon the real property to evade any specific performance obligation to the purchaser, because of a tax obligation that would be imposed on the estate as a result of the sale. When the gavel fell at the auction, the debtor in possession entered into a binding contract on behalf of the estate to sell the property. The contract binds the estate and therefore the chapter 7 trustee who succeeds the debtor in possession as representative of the estate. Therefore, the court refuses to authorize abandonment of the property, which would defeat the estate's contract. *In re Linton Props., LLC*, 400 B.R. 1 (Bankr. D.D.C. 2009).

12.3.q. Court denies sale free and clear of valueless junior lien. The trustee sold real property free and clear of a junior lien to the senior lienor under a credit bid equal to the senior lien clam amount. The junior lienor appealed the order approving the sale free and clear. Section 363(f) permits sale free and clear only under five circumstances, only two of which might be present here: "(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;" or "(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest;". Paragraph (3) uses "aggregate value of all liens" rather than the more common Bankruptcy Code phrase "aggregate value of all claims". "Aggregate value of all liens" refers to their face value, not their economic value. Otherwise, paragraph (3) would authorize sale free and clear of all liens, as section 1206 does, and nothing indicates that Congress intended such a broad rule. In addition, the sale price must be greater than the aggregate value. Whenever the sale price is less than the face amount of all claims secured by the liens, it would be equal to, not greater than, their economic value. Thus, paragraph (3) authorizes sale free and clear only at a price greater than all claims secured by the liens. Paragraph (5) applies to liens, not just other interests, based on the use of the same word "interest" in section 363(f)'s introductory clause and in paragraph (3). Paragraph (5)'s requirement of being able to compel a money satisfaction means for less than full payment; otherwise, it would be so expansive as to apply to all liens, which can all be satisfied by full payment. It also requires a showing that a legal or equitable proceeding could compel money satisfaction. Plan confirmation under section 1129(b)(2) does not qualify as such a proceeding, because its use would require compliance with plan confirmation requirements, which are not present in a section 363 sale process, and if the proceeding to permit sale free and clear were found elsewhere in the Bankruptcy Code, paragraph (5) would be unnecessary. Therefore, the court may not authorize the sale free and clear of the junior lien at a price less than the full amount of all claims secured by liens on the property. *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25 (9th Cir. B.A.P. 2008).

12.3.r. Trustee may sell free and clear of a lease that the debtor had not assumed. The debtor's predecessor as real property owner leased the property for a billboard. The lessee failed to record the lease. The warranty deed from the predecessor to its successor described the lease, which gave constructive notice of the otherwise unrecorded lease, and the trustee actually became aware of the lease during his administration of the case. The trustee sought to sell the real property free and clear of all liens and interests. The trustee did not give the lessee notice of the sale. The court approved the sale free and clear, unaware that an interested party had not received notice. After the sale, the buyer sought an order that the sale was free and clear of the lease. Although a bankruptcy sale is in rem and generally good against the world, the sale does not cut off rights of someone who was entitled to direct notice yet did not receive it. Because the trustee knew of the lease, the lessee was entitled to direct notice and could challenge the validity of the sale order. In such a circumstance, some courts void the entire sale, some courts void the sale only as to the party not served with notice, and some courts balance the equities in fashioning appropriate relief, which the court adopts as the appropriate approach here. Section 365(h) permits a lessee to remain in possession of a leasehold under a lease that the trustee rejects, while section 363(f) permits sale free and clear of all interests. Because the Bankruptcy Code does not indicate whether one section or the other takes precedence, the court must give them both effect. If a subsequent property owner did not assume the lease and filed bankruptcy, section 365(h) would not apply, as the lease is not a "lease of the debtor". Therefore, section 365(h) is satisfied here, and the trustee may sell free and clear under section 363(f). The lease here had a cash-out option, which meets section 365(f)(5)'s requirement that the interest holder could be compelled to accept a money satisfaction of its interest. Therefore, the court affirms the sale order free and clear but gives the lessee a claim for the cash-out option amount. *S. Motor Co. v. Carter-Pritchett-Hodges, Inc. (In re MMH Auto. Group, LLC)*, 385 B.R. 347 (Bankr. S.D. Fla. 2008).

12.3.s. Secured creditor who credit bids at an auction may be liable for costs of sale. The secured creditor twice moved for stay relief and twice withdrew its motions. The debtor in possession sought authority to retain a financial advisor to sell the secured creditor's collateral free and clear. The secured creditor objected and reserved the right to object to the advisor's fees and expenses. The court authorized the retention and a sale free and clear, with lien to attach to proceeds. The advisor conducted an auction, which started with a stalking horse bid. Ultimately, the highest and best offer was the secured creditor's credit bid. The court approved the sale to the secured creditor. The secured creditor is liable under section 506(b) to pay the fees and expenses of conducting the auction, because it benefited from

actions taken to generate interest in the property and establish its value and from the sale. *Borrego Springs Bank, N.A. v. Skuna River Lumber, LLC*, 381 B.R. 211 (N.D. Miss. 2008).

12.3.t. Court denies partition of a commercial property and awards attorney's fees against co-owner. The debtor owned a 50% undivided interest as a tenant in common in rental property that housed a bar, a restaurant, and several apartments. Appraisals of the entire property ranged from $1.85 million to $2.25 million. The trustee received a $650,000 offer, later withdrawn, to purchase the debtor's 50% interest. Section 363(h) permits sale of the entire property if partition is impracticable, the price the estate would receive for a sale of the interest is "significantly less" than the price for the entire property, and the benefit to the estate outweighs the detriment to the co-owners. "Impracticable" does not mean impossible; it falls between the concepts of not possible and not practical, requiring only that partition not be feasible, sensible or practical. It is not practicable to partition this commercial building. The court need not perform a precise mathematical calculation to determine whether the price difference is significant. Here, the apparent difference meets the test. Section 365(j), which grants the co-owner effectively a right of first refusal or an interest in the proceeds, provides adequate protection; nothing more is required. When the co-owner refused to cooperate, so that the trustee had to sue to gain access to the building, the court may properly award attorney's fees to the trustee. *56 Assoc. v. DiOrio*, 381 B.R. 431 (D.R.I. 2008).

12.3.u. Estate need not sell insurance policy claims free and clear. The estate asserted claims for indemnification and defense costs reimbursement under its directors and officers liability policies. The insurer disputed the claims. The debtors' directors and officers also asserted claims under the policies. The aggregate of the claims exceeded policy limits. The policies were "first come, first served" policies, so that whichever insured successfully asserted claims under the policies first would get paid, leaving the others without policy proceeds to recover. After plan confirmation, the estate proposed to settle with the insurer by selling it all of the estate's claims under the policies for a cash payment, free and clear of the claims of the directors and officers. The directors and officers may have contractual rights under the policies against the insurer. However, because of the nature of a first come-first served policy, they do not have an interest in the estate's claims under the policies against the insurer. The estate may assert a claim for the entire policy proceeds without the consent of the directors or officers. Accordingly, the directors and officers do not have an interest in the estate's interest in the policy proceeds; they have a direct, independent claim against the insurer. Therefore, they have no interest in the estate's property, and a sale free and clear is unnecessary and improper. *In re Adelphia Comm'ns Corp.*, 364 B.R. 518 (Bankr. S.D.N.Y. 2007).

12.3.v. Free and clear sale of stock does not protect against claims against the subsidiary. During its chapter 11 case, the debtor in possession sold the shares in its nondebtor subsidiary "free and clear of any and all … claims (… as defined in § 105(5) of the Bankruptcy Code), [and] preferences." The liquidating trustee later sued the subsidiary for recovery of a preference. The purchaser (the subsidiary's new parent) sought declaratory and injunctive relief against the preference action. The new parent had standing to bring the declaratory relief action because the preference action could have deprived it of the benefit of its bargain with the estate. The court has jurisdiction over the declaratory relief action because it seeks interpretation and enforcement of the court's order approving the sale, even though neither the new parent nor the former subsidiary were debtors in this court. The court denies declaratory relief, however, because the sale order provided for a free and clear sale of only the stock, not the subsidiary's assets. Thus, the subsidiary remained liable for any claims against it, including claims that the estate of the former parent may have had. *Amphenol Corp. v. Shandler (In re Insilco Tech., Inc.)* 351 B.R. 313 (Bankr. D. Del. 2006).

12.3.w. Claim to ownership of property sold under section 363 does not defeat mootness rule of section 363(m). The trustee proposed to sell the debtor's interest in an oil and gas lease that the lessor claimed the debtor had abandoned long before bankruptcy. The court approved the sale without adjudicating the lessor's claim, and the sale closed. The lessor appealed but did not seek a stay of the sale order pending appeal. The lessor's appeal was moot under section 363(m), even though the lessor claimed that the estate had no interest in the property. Section 363(m) does not contain an exception for a claim of the kind the lessor asserts, and to recognize one would invite adverse claimants or sale objectors to object, eviscerating the finality policy of section 363(m). *Hazelbaker v. Hope Gas, Inc. (In re Rare Earth Minerals)*, 445 F.3d 359 (4th Cir. 2006).

12.3.x. Secured lenders may credit bid the full amount of their claim. At a section 363 sale, the secured lenders credit bid the entire face amount of their allowed claims. No other bidders appeared. The creditors' committee argued the lenders could credit bid only the secured portion, as determined under section 506(a). The court rejects the argument, reasoning that sections 363(k) and 506(a) do not require a 506(a) bifurcation valuation before an auction, and the auction in fact determines the market value of the collateral, based on the bids received, including the secured creditors' bid. Therefore, the lender may credit bid up to the full face amount of the allowed claim; the bid fixes the lender's allowed secured claim under section 506(a), which is equal to the amount bid. *Cohen v. KB Mezz. Fund II, LP (In re Submicron Sys. Corp.)*, 432 F.3d 448 (3d Cir. 2006).

12.3.y. Settlement of a dispute involving disposition of collateral might not implicate section 363(f). The debtor had contracted to build a methane gas recovery facility on a landfill and, separately, to sell the gas. The debtor's lenders had a security interest in all the debtor's assets, including both contracts. The debtor breached both contracts. The debtor's chapter 11 trustee settled disputes with the landfill operator and the gas purchaser over the debtor's breaches by agreeing to accept a small payment and a release of claims from both counterparties and to give up the estate's right to the gas. The settlement does not violate section 363(f). Outside of bankruptcy, the debtor could have entered into the settlement without the lenders' consent. The trustee has the same power. Because the settlement must be beneficial to the estate, the lenders' interests are protected; section 363(f) does not prevent transactions that make lenders better off. *In re Resource Tech. Corp.*, 430 F.3d 884 (7th Cir. 2005).

12.3.z. Section 363 does not authorize sale free and clear and distribution of noncash sale proceeds in satisfaction of secured claims. The debtor in possession sold all of its assets to a new entity, which paid for the purchase in securities of the new entity. The assets were subject to liens in favor of first lien and second lien creditors. The first lien creditors objected to the distribution to them of a portion of the securities, which the court valued at an amount equal to their claim, in full satisfaction of their claims and of the balance to the second lien creditors, even if non-distribution would severely jeopardize both groups' recovery. The lien creditors are entitled to adequate protection of their liens upon the sale, which could be satisfied by the liens attaching to the sale proceeds—the securities. However, distribution of the securities did not adequately protect their interest in property of the estate, because upon distribution, the securities were no longer property of the estate. The sale order could not impair the first lien creditors' rights and interests to provide adequate protection of the second lien creditors' interests. Once the replacement lien attached to the securities, there was no need for further adequate protection by way of distribution, which permanently impaired the first lien creditors' rights. In short, the debtor in possession may not use a business judgment standard supporting a section 363 sale to effect a distribution other than in cash outside of a plan to a secured creditor who does not consent. *Contrarian Funds, LLC v. WestPoint Stevens, Inc. (In re WestPoint Stevens, Inc.)*, 333 B.R. 30 (S.D.N.Y. 2005).

12.3.aa. Bidding at an auction does not waive rights to object to the sale. The bankruptcy court authorized an asset sale, with a portion of the proceeds distributed to the first lien lenders and the balance to the second lien lenders. The first lien lenders, as a group, bid at the sale. The proceeds were the acquiring company's equity securities. The first lien lenders were willing to accept that consideration if they had been the successful bidder, but not from the competing bidder. Their participation in the auction does not waive their right to challenge whether the sale and the form of consideration were proper. *Contrarian Funds, LLC v. WestPoint Stevens, Inc. (In re WestPoint Stevens, Inc.)*, 333 B.R. 30 (S.D.N.Y. 2005).

12.3.bb. Court allows disappointed bidder an administrative expense claim. The debtor in possession agreed to sell its assets to a stalking horse bidder, obtained approval of bid procedures which included a break-up fee and expense reimbursement, conducted an auction at which the stalking horse bidder was the successful bidder, and obtained approval of the sale. Before closing and before the order became final, a creditor who was also interested in bidding but who had not received notice of the auction moved for reconsideration of the sale approval order. The court vacated the approval, based on inadequate notice to the creditor-bidder and ordered a new auction, at which the creditor was the high bidder. After the sale closed, the stalking horse bidder sought reimbursement for expenses it incurred in connection with the sale. The court allows the expenses incurred in connection with preparing to close the sale as an administrative expense, because they arose from a transaction with the estate that benefited

the estate by permitting the quick closing of a sale that the debtor in possession had argued was essential to preserve value for the estate. *In re Women First Healthcare, Inc.*, 332 B.R. 115 (Bankr. D. Del. 2005).

12.3.cc. Trustee's attorney's fees may not be deducted from sale proceeds payable to a co-owner. Section 363(h) permits a trustee to sell an estate's and a co-owner's interest in real property; section 363(j) provides that "the trustee shall distribute to . . . the co-owners . . . the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such . . . co-owners." The trustee here incurred attorney's fees to defend against a stay relief action against the property and to market and sell the property. The trustee could not charge the fees against the co-owner, because they were included within "compensation of the trustee." In addition, despite the trustee's dispute with the co-owner over matters relating to the real property, the trustee must turn over the sale proceeds immediately and may not withhold them pending resolution of the disputes. *Stine v. Diamond (In re Flynn)*, 418 F.3d 1005 (9th Cir. 2005).

12.3.dd. Sales of avoiding power to defendant must be treated as a compromise. The trustee proposed to sell the estate's avoiding power causes of action to a newly formed company owned by two of the defendants. A group of creditors, representing 70% of the claims in the case, was the other bidder. The court could not approve the sale to the defendants' company unless it analyzed the transaction not only as a sale under section 363, but also as a compromise under Rule 9019. Although the defendants' company's offer price was ostensibly higher, making it the preferred buyer under section 363, the bid did not satisfy the fair and equitable requirement for a compromise. In particular, the interests of creditors are said to be of paramount importance and entitled to deference. The competing bidders represented 70% of the claims, and their interests were not adequately considered. In addition, the court should consider the alternative possibility of allowing the creditors to pursue the causes of action in the name of the trustee, allowing them their fees and expenses under sections 503(b)((3) and (4) if they are successful. *Simantob v. Claims Prosecutor, LLC (In re Lahijani)*, 324 B.R. 282 (Bankr. 9th Cir. 2005).

12.3.ee. Appellate court remands for bankruptcy court to determine "good faith" to evaluate whether appeal from sale order is moot. Section 363(m) generally makes an appeal from an order authorizing a sale of property of the estate under section 363 moot if the purchaser purchased in good faith. If the bankruptcy court does not make findings on whether the purchaser purchased in good faith, the appellate court will not determine whether the appeal is moot but will remand for findings on whether the buyer purchased in good faith. It will not make the finding itself. *First State Operating Co. v. Holbrook (In re Lotspeich)*, 328 B.R. 209 (Bankr. 10th Cir. 2005).

12.3.ff. Reorganized debtor may not sell assets free and clear after plan confirmation. After the effective date of the debtor's plan, the reorganized debtor sought to sell its assets free and clear of liens under section 363(f). Although the plan provided for post-confirmation retention of jurisdiction to "hear and determine any and all pending or future applications for approval of the sale of the Assets or any portion thereof, free and clear of all liens pursuant to § 363 of the Bankruptcy Code," the plan did not itself provide for the sale of assets free and clear of liens. The court refuses to approve the sale, "because Section 363(f) is not operational once the plan is confirmed." It is not clear whether the court would have permitted the sale if the plan had been more explicit in providing for the post-confirmation asset sale. *In re Golf, L.L.C.*, 322 B.R. 874 (Bankr. D. Neb. 2005).

12.3.gg. Lien holder has standing to object to section 363 sale. Adverse parties, including a lien holder, disputed the trustee's claim that the debtor owned real property. The trustee commenced an adversary proceeding to determine title. Then, after 18 months of marketing the property, the trustee found a buyer and sought court approval by motion of a sale free and clear of the lien. The lien holder opposed the motion on essentially the same grounds as were being litigated in the adversary proceeding, but the court determined that the debtor "had some interest in the property" and authorized the sale. The lien holder has standing to object to the trustee's motion to approve the sale, even though the holder does not claim any ownership interest in the property. Because an unsecured creditor may object to the disposition of estate assets, a secured creditor may surely do so, especially where the sale is to be free and clear of the secured creditor's lien. The secured creditor is not limited to a challenge based only on

the grounds set forth in section 363(f), which lists the circumstances under which property may be sold free and clear of a lien. *Darby v. Zimmerman (In re Popp)*, 323 B.R. 260 (B.A.P. 9th Cir. 2005).

12.3.hh. Bankruptcy court must determine property ownership before it may authorize a sale under section 363. Adverse parties disputed the trustee's claim that the debtor owned real property. The trustee commenced an adversary proceeding to determine title. Then, after 18 months of marketing the property, the trustee found a buyer and filed a motion for court approval of the sale. The adversary proceeding defendants opposed the motion on essentially the same grounds as were being litigated in the adversary proceeding, but the court determined that the debtor "had some interest in the property" and authorized the sale. Under *In re Rodeo Canon Dev. Corp.*, 362 F.3d 603 (9th Cir. 2004), *opinion withdrawn*, 2005 U.S. App. LEXIS 3786 (9th Cir. Mar. 8, 2005), if the estate's title to the property is in dispute and has not been determined, section 363 does not apply. *Rodeo Canon* states a prudential rule of efficient dispute resolution, not a rule prohibiting a bankruptcy court from determining ownership in a contested matter. Because the court here made no such determination, despite the pendency of the adversary proceeding for over 18 months, and found in the contested matter only that the debtor had "some interest in the property," a finding that ultimately could be inconsistent with the adversary proceeding outcome, it was improper for the court to authorize the sale. However, the Ninth Circuit withdrew its opinion two weeks *after* the BAP's decision, so whether the BAP's decision on this point will have any more than persuasive effect is unclear. *Darby v. Zimmerman (In re Popp)*, 323 B.R. 260 (B.A.P. 9th Cir. 2005).

12.3.ii. Mootness rule does not apply to sale to which section 363 does not apply. Adverse parties, including a lien holder, disputed the trustee's claim that the debtor owned real property. The trustee commenced an adversary proceeding to determine title. Then, after 18 months of marketing the property, the trustee found a buyer and sought court approval of the sale by motion. The adversary proceeding defendants opposed the motion on essentially the same grounds as were being litigated in the adversary proceeding, but the court determined that the debtor "had some interest in the property" and authorized the sale. Under *In re Rodeo Canon Dev. Corp.*, 362 F.3d 603 (9th Cir. 2004), if the estate's title to the property is in dispute and has not been determined, section 363 does not apply. Therefore, section 363(m) does not apply, and the appellate court may hear an appeal from the order approving the sale. In addition, the buyer expressly took the risk in the sale contract that the estate might not have title to the property, so equitable considerations did not require a mootness finding. *Darby v. Zimmerman (In re Popp)*, 323 B.R. 260 (B.A.P. 9th Cir. 2005).

12.3.jj. Mootness rule of section 363(m) applies to a sale of a leasehold. The debtor in possession sold the right to designate an assignee of the debtor's leasehold interest. The lessor appealed. The leasehold interest is property of the estate. Therefore, even though section 365 governs an assignment of a lease, section 363(m) still applies. The fact that this transaction took place in two steps – first a sale of the right to designate an assignee and then the assignment – rather than one does not deprive it of section 363(m)'s protection. *Weingarten Nostat, Inc. v. Service Merch. Co.,* 396 F.3d 737 (6th Cir. 2004).

12.3.kk. Court may not approve sale without adequate business justification. The debtor filed a chapter 11 case solely to sell its single real estate asset, which was overencumbered. It intended to convert its case to chapter 7 immediately after the sale. The secured creditor consented. The court refuses to authorize the sale, because of the absence of any business justification for the sale or need for chapter 11. The secured creditor could conduct a foreclosure sale outside of chapter 11 with the same effect. *In re Encore Healthcare Assocs.*, 312 B.R. 52 (Bankr. E.D. Pa. 2004).

12.3.ll. Authorization to sell property of the estate is improper if the estate's ownership is disputed. A general partner, who was a chapter 7 debtor, held legal title to real property. The other general partner asserted that the partnership owned the property because it had been purchased with partnership funds. A lender made prepetition loans to the debtor partner, secured by the property. The nondebtor partner claimed the liens were invalid because the debtor partner did not own the property and therefore could not grant liens. The trustee sought to sell the property free of the disputed ownership claims and the disputed liens, with all interests to attach to the proceeds. The bankruptcy court authorized the sale and permitted payment of some of the proceeds to the lender, with the balance held pending resolution of the

disputes. On appeal seeking disgorgement of the payments to the lender, the Ninth Circuit concludes that the order authorizing the sale was improper, because the bankruptcy court may not authorize a sale of property that is not property of the estate, and until the dispute about ownership was resolved, it could not authorize the sale. However, because the sale was consummated, the Ninth Circuit holds that it is no longer subject to collateral attack. The court addresses only the disgorgement issue. *Warnick v. Yassian (In re Rodeo Canon Dev. Corp.)*, 362 F.3d 603 (9th Cir. 2004), *petition for reh'g pending*.

12.3.mm. Auction is reopened to permit overbids. A bid procedures order provided for an out-of-court auction two days before the sale approval hearing date, authorized the debtor in possession to conduct the auction, permitted the debtor in possession to modify the auction procedures at any time, and provided that only court approval of a bid would constitute acceptance. During the sale process, several bidders had objected to a key sale term. The debtor in possession revised that provision but inadvertently did not notify all bidders. At the auction, the debtor in possession advised all bidders of the revision, but one of the bidders could not contact his partners in time to determine how much that would affect his bid. He waited till the next day, after the auction had concluded, to notify the debtor in possession that he would overbid the winning bidder by 9% because of the change. The debtor in possession recommended to the court at the sale hearing that the bidding be reopened. The court agreed. At the subsequent auction, the original winning bidder won with a bid 16% higher than his prior winning bid. He appealed the reopening order. The court of appeals acknowledges the importance of finality of sales to protect the process and not defeat the legitimate expectations of bidders. In this case, however, the bid procedures order provision that permitted modifications at any time and that delayed acceptance of an offer until court approval defeated any legitimate expectation that the winning bidder may have had at the conclusion of the auction. *Corporated Assets, Inc. v. Paloian*, 368 F.3d 761 (7th Cir. 2004).

12.3.nn. Sale free and clear of lien requires equity in the property. Noting the case law on both sides of the issue, the district court concludes that for a trustee to sell free and clear on liens under section 363(f)(3), the sale price must exceed the face amount of claims secured by liens on the property. *Criimi Mae Services Limited Partnership v. WDH Howell, LLC (In re WDH Howell, LLC)*, 298 B.R. 527 (D.N.J. 2003).

12.3.oo. Settlement of a claim may be a sale and does not bind trustee until court approval. The bankruptcy court reopened the estate to allow the trustee to pursue an asset that had not been scheduled. After investigation, the trustee settled with a group that had suspiciously appeared to use the asset, for payment to the estate of $40,000. The trustee presented the agreement as a compromise. A creditor objected and a third party sought to overbid. The trustee, feeling bound by the agreement, pressed the approval of the compromise. The B.A.P. reversed the bankruptcy court's order approving the compromise. The B.A.P. rules that the trustee is not bound to press the compromise if subsequent events, such as a higher offer, change the evaluation of whether the compromise is in the best interest of the estate, especially where the agreement itself provided that it was subject to court approval. In addition, a compromise of this sort is in reality a sale, which should be subject to the bid procedures under section 363 and Rule 6004. *Goodwin v. Mickey Thompson Entertainment Group, Inc. (In re Mickey Thompson Entertainment Group, Inc.)*, 292 B.R. 415 (9th Cir. B.A.P. 2003).

12.3.pp. A trustee may sell free and clear of a lessee's rights under section 365(h). The bankruptcy court authorized the sale of real property free and clear of all interests. A lessee did not object to the sale. The Seventh Circuit rules that "interest" includes a lessee's possessory interest, which is an interest under a lease. Selling free and clear of that interest is not inconsistent with section 365(h), because the latter section applies only to the rejection of a lease, not to the sale of the underlying property, and because the lessee can protect his interest under section 365(e), which requires the court to provide adequate protection. *Precision Industries v. Qualitech Steel SEQ, LLC*, 327 F.3d 537 (7th Cir. 2003).

12.3.qq. Sale free and clear releases unsecured claims. The plaintiff had sued the debtor before bankruptcy for injuries resulting from environmental clean-up activities. After the debtor filed chapter 11, it sold all of its assets free and clear of all claims. The order prevented the plaintiff from continuing its action against the purchaser. "Interest," as used in section 363(f), includes unsecured claims, at least to the

extent that they are associated with the property being sold. In addition, the Bankruptcy Code preempts state law on successor liability. *Myers v. United States*, 297 B.R. 774 (S.D. Cal. 2003).

12.3.rr. Pre-plan sales do not qualify for transfer tax exemption. Section 1146(c) exempts from documentary transfer taxes a sale "under a plan confirmed under section 1129." Here, the sale was made before confirmation of a plan under section 363 but were said to be necessary for the plan, and the plan retroactively authorized the transfers. The court rules that "under a plan" requires that the sales be authorized by the plan, not authorized under section 363, for the tax exemption to apply. *Baltimore County v. Hechinger Liquidation Trust (In re Hechinger Investment Co. of Delaware, Inc.)*, 335 F.3d 243 (3d Cir. 2003).

12.3.ss. Co-owner of estate property is liable for portion of attorney's fees related to sale. At the time of bankruptcy, the debtor and his co-owner were in litigation over partition of real property. After bankruptcy, the trustee continued the litigation, fended off a stay relief motion, and ultimately marketed the property, incurring attorney's fees in the course of doing so, including fees to negotiate a resolution of claims with the secured creditor. The trustee may charge the attorney's fees against the gross proceeds of sale, before allocation between the estate and the co-owner, because the attorney's fees were necessary to preserve the property and consummate the sale. Thus, the co-owner benefited from the services. In addition, the trustee may withhold payment of the co-owner's shares pending resolution of any disputes with the co-owner. *Stine v. Diamond (In re Flynn)*, 297 B.R. 599 (9th Cir. B.A.P. 2003).

12.3.tt. Airline assets may be sold free and clear of travel voucher claims. TWA had settled employment discrimination litigation by issuance of travel vouchers. The sale of TWA's assets to American Airlines was free and clear of all interests. The employment discrimination claimants asserted that American remained liable for the travel vouchers because they were not "interests" of the kind that could be extinguished in a sale free and clear under section 363(f). The Third Circuit rules otherwise. Section 363(f) does not apply only to interim interests such as liens but also to any obligations that are connected to or arise from the property being sold, even unsecured claims such as the travel vouchers. Moreover, the court rules that section 363(f)(5), which permits sale free and clear if the claimant could be compelled to accept a money satisfaction in a legal or equitable proceeding, permits the sale here. The court reasons that in a chapter 7 case, the travel vouchers would have been converted to dollar amounts, which would have been allowed and could be satisfied by distribution on unsecured claims. *In re TransWorld Airlines, Inc.*, 322 F.3d 283 (3d Cir. 2003).

12.3.uu. Bankruptcy sale extinguishes interest in intellectual property. The debtor licensed financial markets data to its customer for an annual fee. When the debtor filed chapter 11, it sold all of its assets other than the licenses to one buyer and assumed and assigned the license agreements to another buyer. When the second buyer stopped providing the service, the customer sued the first buyer to provide the service without charge, on the ground that the license granted the customer an interest in the debtors' intellectual property, which could not be extinguished by the sale of the underlying property. The Seventh Circuit rules against the customer on the grounds that the license did not reach future financial markets data that the debtor never created, that the sale, consistent with section 363(f), extinguished all interests in the assets acquired by the first buyer, including in the intellectual property that the first buyer acquired from the debtor, and that, to the extent the agreement was an executory contract to grant future licenses, the contract did not survive bankruptcy and bind the first buyer, because it had been assigned to the second buyer. The court of appeals notes that consent under section 363(f)(1) may be evidenced by failure to object to a sale free and clear, as long as there is notice. *FutureSource LLC v. Reuters Ltd.*, 312 F.3d 281 (7th Cir. 2002).

12.3.vv. Break-up fee allowed under "administrative expense" test. During the beginning of the bidding process for the estate's principle asset, the bankruptcy court approved an agreement with a potential bidder that included among its terms a break-up fee. Later, after the bidder was unsuccessful, the bankruptcy court denied administrative expense priority to the break-up fee, even though it held that the bidder held a post-petition claim against the estate. The Eighth Circuit B.A.P. reverses. First, it reviews the three tests that courts have used to determine the allowability of break-up fees: the business judgment test, the best interest of the estate test, and the administrative claim test. It adopts the administrative claim test and determines that the bidders conduct provided a direct benefit to the estate

and so should be allowed as an administrative expense claim. *AgriProcessors, Inc. v. Iowa Quality Beef Supply Network, L.L.C. (In re Tama Beef Packing, Inc.)*, 290 B.R. 90 (8th Cir. B.A.P. 2003).

12.3.ww. Bankruptcy court may make "good faith" finding under section 363(m) on remand. The trustee moved to dismiss an appeal from a sale order as moot on the ground that the sale had been completed to a good faith purchaser. The bankruptcy court had not made any findings at the time of the sale on the issue of good faith. The B.A.P. remands to the bankruptcy court for the limited purpose of examining good faith and making findings under a motion under Rule 60(b). The B.A.P. reasons that, in the Ninth Circuit, the bankruptcy court is not required to make a good faith finding at the time of approval of the original sale, and, indeed, the evidence suggesting a lack of good faith is not likely to emerge until after the sale. Because an appeal from the sale order divests the bankruptcy court of jurisdiction to determine good faith, the B.A.P. remands for that limited purpose. *Thomas v. Namba (In re Thomas)*, 287 B.R. 782 (9th Cir. B.A.P. 2002).

12.3.xx. Good faith under section 363(m) must be proven and may not be assumed. After an objector to a sale argued that the sale was not in good faith, the trustee moved the bankruptcy court for an order determining good faith, but later withdrew the motion. On appeal, the B.A.P. rules that the trustee waived the finding of good faith and that without such a finding, section 363(m) does not apply. The proponent of section 363(m) good faith has the burden of proof, and the appellate court will not draw an inference of good faith from a trial court record that is silent on that question. *T.C. Investors v. Joseph (In re M Capital Corp.)*, 290 B.R. 743 (9th Cir. B.A.P. 2003).

12.3.yy. Court may approve break-up fee for plan bid. The buyer's purchase agreement for the debtor's assets provided for the sale to be approved under a plan rather than under section 363. The sale agreement provided for a termination fee if the bid were topped at a court approved auction of the plan was not confirmed. The bankruptcy court approved the break-up fee agreement before plan solicitation. Some creditors objected on the ground that the presence of the break-up fee would have a coercive effect on voting. The court rejected the argument, holding that a break-up fee in the context of a plan agreement was equally appropriate as in the context of a section 363(b) sale. *DDJ Capital Management, LLC v. Fruit of the Loom, Inc. (In re Fruit of the Loom, Inc.)*, 274 B.R. 631 (Bankr. D. Del. 2002).

12.3.zz. Purchaser of intellectual property does not receive royalties from rejected license agreements. The purchaser acquired all of the assets of the debtor, including its intellectual property. The debtor had granted an exclusive license outside the United States to a licensee. Because the debtor was unable to provide the service required under the license agreement, the debtor rejected the agreement. At the same time, the purchase excluded the agreement and any assets or liabilities related to that licensee from its purchase. After rejection, the licensee elected to retain the license to the intellectual property under section 365(n)(2)(B) and make net license royalty payments. On a dispute between the debtor and the purchaser over the entitlement to the net license royalty payments, the court rules that the exclusion of the license agreement from the purchase entitled the debtor to the royalty payments, despite the purchaser's acquisition of all of the debtor's intellectual property. The court reasons that section 365(n)(2)(B) requires the licensee to "make all royalty payments due under the contract," which requires the payments to be made to the party to the contract (the debtor), not the owner of the intellectual property. What is more, rejection did not terminate the debtor's rights under the agreement. *Schlumberger Resource Mgmt. Servs, Inc. v. Cellnet Data Systems, Inc. (In re Cellnet Data Systems, Inc.)*, 277 B.R. 588 (D. Del. 2002).

12.3.aaa. Order approving sale precludes subsequent collusive bidding challenge, except under Rule 60(b). An order approving a sale under section 363 is *res judicata* on the issue of whether the bidders engaged in collusive bidding prohibited under section 363(n). Therefore, the order can be challenged only under Rule 60(b)(3) of the Federal Rules of Civil Procedure (Bankruptcy Rule 9024), which imposes a one-year period of limitation and does not permit subsequent collateral attacks. *Gazes v. Phillip Del Prete (In re Clinton Street Food Corp.)*, 254 B.R. 523 (Bankr. S.D.N.Y. 2000).

12.3.bbb. Section 363(m) sale mootness rule applies to assignment of executory contracts. The debtor in possession assumed and assigned a lease of real property as part of a sale of 41 leases.

Because the assignments were part of a sale, section 363(m) applied, and the failure of the landlord to obtain a stay of the order authorizing the assignment pending the appeal rendered the appeal moot. *L.R.S.C. Co. v. Rickel Home Centers, Inc. (In re Rickel Home Centers, Inc.)*, 209 F.3d 291(3d Cir. 2000).

12.3.ccc. Ambiguously designated purchaser defeats section 363(m) mootness protection. The bankruptcy court approved the sale of a franchise agreement to "Symbolic Motor Car Company," which was a d.b.a. of two separate corporations, but did not specify which corporation was taking the assignment. Holding that the requirement of a "good faith purchaser" in section 363(m) requires the identification of a "purchaser," the Ninth Circuit rules that the appeal from the order approving the sale of the franchise agreements does not meet the requirements for section 363(m) protection and is not moot. The Ninth Circuit did not consider any equitable mootness argument, even though the purchaser was not a party to the appeal. *Ferrari North America, Inc. v. Sims (In re R.B.B., Inc)*, 211 F.3d 475 (9th Cir. 2000).

12.3.ddd. Allowability of breakup fees is governed by section 503(b)'s "actual and necessary" standard. In a case of first impression at the court of appeals level, the Third Circuit rules that the allowability of a breakup fee is not governed by the business judgment test but rather by the test of section 503(b) of whether the fee is an actual and necessary expense of administration of the estate. In determining whether the fee provides some benefit to the estate, the Third Circuit examined whether the assurance of a breakup fee promoted more competitive bidding, guaranteed a high minimum bid, induced a bidder to research the value of the debtor in a way on which other bidders could rely, and did not chill the bidding. The court found the breakup fee in this case, in which numerous bidders competed to make the initial stalking horse bid, did not meet these standards. *Calpine Corporation v. O'Brien Environmental Energy, Inc. (In re O'Brien Environmental Energy, Inc.)*, 181 F.3d 527 (3d Cir. 1999).

12.3.eee. A no-shop clause is *per se* illegal in chapter 11. The debtor entered into a pre-petition agreement with a purchaser to sell all of its assets. The agreement contained a no-shop clause that prohibited the debtor from soliciting other bids or even sharing confidential information with potential bidders. In disallowing the purchaser's claim for breach of the agreement, the court holds the no-shop clause *per se* illegal in a chapter 11 case, because it prohibits a debtor from fulfilling its fiduciary duty to maximize the value of the estate. The court condemns the conduct of the purchaser in forcing the debtor to complete the agreement without exposing it the possibility of a better offer. The court suggests, however, that a reasonable break-up fee would be legitimate. *In re Big Rivers Electric Corp.*, 233 B.R. 726 (Bankr. W.D. Ky. 1998), *aff'd*, 233 B.R. 739 (W.D. Ky. 1998).

12.3.fff. Bankruptcy court sale order may not eliminate successor liability. Although the order authorizing the sale of all of the debtors assets stated that the buyer "is not a successor in interest [and does not] reflect a continuity of the operations of the Debtors," the order could not protect the buyer against post-confirmation tort claims against the debtor, because the bankruptcy law could not preempt state law on this issue. In addition, the bankruptcy court could not give adequate notice to future tort claimants so as to bind them to the terms of the sale order. *Schwinn Cycling and Fitness, Inc. v. Benonis*, 217 B.R. 790 (N.D. Ill. 1997).

12.3.ggg. The mootness rule upon a sale applies to an assignment of an executory contract. The mootness rule of section 363(m) applies where the debtor assumed and assigned a franchise agreement, because the franchise agreement was property, that is, a license to use a trademark, among other things. Section 363(m) does not, however, imply a *per se* rule that every appeal from an order approving a sale must be dismissed. There are two prerequisites for mootness: the sale was not stayed and the court, if reversing or modifying the authorization to sell, would affect the validity of the sale. *Krebs Chrysler-Plymouth, Inc. v. Valley Motors, Inc.*, 141 F.3d 490 (3d Cir. 1998).

12.3.hhh. A settlement is not a sale. An appeal from an order approving a settlement of a claim belonging to the estate is not governed by section 363(m), because the settlement of the claim is not a sale of an asset. *Hicks, Muse & Co., Inc. v. Brandt (In re Healthco Intl., Inc.)*, 136 F.3d 45 (1st Cir. 1998).

12.3.iii. Break-up fee disapproved. Although the standard for approval of a sale of assets out of the ordinary course of business under section 363(b) is the business judgment rule, the court applies a

stricter standard to approval of a break-up fee, "that a court should ensure that revenues are maximized and that the best interests of the debtors' estate, creditors and equity-holders are furthered." *In re Tiara Motor Coach Corporation*, 212 B.R. 133 (Bankr. N.D. Ind. 1997).

12.3.jjj. Appeal is not moot despite sale of underlying property. An appeal from an order setting aside an earlier order approving sale of property was not moot, even though the property had subsequently been sold to an unrelated buyer. Section 363(m) did not apply, because the appeal did not challenge the validity of the subsequent sale. The court also noted the possibility of equitable relief on remand, because the proceeds of the subsequent sale were being held pending the outcome of the appeal. *Golfland Entertainment Center, Inc. v. Peak Investment, Inc. (In re BCD Corp.)*, 119 F.3d 852 (10th Cir. 1997).

12.3.kkk. Appeal from order authorizing sale of non-estate property is moot. The policy of section 363(m) of the Bankruptcy Code in favor of finality of sales is sufficiently strong that even a challenge that the property sold did not belong to the estate will not be heard on appeal if the purchaser was in good faith. *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.2d 380 (2d Cir. 1997).

12.3.lll. Second Circuit sets standard for good faith purchase under section 363(m). In an appeal challenging the good faith of a purchaser under Section 363(m), the Second Circuit limits the inquiry of good faith to the conduct of the purchaser in the course of the bankruptcy case, including actions and preparation for and during the sale itself. "That is, the good faith requirement prohibits fraudulent, collusive actions specifically intended to affect the sale price or control the outcome of the sale." *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.2d 380 (2d Cir. 1997).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.1.a. Quasi-judicial immunity and *Barton v. Barbour* bar debtor's law firm's actions against trustee for malicious prosecution. The trustee brought an action in the bankruptcy court against the debtor's law firm to avoid a transfer of property of the debtor's subsidiary made during the involuntary gap period. The bankruptcy court granted the law firm's motion to dismiss for failure to state the claim that the property was property of the estate. The trustee brought another action in state court against the law firm for breach of fiduciary duty, conspiracy to commit fraud and other state law claims arising out of the same transfer. The state court dismissed the action on statute of limitations and other grounds. The law firm then sued the trustee in bankruptcy court, and sought leave from the bankruptcy court to sue in state court, for malicious prosecution. A trustee is entitled to quasi-judicial immunity for actions taken in his official capacity and within his authority, though not for a lawsuit by an estate beneficiary for the trustee's breach of fiduciary duty to the estate. Prior court approval of the trustee's action is not required as a condition to the immunity. Seizure of property that is not property of the estate is outside the trustee's authority, but bringing an action to recover property, even if unsuccessful because the property was not estate property, is within the trustee's official capacity and not outside the trustee's authority. Bringing the action is part of the trustee's duties, even if the trustee is unsuccessful. In this case, the trustee acted within his official capacity in bringing the avoiding power action and did not improperly seize the property. He was therefore entitled to quasi-judicial immunity in the bankruptcy court action. *Barton v. Barbour*, 104 U.S. 126 (1881), requires that a party seeking to sue a trustee in another court for an act done in the trustee's official capacity and within his authority first obtain leave from the appointing court. For the same reasons that the trustee's avoiding power action was entitled to quasi-judicial immunity in the bankruptcy court, the court denied the law firm leave to sue the trustee in state court on account of the trustee's unsuccessful state court action. *Grant, Konvalinka & Harrison, PC v. Banks (In re McKenzie)*, 716 F.3d 404 (6th Cir. 2013).

13.1.b. *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).

13.1.c. Discharged trustee in closed case has standing to be heard on motion to reopen. The chapter 7 debtors received their discharge, their case was closed and their trustee was discharged without their having disclosed a prepetition personal injury claim. They moved to reopen the case and convert it to chapter 11. The trustee joined the motion to reopen but opposed the motion to convert. Because the motion to reopen was combined with the motion to convert, the previously discharged trustee had not been reappointed at the time of the hearing on the motion. Nevertheless, to deny the trustee standing in these circumstances would be a hypertechnical reading of the statute that would exalt form over substance. The trustee is the most knowledgeable person about the issues in the case and the only one with sufficient incentives to challenge a debtor who seeks to reopen based on a previous failure to disclose assets. Under section 554, the estate retains any undisclosed assets, and the trustee is the representative of the estate and so should have standing to be heard on a combined motion. Section 727(e) implicitly recognizes a discharged trustee's standing by granting authority for the trustee to seek revocation of the debtor's discharge after the case is closed. After reopening, the U.S. trustee might not appoint the same trustee for the case. But until that happens, the former trustee is in the best position to challenge a nondisclosing debtor's motion to convert. Therefore, the trustee has standing to oppose the motion. *Levesque v. Shapiro (In re Levesque)*, 473 B.R. 331 (9th Cir. B.A.P. 2012).

13.1.d. Section 326(a) grants a chapter 7 trustee a commission. The chapter 7 trustee initially filed a no-asset report. Later, the trustee collected tax refunds owing to the debtor and issued a notice to creditors to file proofs of claim. He distributed a portion of the refunds to the debtor as an exemption and a portion as a dividend on general unsecured claims. He applied for compensation based on the percentages of money disbursed that section 326(a) lists, independent of the time or effort spent in the case. Section 326(a) provides "the court may allow reasonable compensation under section 330(a) of this title to a trustee … not to exceed [specified percentages] upon all moneys disbursed or turned over to parties in interest." Section 330(a)(1) permits the court to "award to a trustee … reasonable compensation for actual, necessary services rendered." Section 330(a)(7) provides, "In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326." Section 330(a)(3) provides additional factors, which are similar to the lodestar analysis, that the court must consider in determining reasonable compensation to a chapter 11 (but not chapter 7) trustee. Section 330(a)(7) consists of two clauses, the introductory dependent clause, and the independent "commission" clause. The commission clause requires a commission, that is, a percentage fee, tied to the percentages listed in section 326(a). Fixed commissions are generally not subject to adjustment for reasonableness, but the dependent clause suggests a court may apply a reasonableness assessment. The reasonableness factors in section 330(a)(3) apply only to a chapter 11 trustee's fees. A chapter 7 trustee's fees are subject to a different reasonableness assessment, which is whether there is a rational relationship between the commission and the services rendered. Congress has fixed both the chapter 7 trustee's duties and the commission rate, so there is a presumption that there is a rational relationship between them. That relationship breaks down only in extraordinary circumstances. In such cases, the court may apply a reasonableness analysis. Otherwise, a chapter 7 trustee is entitled to the commission rate. *Hopkins v. Asset Acceptance LLC (In re Salgado-Nava)*, 473 B.R. 911 (9th Cir. B.A.P. 2012).

13.1.e. *Barton v. Barbour* applies to an action against a liquidating trustee for activities taken in administering the estate. The trustee sold the estate's real property, without the court's approval, in violation of a covenant restricting the sale. A purchaser of a different, related parcel sought leave to sue the

trustee in state court for violation of the covenant and for depriving it of property without notice and due process. Under *Barton v. Barbour*, 104 U.S. 126 (1881), an action against a federal court equity receiver first requires permission of the court that appointed the receiver. Otherwise, the effect of the action would be to take property from the receiver to satisfy the plaintiff's claim, without regard to the claims of other creditors. Without such permission, no other court has jurisdiction to hear the action. Courts have applied *Barton* to protect bankruptcy trustees, because they are similarly officers of the court whose possession of assets is effectively the court's possession. A judgment against a trustee may affect the administration of assets in the same way that an action against a receiver might. In addition, 28 U.S.C. § 959(a) implicitly codifies the *Barton* rule in bankruptcy cases. It permits an action against a trustee or debtor in possession "with respect to their acts … in carrying on business", but not otherwise. Section 323(b), which establishes that a trustee has the capacity to sue and be sued, addresses only capacity, not the procedures a plaintiff must follow before bringing an action. In this case, the action against the trustee was for activities in administering the estate, not in conducting the debtor's business. Therefore, *Barton* applies and section 959(a) does not. In determining whether to permit the action to proceed, the bankruptcy court must consider only whether the claim is "not without foundation". It need not conduct a trial on the merits or even consider a claim of immunity or other defenses the trustee might raise. Those may be heard in the nonbankruptcy forum. *In re Vistacare Group, LLC*, 678 F.3d 218 (3d Cir. 2012).

13.1.f. *Barton v. Barbour* applies to a trustee's attorneys who are accused of wrongful conduct or even fraud in pursuing assets for the estate. The trustee sued the debtor's former officers to avoid transfers and for breach of fiduciary duty. The defendants later brought an action against the trustee's attorneys, claiming that in depositions and to support expert testimony, they used copies of the tax returns that they knew were not the debtor's tax returns and that they wrongfully obtained and used copies of the defendants' individual tax returns. Under *Barton v. Barbour*, 104 U.S. 126 (1881), a plaintiff may not sue a receiver appointed by a federal court without leave of court. *Barton* applies equally to bankruptcy trustees and their attorneys for conduct within the context of their roles of recovering assets for the estate. *Barton* applies to a trustee's attorney even if the trustee did not specifically direct the conduct that is the subject of the action and to conduct that the plaintiff alleges was wrongful. The doctrine also applies to conduct that the plaintiff alleges was fraudulent, because trustees and their attorneys equally need protection from unfounded allegations of fraud, and because bringing such matters before the appointing court helps that court to police its appointees. The attorneys' conduct here was in pursuit of recoveries for the estate and is therefore covered by *Barton*, so the action must be dismissed. *McDaniel v. Blust*, 668 F.3d 153 (4th Cir. 2012).

13.1.g. Credit bid is not "moneys disbursed" for the purpose of calculating a trustee's compensation. The chapter 7 trustee negotiated the sale of the estate's principal asset to the secured creditor, by credit bid, subject to overbids. There were no overbids. At closing, the trustee conveyed the property free and clear of liens to the secured creditor's designee and applied the credit bid to reduce the amount owing on the lien. The trustee sought compensation for his work in the case. Section 326(a) limits a trustee's compensation to a percentage of "moneys disbursed or turned over in the case by the trustee to parties in interest … including holders of secured claims". "Money" is a medium of exchange. "To disburse" means to pay out money. A credit bid is not a medium of exchange that would constitute money disbursed under section 326(a). Such a reading is consistent with the use of "money" elsewhere in the Code, such as in section 345 and in section 704(a)(1), which requires a trustee to "collect and reduce to money the property of the estate". It is also consistent with the purpose of section 704(a)(1), because it measures the trustee's compensation only by the amount of money that the trustee produces consistent with the section 704(a)(1) duty, not by the value of property that the trustee simply turns over to parties in interest. Property turnover or transfer on a credit bid does not produce a net benefit to the estate or additional disbursements to holders of unsecured claims, who would have to bear the expense of the trustee's compensation based on the credit bid. Therefore, the trustee may not base compensation on the amount of a secured creditor's credit bid. *U.S. Trustee v. Tamm (In re Hokulani Square, Inc.)*, 460 B.R. 763 (9th Cir. B.A.P. 2011).

13.1.h. Declaratory action against the trustee to determine avoidability of a transfer violates *Barton v. Barbour*. The trustee brought an action to recover voidable transfers from the initial transferee and from its related subsequent transferee. The subsequent transferee then brought an action in the

Grand Court of the Cayman Islands for a declaration that it was not liable to the trustee. *Barton v. Barbour*, 104 U.S. 126 (1881), prohibits an action against a trustee without leave of the appointing court. The Cayman action violates *Barton*. The court enjoins the subsequent transferee from proceeding with the action. *Picard v. Maxam Absolute Return Fund, L.P. (In re Bernard L. Madoff Inv. Secs., LLC)*, 460 B.R. 106 (Bankr. S.D.N.Y. 2011).

13.1.i. Section 326(a) percentages may apply to noncash disbursements where chapter 11 trustee confirms plan that does not provide for cash distributions. A chapter 11 trustee administered a case and proposed and confirmed a plan that resulted in distribution of securities (rather than cash) to creditors and investors. Section 326(a) limits a chapter 7 or chapter 11 trustee's compensation to a percentage of "all moneys disbursed or turned over in the case by the trustee to parties in interest". In this case, the trustee's fee request exceeded the percentage of cash disbursed but not the percentage of securities distributed under the plan. Section 704(a)(1) requires a chapter 7 trustee to "collect and reduce to money the property of the estate for which such trustee serves". There is no comparable duty of a chapter 11 trustee, who is required instead to propose and confirm a plan, which might provide for distribution of property other than cash. It would create an absurd result to apply section 326(a) literally to deny the trustee compensation for doing what the statute requires. Therefore, the court applies a "constructive disbursement" exception to section 326(a) to permit the trustee to be compensated for his efforts. *In re Radical Bunny, LLC*, 459 B.R. 434 (Bankr. D. Ariz. 2011)

13.1.j. Trustee may employ counsel at the expense of the estate to defend a malicious prosecution action. The trustee sued to recover a postpetition transfer. The court dismissed the complaint on the pleading, because the trustee failed to allege that the transfer was of property of the debtor or the estate. The defendants in the action sued the trustee and his counsel for malicious prosecution and abuse of process. Trustees are entitled to quasi-judicial immunity for actions within the scope of their official duties and a presumption that they act within the scope of their duties, to protect them from claims, so that they will not refrain from aggressively pursuing actions to recover assets for the estate. Consistent with the policy to protect trustees in carrying out their official duties, a trustee should be able to employ counsel at the expense of the estate to defend an action asserting claims against the trustee arising out of the trustee's official duties. *In re McKenzie*, 453 B.R. 737 (Bankr. E.D. Tenn. 2011).

13.1.k. A trustee needs court approval to compensate professionals from pension plan assets in administering an ERISA plan. The debtor maintained an ERISA-qualified defined benefit plan for its employees. The chapter 7 trustee assumed plan administration responsibilities as required under section 704(a)(11). Under ERISA, a plan administrator may retain and compensate professionals and may compensate himself without any court or agency approval. However, section 327(a) requires that the trustee obtain court approval to hire a professional "to represent or assist the trustee in carrying out the trustee's duties under this title". In addition, section 330(a) permits the court to award compensation to the trustee and professionals. Trustees are creatures of the Bankruptcy Code; they "arise under" the Bankruptcy Code, and their oversight and compensation are within the bankruptcy courts' core jurisdiction. By delegating to a trustee the responsibility to administer pension plans, Congress brought their compensation for doing so within the bankruptcy court's core jurisdiction. Therefore, the court has jurisdiction to review the compensation request. *In re Franchi Equip. Co., Inc.*, 452 B.R. 352 (Bankr. D. Mass. 2011).

13.1.l. Court holds trustee liable on her bond. The debtor's father died two months after her bankruptcy, leaving a substantial estate. The trustee inquired of the debtor about the assets to which she would be entitled under the will, but the debtor resisted turnover. A creditor pressed the trustee several times to act, but the trustee took no action to recover the assets from the debtor until over seven years later, by which time the debtor had spent the assets. Section 322(a) requires a trustee to file a bond in favor of the United States conditioned on the faithful performance of the trustee's official duties. The trustee here did so. Rule 2010(b) permits a creditor to bring an action on the bond in the name of the United States. The creditor sued the surety on the bond under Rule 2010(b). Section 322(d) prohibits commencement of an action on the bond more than two years after the trustee's discharge. The statute of limitations does not supplement nonbankruptcy statutes but completely supplants them. Although the state statute for recovery on a bond had expired when the creditor brought the action, the section 322(d)

had not. Therefore, the action was timely. A trustee is personally liable only for gross negligence. The same standard applies to liability on a bond, as the liability of the surety is joint and several with the liability of the trustee. Although courts disagree on the proper standard to define gross negligence, the trustee's failure here to pursue substantial assets for over seven years qualifies. Therefore, the surety is liable for the loss occasioned by the trustee's inaction. The liability is to the estate, not to the creditor bringing the action, because the bond is in favor of the United States to cover losses to the estate. *U.S. ex rel. Lamesa Nat'l Bank v. Liberty Mut. Surety (In re McSchooler)*, 449 B.R. 502 (Bankr. N.D. Tex. 2010).

13.1.m. Court approved contract does not create a relationship that renders a trustee not disinterested. After bankruptcy, the debtor transferred his principal asset. Upon learning of the transfer, the trustee sued the transferee. A creditor claimed the debtor had held the asset as agent for the benefit of the creditor and had no authority to transfer it. A claims buyer bought the creditor's claim and later entered into an asset purchase agreement with the trustee to buy the estate's interest in the asset and the trustee's claim against the transferee. The agreement provided for a payment to the claims buyer if the trustee settled the suit against the transferee without the buyer's consent. The court approved the agreement. The transferee filed a chapter 11 plan that provided for dismissal of the trustee's suit against him, turnover of all the estate's property to him, payment to the buyer of any amounts that would be owing under the asset purchase agreement if the trustee settled the suit without the buyer's consent and payment in full of all claims, including the claim buyer's claim. The trustee and the buyer filed a competing plan. The transferee objected to confirmation of the trustee/claim buyer's plan on the ground that the trustee was not disinterested. (The opinion does not explain why non-disinterestedness provided a plan objection ground.) A person is "disinterested" when the person "does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security interest holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or for any other reason". A court approved, non-personal relationship with a creditor based on a postpetition contract does not render the trustee interested. *Search Market Direct, Inc. v. Jubber (In re Paige)*, 439 B.R. 786 (D. Utah 2010).

13.1.n. Disinterestedness requirement applies to personal interests, not to a interest held in a representative capacity. Some of the companies in the debtor group conducted a Ponzi scheme; others conducted legitimate business. Upon the government's civil action against the debtors for an asset freeze and forfeiture, the district court appointed a receiver for all the companies. The receivership order authorized the receiver to act as management of and to file bankruptcy petitions for all of the debtors. It also directed the receiver to "[c]ooperate with the United States Attorney's office and Court personnel as needed to ensure that any assets subject to the terms of this Order are available for criminal restitution, forfeiture, or other legal remedies in proceedings commenced by or on behalf of the United States." The receiver filed chapter 11 petitions for all of the debtors and remained receiver in the civil action. The court granted the U.S. Trustee's motion for a trustee, and, over the objection of a creditor of one of the legitimate businesses, the U.S. Trustee appointed the receiver as trustee for each of the debtors. Section 1104 requires that a trustee be a disinterested person. The definition of disinterested addresses only a person's personal interests, not interests held in a representative capacity, for example, as a receiver. In any event, the receivership orders did not create an adverse interest, as they required only transparency in operation of the receivership, not that the receiver align with the U.S. Attorney's office in seeking forfeiture. Therefore, the receiver was a disinterested person and qualified to serve as trustee. Rule 2009 permits appointment of a single trustee for related cases unless prejudice would result to the separate estates. Because the cases were still in the phase of locating assets, inter-estate conflicts were not yet apparent, and the appointment of a single trustee was appropriate. *Ritchie Spec. Credit Invs. v. U.S. Trustee*, 620 F.3d 847 (8th Cir. 2010).

13.1.o. A trustee needs court approval for retention of professionals and compensation in administering an ERISA plan. The debtor maintained an ERISA-qualified defined benefit plan for its employees. The chapter 7 trustee assumed plan administration responsibilities as required under section 704(a)(11). Under ERISA, a plan administrator may retain and compensate professionals and may compensate himself without any court or agency approval. However, section 327(a) requires that the trustee obtain court approval to hire a professional "to represent or assist the trustee in carrying out the trustee's duties under this title". In addition, section 330(a) permits the court to award compensation to

the trustee and professionals. Neither section 327 nor section 330 is limited to situations in which the trustee or professionals are to be paid from the estate. Therefore, they apply to the trustee's employment and compensation of professionals and to the trustee's own compensation, even though the pension plan, and not the estate, will make all payments. The court does not address whether the compensation that it awards is also an administrative expense under section 503(b)(2), which provides, "there shall be allowed administrative expenses … including … (2) compensation and reimbursement awarded under section 330(a)". *In re The Robert Plan Corp.*, 439 B.R. 29 (Bankr. E.D.N.Y. 2010).

13.1.p. Liquidating trustee under a chapter 11 plan may pursue creditor-assigned claims. The debtor defrauded many of its investors. The investors asserted claims against the debtor's clearing bank, lender and depository. The chapter 11 plan created a liquidating trust to pursue the estate's claims and permitted individual investors to assign claims to the trustee to pursue collectively on their behalf. *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), prohibited a bankruptcy trustee from asserting creditors' claims, for three reasons: the Bankruptcy Act did not authorize the trustee to do so; the defendant might have had a subrogation right against the estate which would have defeated any recovery for the estate; and the trustee's action risked double recovery, as the creditors could still pursue their own claims. The Bankruptcy Code did not affect authorization. However, the Code's restrictions on a bankruptcy trustee do not limit the power a plan may grant to a reorganized debtor, including a liquidating trustee. Where creditors assign claims, *Caplin*'s latter two reasons do not apply. Therefore, the liquidating trustee may assert the assigned claims against the bank. *Grede v. Bank of N.Y. Mellon*, 598 F.3d 899 (7th Cir. 2010).

13.1.q. Trustee may not receive early discharge of ERISA plan fiduciary claims. The debtor maintained a 401(k) plan. After bankruptcy, the trustee distributed all funds in the plan to the plan beneficiaries and sought court approval of a procedure that would have set a 60-day bar date for asserting claims under the plan and discharged the trustee thereafter from any claims not asserted. The Department of Labor objected. Section 704(a)(11) requires a trustee to serve as a plan administrator for any ERISA plan for which the debtor served as plan administrator. ERISA has a six-year statute of limitations for claims against a plan fiduciary, such as an administrator, but section 704(a)(1) requires the trustee to close the estate "as expeditiously as is compatible with the best interests of parties in interests". Section 704(a)(11) creates the trustee's duties, not ERISA. By placing the duties in the Bankruptcy Code, Congress intended to fit the trustee's ERISA duties within the Bankruptcy Code's framework. Section 350(a) authorizes the court to discharge the trustee "[a]fter an estate has been fully administered. The court therefore has jurisdiction to discharge the trustee from any ERISA liabilities, but only at the end of the case, not piecemeal during the case. Thus, the court denies the trustee's motion but notes that the trustee will be entitled to the discharge once the estate is fully administered and the case is ready to be closed. *In re NSCO, Inc.*, 427 B.R. 165 (Bankr. D. Mass. 2010).

13.1.r. Chapter 7 trustee's compensation must be reasonable, despite section 330(a)(7)'s "commission" requirement. The trustee quickly handled about $120,000 in a chapter 7 case, for which the maximum fee under section 326(a) would be about $9,200. Section 326(a) permits the court to award a "reasonable" fee, subject to a maximum based on a percentage of the "handle". Section 330(a)(7) provides that in determining the amount of reasonable compensation for a chapter 7 trustee, "the court shall treat such compensation as a commission, based on section 326(a)". This provision begs the question of what commission is reasonable under the circumstances. Section 330(a)(3) requires the court to consider several factors in determining the reasonableness of the compensation of estate professionals other than a chapter 7 trustee, but it does not prohibit the court from considering those factors in awarding a chapter 7 trustee compensation. Finally, section 326(a) and section 330(a)(7) both refer to "reasonable" compensation. Therefore, the court reviews the extent of work the trustee did in this case and awards a fee of $5,000. The court notes that such compensation is higher, because of section 330(a)(7), than would have been awarded under a straight "lodestar" analysis, thereby giving some effect to section 330(a)(7)'s "commission" requirement. *In re Ward*, 418 B.R. 667 (W.D. Pa. 2009).

13.1.s. Barton immunity does not apply in the appointing court, but the trustee may still get derived quasi-judicial immunity. The trustee sued the debtor and his wife for a fraudulent transfer. They settled. The settlement contemplated the sale of the recovered property. The trustee negotiated a sale

and, on notice to creditors and the debtor, obtained bankruptcy court approval. The debtor later sued the trustee in state court alleging that the sale violated the settlement agreement. The trustee removed the action to the bankruptcy court. The *Barton* doctrine requires that a party obtain leave of the appointing court before suing a trustee in another court for acts done in the trustee's official capacity. The doctrine's purpose is to permit the appointing court to supervise the case's administration, not to deny a forum to an unwary plaintiff. Once the trustee removed the action to the bankruptcy court, therefore, the doctrine's purpose had been met, and the debtor plaintiff's failure to obtain prior leave of court did not require dismissal of the action for lack of jurisdiction. However, derived quasi-judicial immunity protects a trustee who acts within her authority, after candid disclosure of her proposed action to the bankruptcy court and notice to the plaintiff and with bankruptcy court approval. Here, all requirements were met. The court therefore properly dismissed the action. *Harris v. Wittman (In re Harris)*, 590 F.3d 730 (9th Cir. 2009).

13.1.t. Trustee has quasi-judicial immunity for statements made at 341 meeting and in written communications to creditors. The court ordered the appointment of a chapter 11 trustee, who, upon investigation, determined that the debtor had been conducting a Ponzi scheme. At the section 341 meeting, the trustee advised creditors present that the debtor's principal had lied to and defrauded them. The principal then wrote to creditors defending himself and urging creditors to take action in the bankruptcy court. The trustee wrote in response and posted his letter on his official website, once again accusing the principal of conducting a Ponzi scheme. The principal sued in state court; the trustee removed the action to the bankruptcy court. Determining whether a non-judicial officer has quasi-judicial immunity requires a two-step process. The first step examines whether the common law accorded the relevant officer immunity. The second examines whether immunity covers the particular functions at issue. In this case, bankruptcy trustees have historically received absolute quasi-judicial immunity for their official acts because they perform some functions that are judicial in nature. The functions for which the principal sued here were the trustee's conduct of the 341 meeting, orally reporting on his ongoing investigation and informing creditors about the estate's assets to protect the estate from further dissipation and harm. The trustee's statutory duties give him broad authority to investigate, inform creditors and preserve the estate's assets. These functions are "essential to the authoritative adjudication of private rights to the bankruptcy estate" and therefore protected by quasi-judicial immunity. *Nilsen v. Neilson (In re Cedar Funding, Inc.)*, 419 B.R. 807 (9th Cir. B.A.P. 2009).

13.1.u. Trustee for a creditors liquidating trust does not have a bankruptcy trustee's immunity. The debtor in possession asserted claims for breach of fiduciary duty against its former directors. The D&O insurance carrier refused coverage. The debtor confirmed a plan that assigned its claims against its former directors to a creditors trust. The trustee settled with the directors and took an assignment of and pursued their claims against the carrier, which the court dismissed. Applicable state law shifted attorney's fees to the losing party. A bankruptcy trustee is not generally liable personally for acts taken solely in its representative capacity. However, the trustee of a liquidating creditors trust is not a bankruptcy trustee for these purposes. The court characterizes the trustee as having been employed by the creditors committee under section 1103 and notes that this action took place outside of bankruptcy court, so the trustee here does not have a bankruptcy trustee's immunity. However, applicable nonbankruptcy law protects a trustee against personal liability if the trustee is not personally at fault for the obligation. *Biltmore Assocs., LLC v. Twin City Fire Ins. Co.*, 572 F.3d 663 (9th Cir. 2009).

13.1.v. *Barton* doctrine protects the trustee's professionals and lenders. The chapter 7 trustee retained lawyers and an investigator to pursue assets that a debtor had hidden. He also borrowed funds from existing creditors to finance the investigation and pursuit. The debtor sued the trustee, the lawyers, the investigator and the creditor/lenders and their counsel in district court alleging violation of federal wiretapping laws, RICO, the Fair Debt Collection Practices Act and other laws. *Barton v. Barbour*, 104 U.S. 126 (1881), deprives a court of jurisdiction over an action against a court-appointed receiver unless the appointing court has granted leave to sue. Later case law has applied *Barton* to trustees in bankruptcy, to protect the administration of a bankruptcy estate, because the trustee is acting as an officer of the court in carrying out his official duties. Court-approved professionals for the trustee function as the equivalent of court-appointed officers by assisting the trustee in his official duties. Similarly, court-approved lenders who finance the trustee's duties also function as the equivalent of court-appointed officers, as does their counsel. Therefore, *Barton* protects all the defendants in this

action, and the district court must dismiss the action for lack of subject matter jurisdiction. *Lawrence v. Goldberg*, 573 F.3d 1265 (11th Cir. 2009).

13.1.w. *Barton* doctrine applies to a litigation trustee, but only if the court has jurisdiction over the proposed action. The confirmed chapter 11 plan provided for the creation of a litigation trust, for the vesting in the trust of prepetition causes of action and for the bankruptcy court to retain jurisdiction over matters relating to the trust. After the trust expired, but while it was still in wind-down, a trust beneficiary sued the trustee in the bankruptcy court for breach of contract and breach of fiduciary duty in administering the trust. The *Barton* doctrine prohibits a party from suing a trustee appointed by a federal court without the court's permission. The doctrine protects the court's jurisdiction over the property that the trustee administers. Although the court did not appoint the liquidating trustee, the liquidating trustee is the functional equivalent of a bankruptcy trustee, because the liquidating trustee is administering the remaining assets of the bankruptcy estate. The bankruptcy court's postconfirmation jurisdiction is more limited than its preconfirmation jurisdiction, extending only to matters that affect implementation or execution of the plan. The bankruptcy court has postconfirmation jurisdiction over a matter involving a liquidating trust where the cause of action arose prepetition or arises under title 11 but not where the cause of action has only an incidental effect on the reorganized debtor or the implementation of the plan. Here, the court did not have postconfirmation jurisdiction over the action. As a result, the *Barton* doctrine cannot bar the action against the trustee. *In re WRT Energy Corp.*, 402 B.R. 717 (Bankr. W.D. La. 2007).

13.1.x. Court allows full "commission" to chapter 7 trustee. The chapter 7 trustee sought compensation calculated using section 326(a)'s percentages. Section 330(a)(7) provides, "In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326." The typical *Johnson* compensation factors used to determine reasonableness of compensation are stated only in section 330(a)(3), which applies by its terms only to a chapter 11 trustee and other professionals. Sections 330(a)(1) and (2), which permit the court to grant reasonable compensation in an amount less than requested, still apply to a chapter 7 trustee. Therefore, a chapter 7 trustee is entitled to compensation based on the commission structure, but the court may determine reasonableness, may award less than requested and may use the *Johnson* factors in determining a chapter 7 trustee's compensation. In this case, the trustee performed well and should receive the full commission amount. *In re Coyote Ranch Contractors, LLC*, 400 B.R. 84 (Bankr. N.D. Tex. 2009).

13.1.y. "Cause" for trustee removal requires analysis of the totality of the circumstances. The chapter 7 trustee in a Ponzi scheme case had represented the former CFO, who resigned when he learned of the Ponzi scheme, and the CFO's domestic partner in recovering the partner's investment in the debtor. Both engagements preceded the petition date by at least two years. The trustee initially disclosed the latter representation but disclosed the former only in the context of litigation on behalf of the estate. The bankruptcy court properly removed the trustee under section 324 for cause. "Cause" is to be determined based on the totality of the circumstances. Lack of disinterestedness under the catch-all provision of section 101(14)(E), that is, based on "an interest materially adverse to the interest of the estate …, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor … or for any other reason," is similarly to be determined based on the totality of circumstances. The trustee's prior connection with the debtor's former CFO and an investor, the lack of prompt disclosure, even though inadvertent, the general distrust that these facts engendered among some of the creditors and the appearance that the trustee might not act impartially as to the former CFO fully supported the bankruptcy court's determination of adequate cause for removal. *Dye v. Brown (In re AFI Holding, Inc.)*, 530 F.3d 832 (9th Cir. 2008), *adopting lower court opinion at* 355 B.R. 139 (9th Cir. B.A.P. 2006).

13.1.z. *Barton* doctrine does not apply to sanctions against a trustee in a nonbankruptcy court action the trustee initiates. The trustee sued the corporate debtor's principal and attorney in state court to recover a fraudulent transfer the debtor made. State law was clear that such a claim would not lie. State law provides for an award of attorney's fees against a plaintiff that brings an action not supported by the facts or the law. The state court awarded fees against the trustee (in her official capacity) and her lawyer. The *Barton* doctrine prohibits an action against a trustee without leave of the appointing court. This action was by, not against, the trustee, and none of the rationales for the *Barton*

doctrine apply. The sanctions award was against the estate, not the trustee personally, so allowing the award would not necessarily discourage trustee service or increase a trustee's insurance costs. The trustee chose the forum, so allowing the sanctions would not encourage creditors to pick apart the estate by bringing actions in different courts or prevent uniform application of the bankruptcy laws. Therefore, the defendants may obtain the sanctions order from the state court without leave of the bankruptcy court. *In re Ridley Owens, Inc.*, 391 B.R. 867 (Bankr. N.D. Fla. 2008).

13.1.aa. Court may consider time spent in determining a chapter 7 trustee's compensation. The 2005 amendments added section 330(a)(7), which provides that in determining the trustee's compensation, "the court shall treat such compensation as a commission, based on section 326." In addition, it deleted chapter 7 trustees from the list of professionals subject to lodestar review under section 330(a)(3). Nevertheless, in determining compensation, the court may still consider the time a chapter 7 trustee reasonably spends. First, "commission" is ambiguous, and section 330(a)(3), which still applies to chapter 11 trustees, requires consideration of time a chapter 11 trustee spends, despite section 330(a)(7). Second, under section 330(a)(1), compensation must still be reasonable. Third, according some weight to time spent is not the same as a full lodestar analysis. Fourth, the 2005 amendments give the bankruptcy court greater discretion in awarding compensation to chapter 7 trustees, because they eliminated the lodestar standard and did not substitute another. Fifth, duties and work vary substantially from case to case, unrelated to the amount distributed to creditors. Sixth, the only other two reported cases and a leading treatise support requiring consideration of time spent. Finally, imposing timekeeping requirements will not create an undue burden. *In re McKinney*, 374 B.R. 726 (Bankr. N.D. Cal. 2007).

13.1.bb. Court may remove a trustee on its own motion. Section 324 permits "[t]he court, after notice and a hearing, [to] remove a trustee … for cause." It does not require a motion by a party in interest or the U.S. Trustee. Therefore, after the court gave the trustee notice by order to show cause of the basis for removal and an opportunity to rebut the charges, the court could remove a trustee who gave false testimony in a chapter 13 case. Doing so did not cast the judge in the role of both prosecutor and adjudicator. The judge simply determined a basis existed for removal and gave the trustee the opportunity to prove otherwise. A dissent argues that by effectively shifting the burden of proof to the trustee, the court acted improperly and should instead have asked the U.S. Trustee to investigate, report, and recommend. *In re Morgan*, 375 B.R. 838 (8th Cir. B.A.P. 2007).

13.1.cc. "Cause" for trustee removal requires analysis of the totality of the circumstances. The chapter 7 trustee in a Ponzi scheme case had represented the former CFO, who resigned when he learned of the Ponzi scheme, and the CFO's domestic partner in recovering the partner's investment in the debtor. Both engagements preceded the petition date by at least two years. The trustee initially disclosed the latter representation but disclosed the former only in the context of litigation on behalf of the estate. The bankruptcy court properly removed the trustee under section 324 for cause. "Cause" is to be determined based on the totality of the circumstances. Lack of disinterestedness under the catch-all provision of section 101(14)(E), that is, based on "an interest materially adverse to the interest of the estate …, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor … or for any other reason," is similarly to be determined based on the totality of circumstances. The trustee's prior connection with the debtor's former CFO and an investor, the lack of prompt disclosure, even though inadvertent, the general distrust that these facts engendered among some of the creditors, and the appearance that the trustee might not act impartially as to the former CFO fully supported the bankruptcy court's determination of adequate cause for removal. *Dye v. Brown (In re AFI Holding, Inc.)*, 355 B.R. 139 (9th Cir. B.A.P. 2006).

13.1.dd. BAPCPA's section 330(a)(7) does not entitle a chapter 7 trustee to a straight commission. Section 330(a)(1) authorizes the court to award "reasonable compensation for actual, necessary services rendered." Section 326(a) imposes a maximum on trustee compensation, calculated as a percentage of distributions. BAPCPA added section 330(a)(7), which provides, "In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326." The new provision does not supersede the reasonableness of "actual, necessary" requirements of section 330(a)(1). It adds only another consideration of what should go into the analysis of a reasonable fee. In this case, the trustee requested a fee based on the percentage

schedule in section 326(a), without any other evidence of reasonableness or whether the services were actual or necessary. Allowance of the requested amount would have left a distribution on general unsecured claims of 38%, an aggregate distribution approximately equal to the fees requested. The court denies the request and requires the trustee to support the fee application with additional evidence. *In re Clemens*, 349 B.R. 725 (Bankr. D. Utah 2006).

13.1.ee. *Barton* doctrine applies to trustee's counsel. *Barton v. Barbour*, 104 U.S. 126 (1881), held that a plaintiff may not sue a federal court appointed receiver for acts done in the receiver's official capacity and within the receiver's authority as an officer of the court without leave of the appointing court. Later case law has extended the doctrine to suits against a trustee in bankruptcy. The doctrine applies equally to trustee's counsel. Moreover, the court will presume that the defendant counsel's actions were a part of the trustee's official duties unless the plaintiff "initially alleges at the outset facts demonstrating otherwise." This presumption protects the bankruptcy court's exclusive jurisdiction over matters affecting the officers of the estate and prevents a plaintiff from using unsupported allegations to deprive the court of jurisdiction. Here, plaintiff sued trustee's counsel for defamation for bringing a contempt action against her for actions she took in her former husband's bankruptcy. Her complaint alleged only that counsel was unjustified on the facts from making defamatory allegations in the contempt action, not that he was acting outside his official duties. Thus, the state court did not have jurisdiction over plaintiff's suit against trustee's counsel, and the bankruptcy court was not required to abstain from hearing the action. *Lowenbraun v. Canary (In re Lowenbraun)*, 453 F.3d 314 (6th Cir. 2006).

13.1.ff. Creditor who received substantial preference is not qualified to vote for a trustee. After the chapter 11 case was converted to a chapter 7 case, members of the chapter 11 committee attempted to elect a chapter 7 trustee. Before the creditors meeting, the chapter 7 interim trustee had investigated the claim of the largest creditor and concluded that the creditor had received a substantial preference, estimated at about 20% of the total amount of unsecured claims. A creditor is eligible to vote for a chapter 7 trustee if the creditor holds an allowable claim, is not an insider, and does not hold or represent an interest materially adverse to the estate. Because the creditor had received a preference, it held an interest adverse to the estate. Its interest would be in electing a trustee who was less likely to pursue the preference vigorously. Moreover, the size of the preference relative to the size of the case was material. Therefore, the creditor is not eligible to vote. Because the court resolves the issue on that ground, it does not reach the question of whether the receipt of the preference and section 502(d) render the creditor's claim not allowable. *In re Amherst Techs., LLC*, 335 B.R. 502 (Bankr. D.N.H. 2006).

13.1.gg. *Barton* doctrine, which requires leave of appointing court to sue a trustee, applies to a chapter 11 plan liquidating trustee. A chapter 11 plan provided for a liquidating trustee, who brought an action against the debtor's former parent entity for a fraudulent transfer in the bankruptcy court in California. The former parent sued the liquidating trustee in Delaware, alleging a violation of a venue selection clause in a Settlement Agreement that the debtor and the parent had entered into before bankruptcy. The trustee asked the bankruptcy court to enjoin the Delaware action. The action violated *Barton v. Barbour*, 104 U.S. 126 (1881), which requires leave of the appointing court before suing an equity receiver or, by subsequent case law extension, a bankruptcy trustee. *Barton* applies equally to a liquidating trustee appointed under a chapter 11 plan, and 28 U.S.C. § 959(a), which permits suits without leave of court against an operating trustee, does not repeal *Barton*, because it applies only to claims arising out of the active operation of a business. *Beck v. Fort James Corp. (In re Crown Vantage, Inc.)*, 421 F.3d 963 (9th Cir. 2005).

13.1.hh. Suit against trustee requires leave of court. After the chapter 11 plan had been confirmed and the case was closed, the debtor's principal sued the trustee for misfeasance, malfeasance, and breach of fiduciary duty. Under *Barton v. Barbour*, 104 U.S. 126 (1881), leave of the bankruptcy court is required to bring an action against a trustee. Section 959(a) of title 28 permits an action against a trustee without leave of court if the action arises out the trustee's operation of the business of the estate. That exception to *Barton* does not, however, apply to the claims brought here, which went to the trustee's conduct towards the estate, rather than the operation of the business. *Muratore v. Darr*, 375 F.3d 140 (1st Cir. 2004).

13.1.ii. Appointment of interim trustee does not toll the avoiding power statute of limitation. After conversion of a case from chapter 11 to chapter 7, an interim trustee was appointed within two years after the date of the filing of the chapter 11 petition. Creditors requested an election, which was held more than two years after the date of the filing of the petition. Under the express language of section 546(a), the avoiding power statute of limitation expires "the later of two years after the entry of the order for relief; or one year after the appointment or election of the first trustee under section 702 . . ." Because the interim trustee was appointed under section 701 and the permanent trustee was elected under section 702 more than two years after the order for relief, the statute of limitations expired before the election of the permanent trustee. *Singer v. Franklin Box Board Co. (In re American Pad and Paper Co.)*, 303 B.R. 27 (Bankr. D. Del. 2003).

13.1.jj. Avoiding power statute of limitations is extended by the appointment of an interim trustee. Section 546(a) imposes a statute of limitations on the commencement of an avoiding power action of two years after the order for relief or "one year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302." In this case, an interim trustee was appointed under section 701 within two years after the order for relief. A permanent trustee was never appointed or elected under section 702, so the interim trustee served as the permanent trustee under section 702(d). Under these circumstances, the appointment of the interim trustee applied to extend the statute of limitations for one year. *Burtch v. Georgia-Pacific Corp. (In re Allied Digital Technologies)*, 300 B.R. 616 (Bankr. D. Del.).

13.1.kk. Trustee entitled to interest on fees in a surplus case. Section 725(a)(5) provides for payment of interest at the legal rate from the date of the filing of the petition on any claims paid under section 726(a)(1), in a case in which all claims have been paid in full. Because the trustee's fees are paid under section 726(a)(1), which incorporates by reference the priorities set forth in section 507, including administrative expenses, the court rules that the trustee is entitled to interest on his fees at the legal rate from the date of the filing of the petition. *In re Hembree*, 297 B.R. 515 (Bankr. M.D. Tenn. 2002).

13.1.ll. Court may not appoint examiner with expanded powers or a limited purpose trustee. The debtor in possession refused to bring a fraudulent transfer action. The committee moved for the appointment of an examiner with expanded powers to bring the action. The court denies the motion on the ground that an examiner may perform only trustees duties "that the court orders the debtor in possession not to perform," and the debtor's refusal to bring the action is an exercise of its statutory prerogative, not a duty that the court orders the debtor in possession not to perform. The court also denies the motion to appoint a limited purpose trustee on the ground that by its nature, the Code makes the trustee <u>the</u> representative of the estate, and a trustee cannot share its powers or duties with the debtor in possession. *Official Committee of Asbestos Personal Injury Claimants v. Sealed Air Corp. (In re W.R. Grace & Co.)*, 285 B.R. 148 (Bankr. D. Del. 2002).

13.1.mm. Liquidating trustee controls attorney-client privilege. The chapter 11 plan established a liquidating trust to which all assets of the debtors and the estates were transferred. As a result, the liquidating trustee became the holder of the debtor's attorney-client privilege. In this case, where the liquidating trustee did not assert privilege in a reasonable period of time in a discovery dispute between third parties and the debtor's former law firm, the privilege was deemed waived. *Official Committee of Unsecured Creditors v. Fleet Retail Finance Group (In re Hechinger Investment Co. of Delaware)*, 285 B.R. 601 (D. Del. 2002).

13.1.nn. Chapter 13 trustee receives absolute quasi-judicial immunity. The chapter 13 trustee failed to give notice of the confirmation hearing to the debtor, the debtor failed to appear at the hearing, and the court therefore dismissed the chapter 13 case, allowing the mortgagee to foreclose on the debtor's home. In response to the debtor's action against the trustee, the Ninth Circuit rules that the trustee has absolute quasi-judicial immunity, because the scheduling of a confirmation hearing is a function that is judicial in nature, related to a court's inherent power to control its docket. Because the act of giving notice of the hearing cannot be separated from the act of scheduling it ("a hearing without notice is not a hearing"), the Ninth Circuit gives the chapter 13 trustee absolute immunity from a lawsuit for failing to give notice of the hearing. *Curry v. Castillo (In re Castillo)*, 297 F.3d 940 (9th Cir. 2002).

13.1.oo. Court limits trustee's fee. The bankruptcy court awarded the trustee a fee based on the maximum percentages contained in section 326(a). The court of appeals reverses on the grounds that the maximums do not constitute a commission but rather are limits on what constitutes a reasonable fee. The Tenth Circuit instead applies the Lodestar approach. *Connolly v. Harris Trust Co. of California (In re Miniscribe Corp.)*, 309 F.3d 1234 (10th Cir. 2002).

13.1.pp. Trustee not bound by settlement agreement until court approval. The trustee had entered into a settlement agreement with various parties in interest in the case. Before the court approved the agreement, the trustee entered into a broader settlement agreement that would have resolved most issues in the case but that was inconsistent with the first settlement agreement. The trustee sought approval of the second agreement and withdrawal from the first. The court permitted the withdrawal, because the first settlement agreement was not binding until the court had approved it. Circumstances had changed since the trustee entered into the first settlement agreement so as to make approval of that agreement not in the best interest of the estate, even though the changed circumstances were principally the result of the trustee entering into the second settlement agreement. *United States ex rel. Rahman v. Oncology Assocs., P.C. (In re Equimed, Inc.)*, 269 B.R. 139 (D. Md. 2001).

13.1.qq. Section 341 meeting is concluded unless the trustee announces an adjourned date. Bankruptcy Rule 2003(e) permits adjournment of a 341 meeting but requires the trustee to announce the adjourned date and time. In this case, the trustee adjourned the meeting "until further notice," so the meeting was concluded, starting the time running for objections to a claim of exemptions. What is more, conversion of the case from chapter 11 to chapter 7 does not restart the time for filing an objection to a claim of exemptions. Once the property has been exempted in the chapter 11 case, it revests in the debtor and is not property of the estate when the case is converted to chapter 7. Thus, it cannot again be exempted, and the creditors may no longer object to the claim of exemption. *Smith v. Kennedy (In re Smith)*, 235 F.3d 472 (9th Cir. 2000).

13.1.rr. Fourth Amendment applies to trustee's search of debtor's home. The trustee had substantial evidence from the 341 meeting and other sources that the debtor was concealing assets. The trustee obtained an ex parte order from the bankruptcy court to search the debtor's home. On the debtor's motion to suppress the evidence that the trustee found, the bankruptcy court rules that the Fourth Amendment applies to a chapter 7 trustee because of the trustee's sufficiently close relationship with the government. *Taunt v. Barman (In re Barman)*, 252 B.R. 403 (Bankr. E.D. Mich. 2000).

13.1.ss. Fifth Circuit holds bankruptcy trustee liable only for gross negligence. Recognizing the split in the circuits holding bankruptcy trustees liable either for ordinary negligence (9th Cir.) or only for willful and deliberate violation of fiduciary duties (6th, 7th, and 10th Circs.), the Fifth Circuit takes a middle course and rules, in a case of first impression, that a bankruptcy trustee is liable to the estate only for gross negligence. *Dodson v. Huff (In re Smyth)*, 207 F.3d 758 (5th Cir. 2000).

13.1.tt. Secured creditor's credit bid amount is not included in calculating maximum trustee compensation. In determining the maximum compensation allowable to a trustee under section 326(a), the court may not include as "monies disbursed or turned over to parties in interest" the amount of a secured creditor's credit bid. In addition, although the factors set forth in section 330(a) are not exclusive, the court may not consider factors that do not concern the value of the services rendered, such as the delay by the United States Trustee in bringing an objection or the hardship on the trustee from a potential disgorgement order. *Staiano v. Cain (In re Lan Assocs. XI, L.P.)*, 192 F.3d 109 (3d Cir. 1999).

13.1.uu. Trustee may have judicial immunity. A bankruptcy trustee can be held personally liable (surcharged) for negligence in the performance of his official duties. However, if his action was approved by the court, the trustee has derived judicial immunity, as long as there has been complete disclosure to creditors and the court. *LeBlanc v. Salem (In re Mailman Steam Carpet Cleaning Corp.)* 196 F.3d (1st Cir. 1999).

13.1.vv. Court awards trustee hourly rate rather than percentage compensation. The court rules that section 330 requires that a trustee receive "reasonable compensation," rather than a commission

equal to the maximum compensation permitted under section 326. The court then determines that the chapter 11 trustee's services were competent and merited compensation at the trustee's normal hourly rate as a lawyer ($400 per hour). In an opinion highly critical of the trustee's request for a commission of approximately $4.4 million but uncritical of the trustee's performance, the court awards $352,000 as reasonable compensation. The opinion concludes with a table showing billing rates for 16 law firms with fee applications submitted to the Delaware district court in 1998. *In re Marvel Entertainment Group, Inc.*, 234 B.R. 21 (D. Del. 1999).

13.1.ww. An attorney may collect fees from a debtor postpetition. The debtor agreed to pay her attorney in installments both before and after her chapter 7 petition. She gave the attorney post-dated checks for the postpetition payments. In a ruling of first impression, the Ninth Circuit holds that the cashing of the post dated checks does not violate the automatic stay, because, in this case, the checks were actually for postpetition services, rather than for the prepetition services of preparing for and filing the petition. The Ninth Circuit recognizes the absence of any statutory guidance on this issue and creates its own rule, based on its conclusions that a contingent claim does not include the right to payment that arises only upon the performance of future services. *Gordon v. Hines (In re Hines)*, 147 F.3d 1185 (9th Cir. 1998).

13.1.xx. Debtor/creditor acrimony may be cause for the appointment of the trustee. Although the court did not adopt a *per se* rule, the Third Circuit affirms the appointment of a chapter 11 trustee "for cause" under section 1104(a)(1), based on "deep seated conflict and animosity" between the debtor and its creditors. The court also affirms under section 1104(a)(2), ruling that the acrimony gives grounds for the appointment of a trustee as "in the best interest of the creditors, the debtor, and the estate." *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463 (3d Cir. 1998).

13.1.yy. Post-bankruptcy suit against trustee requires leave of court. After the bankruptcy case was closed, the debtor sued the trustee for malicious prosecution of a fraudulent transfer adversary proceeding that the trustee brought but dropped during the bankruptcy case. The post-bankruptcy state court action required approval of the bankruptcy court in advance, just as an action against the trustee during bankruptcy would have required. *In re Linton*, 136 F.3d 544 (7th Cir. 1998).

13.1.zz. Common election of trustee for five subsidiaries is approved. In a case of apparent first impression, the bankruptcy court holds under Bankruptcy Rule 2009(a) that all of the creditors of a group of subsidiaries, as a whole, may elect a single trustee for the subsidiaries. However, a creditor of one subsidiary may not solicit proxies from creditors of the other subsidiaries. *In re Ben Franklin Retail Stores*, 214 B.R. 852 (Bankr. N.D. Ill. 1997).

13.1.aaa. Trustee may not withhold payments to creditor from unrelated cases. The secured creditor was overpaid by insurance proceeds on destroyed collateral. Rather than seeking a recovery from the secured creditor, the chapter 13 withheld payments to the creditor that he was making from other, unrelated chapter 13 cases. Such an action is improper and violates the trustee's duties. *Ford Motor Credit Company v. Stevens (In re Stevens)*, 130 F.3d 1027 (11th Cir. 1997).

13.2 Attorneys

13.2.a. Case dismissal deprives bankruptcy court of jurisdiction to rule on fee application. The chapter 13 debtor sued her mortgage lender to avoid a foreclosure sale. While the court's decision was on appeal, the debtor failed to make plan payments. The bankruptcy court dismissed the chapter 13 case. The debtor's attorney applied for fees for representing the debtor in the litigation. A bankruptcy court has jurisdiction if a proceeding is at least "related to" the bankruptcy, that is, if it would increase or reduce the estate or claims or affect priorities. Once the case is dismissed, fees cannot have an effect on the estate, and the bankruptcy court thereby loses jurisdiction. Under section 349, a dismissal order may provide that the court retains jurisdiction to determine and allow fees, but the order here did not do so. Therefore, the court does not have jurisdiction to allow the fees. The court specifically declines to rule on whether the attorney may collect the fees from the debtor under state law. The court does not address whether the

proceeding might "arise in" the case or "arise under title 11." *Iannini v. Winnecourt*, 487 B.R. 433 (W.D. Pa. 2013).

13.2.b. Plan may provide for payment of creditors committee members' attorneys' fees. The confirmed plan provided that creditors committee members were entitled to reimbursement of fees they paid to their attorneys, separate from attorneys for the committee. Section 503(b)(3)(F) permits allowance of a committee member's expenses other than professional fees incurred in the performance of committee duties. Section 503(b)(4) authorizes fees for a professional retained by one whose expenses are allowable under sections 503(b)(3)(A) through (E), but not (F). However, section 1123(b)(6) permits a plan to include any "appropriate provision not inconsistent with the applicable provisions" of the Code. Section 1129(a)(4) requires as a confirmation condition that any payment for professional services in or in connection with the case be subject to court approval, suggesting that a plan provision authorizing professional fee payments is not inconsistent with applicable Code provisions. Therefore, the plan provision properly authorizes court allowance of attorneys' fees for creditors committee members. *In re Lehman Bros. Holdings Inc.*, 487 B.R. 181 (Bankr. S.D.N.Y. 2013).

13.2.c. Court may not authorize attorney fee payment from property that has revested in the debtor. The chapter 11 trustee sold the debtor's principal asset, producing a surplus after payment of all expenses and claims. The debtor's attorney applied for compensation for services rendered after the trustee's appointment, to be paid from the surplus that was to be returned to the debtor. Before the court ruled on the application, however, the state attorney general obtained an injunction against the trustee's further disbursement of estate funds. Section 330(a) permits a court to award compensation to counsel for the debtor only if the court has previously approved counsel's employment. Here, the estate's employment of counsel terminated upon the trustee's appointment. Therefore, the court may not award compensation. Section 349(b) provides that upon dismissal, property revests in the debtor, except to the extent that the court, for cause, orders otherwise. However, section 349(b) does not authorize the court to direct the disbursement of fund once they leave the estate and revest in the debtor, and it may not be used as a means of circumventing section 330(a)'s limitations. Moreover, in this case, payment of counsel would subordinate the attorney general's claim to the surplus. Therefore, the court denies counsel's fee application. *Harrington v. Nickless (In re Int'l Gospel Party Boosting Jesus Groups, Inc.)*, 487 B.R. 12 (D. Mass. 2013).

13.2.d. 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).

13.2.e. Attorneys' fees for the debtor's opposition to a trustee motion may be compensable. One week after the petition date, the U.S. trustee filed a motion for the appointment of a trustee. The court denied the motion as not in the interests of creditors and the estate. The U.S. trustee objected to the debtor's attorneys' fees incurred in defending against the trustee motion. A debtor enjoys a presumptive right to continue in possession and therefore may oppose a trustee motion. If there was a reasonable basis at the time to contend that the estate would be benefited by defeating the motion, compensation would be allowable. A debtor is not required to consent to any trustee motion, even one filed by the U.S.

trustee. Counsel acts at the debtor's direction. In this case, because the motion was filed so soon after the petition date, it left the debtor little time to evaluate the longer term implications and required the debtor to contest it. Ultimately, the court denied the motion as not in the interests of creditors and the estate. Accordingly, fees may be awarded for contesting the motion. *In re West End Fin. Advs.*, 2012 Bankr. LEXIS 3045 (Bankr. S.D.N.Y. July 3, 2012).

13.2.f. Court denies attorney employment application for lack of adequate information about the attorney. A chapter 7 trustee filed an application for approval to employ an attorney to represent him in the case. The application stated only that the attorney had previously represented the trustee in numerous bankruptcy cases and that the trustee and the attorney had a personal friendship, which fostered confidence and trust. The application did not provide any information about the prior representations, whether they were successful in achieving the results sought or whether they provided any benefit to the estate. Rule 2014 requires an employment application to describe, among other things, the specific facts showing the need for the employment, the reasons for selecting the attorney and the services the attorney will provide. The application must therefore describe the scope of the assignment, with a detailed description of the attorney's duties, and the extent to which the attorney has successfully undertaken such an assignment before. The reference to personal friendship undermines the application, because it is irrelevant to qualifications and may be viewed as a conflict. Therefore, the court denies the employment application without prejudice to refiling a proper application. *In re Bechuck*, 472 B.R. 371 (Bankr. S.D. Tex. 2012).

13.2.g. The debtor in possession may employ a law firm that agrees to accept payment of its prepetition claim only from any equity distribution. A law firm represented the debtor in litigation before bankruptcy. The debtor owed the firm for the representation. The debtor's sole shareholder had guaranteed the obligation. The debtor in possession sought to employ the firm as special bankruptcy counsel. The firm agreed to waive the claim against the debtor and pursue only the shareholder for the amounts owing, but in doing so, took an assignment from the shareholder of his right to any distributions from the estate. Section 327(a) permits the debtor in possession to employ an attorney who is disinterested, that is, one who "is not a creditor … and does not have an interest materially adverse to the interest of the estate or of any class of creditors … by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason." Section 1107(b) relaxes this restriction slightly by preventing disqualification "solely because of … employment by or representation of the debtor" before bankruptcy. The court should apply this section using a "totality of the circumstances" test. Listing and applying 14 factors, the court concludes that the debtor in possession may employ the firm, subject to periodic reporting by the general bankruptcy counsel on issues that might create a conflict. *In re SBMC Healthcare, LLC*, 473 B.R. 871 (Bankr. S.D. Tex. 2012).

13.2.h. A security retainer is not subject to disgorgement in a superseding chapter 7 case. The chapter 11 debtor's attorney received a security retainer, which he deposited into his client trust account. After the filing, the court authorized an interim compensation procedure. The attorney applied for fees, but before the court acted on the application, the case was converted to chapter 7. The chapter 7 case was administratively insolvent, so the chapter 7 trustee sought disgorgement of the retainer from the attorney. Section 726(b) subordinates chapter 11 administrative expenses to chapter 7 administrative expenses and permits the court to order disgorgement of chapter 11 administrative expense payments, including professional compensation that the court has already awarded, if the chapter 7 administration would otherwise be insolvent. However, an attorney who holds a valid security retainer is not subject to disgorgement, because of the attorney's security interest in the retainer. The court therefore remands the case for a determination of whether the attorney had perfected a lien on the retainer. *Cupps & Garrison, LLC v. Rhiel (In re Two Gales, Inc.)*, 454 B.R. 427 (6th Cr. B.A.P. 2011).

13.2.i. Section 329 "contemplation of bankruptcy" test depends on the debtor's state of mind. The debtor retained counsel to represent him in a short sale of his over-encumbered real property and to represent him in various foreclosure proceedings. He decided not to proceed with his defense of the foreclosure. Counsel then recommended that he seek bankruptcy counsel, which he did. He filed a chapter 11 case three months later. As debtor in possession, he sought disgorgement of fees from his prior counsel under section 329. Section 329 requires a lawyer who has represented a debtor "in a case

or in connection with a case" to file a statement with the court of any agreement or payment made for the attorney's "services rendered or to be rendered in contemplation of or in connection with the case" and permits the court to order disgorgement of any such fees. Services are "in contemplation" of bankruptcy if, based on a subjective test of the debtor's state of mind, they were rendered when the debtor was considering bankruptcy, was influenced by the imminence of bankruptcy or were for the prevention of bankruptcy. The services need not be as the debtor's bankruptcy counsel, but they must have more than a casual connection to the later bankruptcy. The district court therefore remands for a factual determination of the debtor's state of mind and the purposes of counsel's services. *Garcia v. Miller (In re Garcia)*, 465 B.R. 361 (N.D. Ill. 2011).

13.2.j. Sections 327, 328 and 330 apply to involuntary chapter 11 debtor's employment of counsel to defend the petition. Creditors filed an involuntary petition under chapter 11 against the debtor. The debtor retained counsel to defend the involuntary petition. Counsel filed an employment application under section 327, which the court approved, with the stipulation that counsel could reapply for employment under chapter 11 if the court ordered relief. During the involuntary gap, counsel received fees from other creditors for defending against the petition. The court ordered relief on the petition and later converted the case to chapter 7. The trustee sought recovery of fees paid to counsel during the gap. Section 303(f) permits the debtor to "continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced". However, section 541(a) creates the estate upon the filing of the petition, and section 1107(a) provides that "debtor in possession" means debtor in a chapter 11 case except when a trustee is serving, even during the involuntary gap period. A debtor in possession has all of the rights and powers, and is subject to all of the limitations, of a trustee. Section 327 requires a trustee to obtain court approval of employment of counsel. Therefore, the debtor must obtain court approval of employment of counsel in an involuntary chapter 11 case, despite section 303(f), and sections 328 and 330, requiring court approval of compensation, also apply. The court notes that the same result would not apply in an involuntary chapter 7 case. *Rushton v. Woodbury & Keller, P.C. (In re C.W. Mining Co.)*, 440 B.R. 878 (Bankr. D. Utah 2010).

13.2.k. Court disqualifies law firm based on conflict of interest in fraudulent transfer action involving dividend. The law firm represented the debtor before bankruptcy in arranging a dividend to the debtor's parent and affiliates. The firm's engagement agreement provided for a fully informed, full future conflict waiver for any disputes between the debtor and the parent and permitted the firm to represent the parent and its affiliates against the debtor if a conflict arose. After bankruptcy, the trustee sued the parent and its affiliates as well as two companies related to the debtor and several individual defendants, who were directors or officers of the debtor and the parent, its affiliates or the debtor, for a fraudulent transfer in connection with the dividend. The firm appeared on behalf of all of the defendants except two of the individual defendants. The trustee moved to disqualify the firm for conflict of interest. A conflict of interest exists here because the firm represented the debtor on the transaction that was the subject of the litigation. A specific future conflict waiver limited to specified parties is enforceable, so the firm may represent the parent and the affiliates. However, the waiver did not cover the individuals or the defendants not designated in the complaint as affiliates of the parent, so the firm is disqualified from representing them in the action. The court does not distinguish between the trustee and the debtor for these purposes. *Miller v. Sun Cap. P'ners, Inc. (In re IH 1, Inc.)*, 441 B.R. 742 (Bankr. D. Del. 2011).

13.2.l. Soliciting potential committee members with whom counsel had no prior relationship disqualifies counsel from committee employment. Immediately after the petition date, a law firm contacted Dr. Liu, with whom the firm had worked before as a translator, to solicit proxies from Chinese creditors listed on the list of top 20 creditors. Dr. Liu obtained proxies from two Chinese creditors, with whom neither the law firm nor Dr. Liu had a prior relationship. Because of the U.S. Trustee's rules, the law firm arranged for another proxy holder for one of the creditors. The law firm gave advice to the creditors on the treatment of their claims for goods in transit. Although there was no agreement on how the proxies would be voted, correspondence between Dr. Liu and the firm suggested that the process was to be "a two-way street". Dr. Liu's proxy was selected for committee membership. At the committee formation meeting, he recommended the law firm as committee counsel, and the committee unanimously voted to select the firm. The firm then recommended that the committee retain Dr. Liu as a translator. The debtor and the U.S. Trustee objected to the combined employment application for the law firm and Dr. Liu. The debtor is a party in interest in the case and so has standing to object to the application. The Rule 7.3 of

Delaware's Rules of Professional Conduct prohibits a lawyer from soliciting a client unless the lawyer has a prior relationship with the client and prohibits employing a third party to do so. Moreover, solicitation has been criticized under the Bankruptcy Act, and the Code contained provisions to discourage it. Although there was no express agreement that Dr. Liu would support the law firm's engagement as committee counsel, there was at least a tacit understanding. The violations are sufficient to disqualify the firm from employment as committee counsel. In addition, the firm did not disclose that it gave advice to and therefore acted as counsel to the two creditors. Acting as counsel is not disqualifying, but nondisclosure is, especially in the context of proxy solicitations. Therefore, the court denies the employment applications. *In re Univ. Bldg. Prods.*, 2010 Bankr. LEXIS 3828 (Bankr. D. Del. Nov. 4, 2010).

13.2.m. 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).

13.2.n. Conflict waiver and conflicts counsel do not permit section 327(a) employment in the face of a disabling conflict. The debtor owned and operated a gas turbine manufactured and maintained by a General Electric turbine subsidiary. The turbine failed, resulting in the debtor's financial troubles, and a dispute arose between them over maintenance, resulting in an arbitration award in favor of the GE turbine subsidiary. Resolution of issues with the GE turbine subsidiary was central to the debtor's effort to reorganize. Although it had resolved some disputes with the subsidiary, further work was needed to normalize the turbine operations and the relationship fully. The debtor filed chapter 11. It sought to employ the U.S. affiliate of an international law firm group under section 327(a) as its general reorganization counsel. The law firm was a member of a Swiss Verein, of which all the firm's foreign affiliates were also members. The firm advertised itself as being able to provide seamless worldwide representation to its clients. Although the U.S. firm did not represent the GE turbine subsidiary, it represented other GE affiliates, and the firm's Norwegian affiliate actively represented the GE turbine subsidiary. The U.S. firm obtained a conflicts waiver letter from GE, apparently applicable to all GE affiliates, including the turbine subsidiary, waiving any objection to the firm's continued representation of the debtor in the chapter 11 case in matters adverse to any GE affiliate, except for litigation or threatening litigation. The debtor retained conflicts counsel, also under section 327(a), to handle all litigation relating to the GE turbine subsidiary. Section 327(a) permits employment of a professional only if the professional does not hold or represent an interest adverse to the estate. Whether a professional holds an adverse interest is determined on a case-by-case basis. Representation of a creditor in an unrelated matter is not automatically disqualifying, though an actual conflict of interest is. The law firm's conflict waiver treated GE and the GE turbine subsidiary as a single entity, and its marketing materials treated its affiliated entities as a single worldwide law firm. The disputes between the debtor and the GE turbine subsidiary had not been fully resolved. Therefore, there is an actual conflict as to GE in the firm's representation of the debtor in

possession. Where there is an actual conflict on an issue that is central to the resolution of the chapter 11 case, neither a conflict waiver nor conflicts counsel permits employment of the firm, because neither satisfy the requirement of section 327(a) that the firm neither hold nor represent an interest adverse to the estate. In addition, in this case, the conflicts waiver was limited and would have hampered the firm's ability to take aggressive positions against the GE turbine subsidiary. A conflicts waiver and conflicts counsel may be necessary and appropriate where the underlying conflict is not itself disabling, but that was not the case here. *In re Proj. Orange Assocs., LLC*, 431 B.R. 363 (Bankr. S.D.N.Y. 2010).

13.2.o. BAPCPA's restriction on attorney advice and its advertising requirement are constitutional. An attorney, her law firm and her clients challenged the constitutionality under the First Amendment of sections 526(a)(4), 528(a) and 528(b)(2), which BAPCPA added to the Bankruptcy Code. Section 526(a)(4) prohibits a "debt relief agency" from advising "an assisted person … to incur more debt in contemplation of such person filing a case under this title". A "debt relief agency" is "any person who provides any bankruptcy assistance to an assisted person" for valuable consideration. "Bankruptcy assistance" is any services "provided to an assisted person with the express or implied purpose of providing information, advice, [or] counsel … or providing legal representation with respect to a case or proceeding under this title". Although the "debt relief agency" definition excludes five categories of persons and institutions, it does not expressly exclude attorneys. Under the plain meaning rule, therefore, "debt relief agency" includes attorneys. Second, the phrase "in contemplation of bankruptcy" has commonly been associated with abusive conduct. Thus, its use here "refers to a specific type of misconduct designed to manipulate the protections of the bankruptcy system", that is, "to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose". Other statutory provisions, such as the exceptions to discharge by fraud or false pretenses or for luxury purchases on the eve of bankruptcy, for dismissal for abuse and requiring an attorney to certify that a bankruptcy filing does not constitute an abuse, support this reading. Such activities can be harmful to the debtor or to creditors and are therefore the prohibition's focus. When so interpreted, the prohibition does not prevent discussing the covered subjects, only affirmative advice to engage in abusive conduct. Nor does it prohibit advice to incur debt for other purposes, such as to refinance a mortgage at a lower rate or buy a reliable car on credit, which may improve the debtor's financial prospects, or to make purchases necessary to support the debtor or a dependent of the debtor. Thus interpreted, the provision is both sufficiently narrow and not too vague to pass constitutional muster. Finally, section 528(a)(4) and (b)(2) require a debt relief agency's advertisements of bankruptcy or debt relief services to contain, "We are a debt relief agency. We help people file for bankruptcy" or a substantially similar statement. A statute may require commercial speech if the requirement is reasonably related to preventing consumer deception. The disclosure requirement is directed at ensuring that debt relief agencies' advertisements disclose that their services involve bankruptcy, which is reasonably related to Congress's purpose and factually correct, and does not prevent the agencies from disclosing additional information about their services or that they are attorneys as well as debt relief agencies. Therefore, the requirement is constitutional. Notably, the Court determines that the context in which the statute uses the term "assisted person" shows that it does not include a consumer creditor. *Milavetz, Gallop & Milavetz, P.A. v. U.S.*, 559 U.S. ___ , 130 S. Ct. 1324, 176 L. Ed. 2d 79 (2010).

13.2.p. Court disqualifies counsel for, among other things, bringing a substantive consolidation motion. A debtor subsidiary contractor held a joint account with a subcontractor. A dispute arose between them over liability and the account's ownership. An arbitrator determined that the subsidiary was liable to the subcontractor for the amount the subcontractor asserted. The subsidiary and its parent filed chapter 11 cases, both represented by the same counsel that had defended the subsidiary in the nonbankruptcy litigation. The debtor's largest asset was its claimed interest in the account, and its largest liability was to the subcontractor. The bankruptcy court determined that the subcontractor owned the account. While the decision was on appeal, the parent and subsidiary debtors moved for substantive consolidation of their estates, the intent of which was to make the account, if determined on appeal to be owned by one of the debtors, available for payment of all claims, rather than available to pay only the subcontractor's claim against the subsidiary. An attorney employed to represent the estate must be disinterested, which requires that the attorney not have "an interest materially adverse to the interest of the estate". Thus, the attorney may not represent conflicting interests. A debtor in possession owes a fiduciary duty to its creditors and therefore may not act solely in its self-interest to the exclusion of creditors' interests. An attorney who represents multiple debtors in possession risks breaching its fiduciary duties when working to benefit one

debtor's estate or creditors at the expense of another debtor's estate or creditors. Therefore, because counsel violated its fiduciary duties by bringing and persisting in the substantive consolidation motion, counsel is disqualified from representing the subsidiary in any substantive consolidation proceeding. *Raymond Mgmt. Servs., Inc. v. Wm. A. Pope Co. (In re Raymond Prof. Group, Inc.)*, 421 B.R. 891 (Bankr. N.D. Ill. 2009).

13.2.q. Chapter 11 trustee may employ former counsel for the creditors committee. During the chapter 11 case, the debtor consented to the appointment of a trustee. The trustee was initially unable to employ counsel because of conflict, geographic, capacity and risk of nonpayment issues. Counsel to the unsecured creditors committee agreed to serve as counsel to the trustee. The committee retained separate counsel, which advised the committee in connection with any conflict waiver that its former counsel required to represent the trustee. The trustee's employment of counsel must meet three requirements under sections 327(a) and (c). Counsel must be disinterested, not hold or represent an interest adverse to the estate and not have an actual conflict of interest. Disinterestedness requires, among other things, that counsel not be a creditor or not have an interest materially adverse to the interest of the estate. To hold an adverse interest is "to possess or assert an economic interest that would tend to decrease the value of the estate", and to represent an adverse interest is to serve as counsel for an entity with such an adverse interest. Counsel here is not a creditor and does not have or hold an adverse interest. Prior committee representation does not amount to representation of an adverse interest or create an actual conflict, as counsel represents only the committee, not individual creditors on the committee. Adversity is a federal question but informed by state ethical rules. Under applicable ethical rules, a client's informed written consent suffices to resolve adversity issues, but in a chapter 11 case, section 327(a) makes the issue a public affair. In this case, all parties in interest supported the representation, and there appears to have been full disclosure and no appearance of impropriety. Therefore, the court approves the employment. *In re Kobra Props.*, 406 B.R. 396 (Bankr. E.D. Cal. 2009).

13.2.r. Bankruptcy court may suspend attorney from practice for bad faith misconduct. The chapter 13 debtor's attorney failed to appear at the section 341 meeting or the confirmation hearing. Even though the court confirmed the debtor's plan, the attorney sent the debtor a letter the day after the hearing advising her that her case had been dismissed. The attorney also solicited the debtor five times to list her home for sale with him and referred her to a loan broker that conditioned the loan on listing the home for sale with the attorney. The bankruptcy court issued an order to show cause why the attorney should not be disbarred or suspended for bad faith misconduct. A bankruptcy court has civil contempt power under section 105(a) and inherent sanction authority. Civil contempt authority may be used only to remedy violation of a specific order and may only compensate a party that has been harmed by violation or coerce compliance. Larger penalties implicate criminal contempt and are beyond the bankruptcy court's power. Inherent sanction authority is broader and therefore must be used more cautiously but may be used to sanction bad faith or willful misconduct. Exercise of inherent sanction authority requires notice of the specific conduct to be sanctioned, notice of the authority that is the basis for the sanction and an opportunity for a hearing but does not require all the protections afforded to a criminal defendant. In this case, the attorney was given the required notices and hearing, and the conflict of interest conduct showed bad faith. Therefore, suspension from practice for three months was authorized and appropriate. *Price v. Lehtinen (In re Lehtinen)*, 564 F.3d 1052 (9th Cir. 2009).

13.2.s. Creditor may obtain derivative standing in a chapter 7 case. The debtor transferred assets to an affiliate. A creditor brought a fraudulent transfer action against the affiliate and later filed an involuntary chapter 7 petition against the debtor. After the order for relief, the trustee determined not to pursue a fraudulent transfer action against the affiliate. The creditor sought derivative standing. Although section 544 grants the trustee authority to pursue a fraudulent transfer action, it says nothing about derivative standing. However, section 503(b)(3)(B) implies derivative standing by authorizing payment as an administrative expense of the costs and expenses of a creditor who recovers, after court approval, assets for the estate. In addition, pre-Code practice clearly permitted derivative standing. Other courts have permitted derivative standing in chapter 11 cases. There is no textual basis for different treatment in chapter 7 cases, and section 503(b)'s applicability in chapters 7 and 11 suggests that the rule should be the same. In chapter 11, the need to guard against a non-disinterested debtor in possession's refusal to an action does not apply to an independent chapter 7 trustee. However, other reasons equally support

derivative standing in chapter 7, including the frequent absence of funds for the trustee to pursue an action. Therefore, the court may grant derivative standing to the creditor in this chapter 7 case. *Hyundai Translead, Inc. v. Jackson Truck & Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231 (6th Cir. 2009).

13.2.t. Order approving counsel's fee application does not always bar a later action for malpractice. The debtor confirmed a plan. The confirmation order provided a bar date for executory contract rejection claims. Debtor's counsel failed to give notice of the bar date to an employee who had an employment contract. The reorganized debtor terminated the employee shortly after confirmation but before the bar date. The employee asserted a severance claim and sued the reorganized debtor after confirmation but did not file an administrative claim. Separately, debtor's counsel sought final allowance of its fees. The court held the fee hearing after the employee's termination but before the employee sued the reorganized debtor. Debtor's counsel continued to represent the reorganized debtor for another nine months. The bankruptcy court later held that the employee stated a claim for breach of her employment agreement because of the lack of notice of the bar date. The reorganized debtor then sued its former counsel for malpractice. Res judiciata bars a later action if a prior decision was a final judgment on the merits, the parties were the same, the prior court had jurisdiction and the causes of action were the same. A malpractice claim, however, remains viable unless the a party could and should have brought it in the prior case. Here, at the time of the fee application hearing, counsel continued to represent the reorganized debtor, and the employee had not yet brought her action. Therefore, the reorganized debtor did not have a full and fair opportunity to raise the malpractice claim at the fee application hearing. The fee application hearing therefore does not bar the reorganized debtor's malpractice action. *Penthouse Media Group, Inc. v. Pachulski Stang Ziehl & Jones LLP*, 406 B.R. 453 (S.D.N.Y. 2009).

13.2.u. Section 526(a)(4), narrowly construed, and section 527(b) are constitutional. An attorney challenged the constitutionality under the First Amendment of sections 526(a)(4) and 527(b). Section 526(a)(4) prohibits a "debt relief agency" from advising "an assisted person … to incur more debt in contemplation of such person filing a case under this title". A "debt relief agency" is "any person who provides any bankruptcy assistance to an assisted person" for valuable consideration. "Bankruptcy assistance" is any services "provided to an assisted person with the express or implied purpose of providing information, advice, [or] counsel … or providing legal representation with respect to a case or proceeding under this title". Although the "debt relief agency" definition excludes five categories of persons and institutions, it does not expressly exclude attorneys. Under the plain meaning rule, therefore, "debt relief agency" may include an attorney. The doctrine of constitutional avoidance requires a court to construe a statute to avoid any constitutional question. Broadly construed, section 526(a)(4)'s prohibition on advice to incur debt in contemplation of bankruptcy might raise constitutional questions, because it would prohibit even legitimate advice to incur debt before bankruptcy. However, Congress may restrict speech to prevent abusive behavior. Section 526(a)(4) may be narrowly construed to avoid the constitutional question. The section prohibits advice to incur debt "in contemplation of" bankruptcy. "In contemplation of" often suggests an abuse of the bankruptcy system. Therefore, section 526(a)(4) should be construed to prohibit advice only "to incur debt in contemplation of bankruptcy when doing so would be an abuse or improper manipulation of the bankruptcy system". Section 527(b) requires a debt relief agency to provide a statement to an assisted person outlining certain information about bankruptcy. Although the First Amendment protects against compelled speech, a statute may require speech under certain circumstances. Here, the government's interest is compelling, because of the large amount of debt discharged in bankruptcy each year. The statement section 527(b) requires is general and therefore may be inaccurate as to applied in certain circumstances. However, section 527(a) does not prohibit the debt relief agency from adding to the statement to explain why the general statement might or might not apply in particular cases. Therefore, the statute does not violate the First Amendment. *Hersh v. U.S. ex re. Mukasey*, 553 F.3d 743 (5th Cir. 2008).

13.2.v. Court upholds contingent fee award under section 328. The estate employed an attorney on a contingent fee basis. The application for employment sought approval under sections 327 and 328, and the order approving the employment provided for employment in accordance with the terms of the contingent fee engagement agreement. The order approving the attorney's employment did not specifically reference section 328. The litigation became long and protracted. The debtor in possession's and the

committee's positions on settlement diverged substantially, the attorney took instructions from the debtor in possession rather than the creditors, the litigation was unusually prolonged and the attorney was an obstacle to the committee's settlement. The committee negotiated a settlement, which the Court of Appeals overturned based on the attorney's appeal. After exclusivity ended, the committee filed a plan that incorporated a larger proposed settlement amount. The attorney sought fees based on that amount. Whether an employment order pre-approves a fee arrangement or makes the final fee subject to reasonableness review under section 330 "depends on the totality of the circumstances, including whether the professional's application, or the court's order, referenced section 328(a), and whether the court evaluated the propriety of the fee arrangement before granting final, and not merely preliminary, approval." Here, the judge's comments on approval of the employment and the reference in the application to section 328 made clear that the court pre-approved the fee arrangement under section 328(a). The court could therefore reduce fees only based on circumstances that could not have been anticipated, not on circumstances that simply were not anticipated. Here, divergence of positions between the debtor in possession and its creditors and the attorney's following the debtor in possession's instructions can be anticipated in any chapter 11 case. The length of the litigation was a result of the court's stay and the appeal, which was successful, all of which were capable of being anticipated at the outset. Therefore, the court allows the attorney's fees in full. *Riker, Danzig, Schere, Hyland & Perretti LLP v. Official Committee of Unsecured Creditors (In re Smart World Techs., LLC)*, 552 F.3d 228 (2d Cir. 2009).

13.2.w. BAPCPA's restriction on attorney advice is unconstitutional on its face; its advertising requirement is unconstitutional in part, as applied. The Connecticut Bar Association challenged the constitutionality of sections 526(a)(4), 527 and 528(a) and 528(b)(2), which BAPCPA added to the Bankruptcy Code in 2005. Section 526(a)(4) prohibits a "debt relief agency" from advising "an assisted person … to incur more debt in contemplation of such person filing a case under this title". A "debt relief agency" is "any person who provides any bankruptcy assistance to an assisted person" for valuable consideration. "Bankruptcy assistance" is any services "provided to an assisted person with the express or implied purpose of providing information, advice, [or] counsel … or providing legal representation with respect to a case or proceeding under" the Bankruptcy Code. Although the "debt relief agency" definition excludes five categories of persons and institutions, it does not expressly exclude attorneys. Under the plain meaning rule, therefore, "debt relief agency" may include an attorney. A "strict scrutiny" test requires speech restrictions to be narrowly tailored to promote a compelling governmental interest; the "balancing test" balances First Amendment rights against the government's legitimate regulatory interest; both tests require that restrictions be narrow. Under either test, the advice restriction is not sufficiently narrow and necessary to further legitimate governmental interests, because it prohibits attorneys from advising even prudent and legal conduct. The government argues that the provision should be interpreted narrowly to prohibit only advice that would lead to abuse of the bankruptcy law, but the statute does not contain any such restriction. It is therefore overbroad and unconstitutional on its face. Section 527 requires disclosure to a client in an engagement agreement of specified "facts", including statements with which the Bar Association does not agree. Requiring the disclosure is permissible regulation of professional services because the contents "are reasonably related to a government objective and not unduly burdensome" and are subject to further explanation by the attorney to the extent the attorney disagrees. Sections 528(a)(3), (a)(4) and (b)(2) require a debt relief agency's advertisements of bankruptcy or debt relief services to contain, "We are a debt relief agency. We help people file for bankruptcy" or a substantially similar statement. A statute may require advertising disclosure if the requirement is reasonably related to preventing consumer deception and not unjustified or unduly burdensome. The "debt relief agency" definition includes attorneys who provide services to non-debtor consumers, such as consumer creditors, landlords and non-debtor spouses and ex-spouses. As applied to these attorneys, the required disclosure is false and therefore not reasonably related to the government's interest in preventing deception. Therefore, the requirement is unconstitutional as applied to debt relief agencies who do not help people file for bankruptcy. *Conn. Bas Assoc. v. United States*, 394 B.R. 274 (D. Conn. 2008).

13.2.x. BAPCPA restriction on attorney advice is unconstitutional; advertising requirement is constitutional. An attorney, her law firm and her clients challenged the constitutionality under the First Amendment of sections 526(a)(4) and 528(a) and 528(b)(2), which BAPCPA added to the Bankruptcy Code in 2005. Section 526(a)(4) prohibits a "debt relief agency" from advising "an assisted person … to

incur more debt in contemplation of such person filing a case under this title". A "debt relief agency" is "any person who provides any bankruptcy assistance to an assisted person" for valuable consideration. "Bankruptcy assistance" is any services "provided to an assisted person with the express or implied purpose of providing information, advice, [or] counsel … or providing legal representation with respect to a case or proceeding under this title". Although the "debt relief agency" definition excludes five categories of persons and institutions, it does not expressly exclude attorneys. Under the plain meaning rule, therefore, "debt relief agency" may include an attorney. If the court imposes strict constitutional scrutiny on the statute, "the government has the burden to prove that the constraints are supported by a compelling governmental interest and are narrowly tailored". If the restrictions are merely ethical regulation, then the court may invoke a more lenient standard under which it balances an attorney's First Amendment rights against the government's legitimate interest in regulating the activity. Although the government argues that the provision should be interpreted narrowly to prohibit only advice that would lead to abuse of the bankruptcy law, the statute does not contain any such restriction. Because its prohibition is broad, covering even legitimate advice and legal activities, the statute violates both the strict scrutiny and more lenient standards and is unconstitutionally overbroad on its face. Section 528(a)(4) and (b)(2) require a debt relief agency's advertisements of bankruptcy or debt relief services to contain, "We are a debt relief agency. We help people file for bankruptcy" or a substantially similar statement. A statute may require speech if the requirement is reasonably related to preventing consumer deception or if not related to potentially deceptive advertising, under an intermediate standard that requires the government to show a substantial interest to be achieved by the restrictions that cannot be served by a more limited restriction. The requirement here is designed to prevent deception and so receives "reasonably related" review. The disclosure requirement is directed at ensuring that debt relief agencies' advertisements disclose that their services involve bankruptcy, which is reasonably related to Congress's purpose and factually correct, and does not prevent the agencies from disclosing additional information about their services or that they are attorneys as well as debt relief agencies. Therefore, the requirement is constitutional. *Milavetz, Gallop & Milavetz, P.A. v. U.S.*, 541 F.3d 785 (8th Cir. 2008).

13.2.y. Court upholds contingency fee award under section 328. The estate employed an attorney on a contingency fee basis. The order approving the employment provided for employment in accordance with the terms of the engagement agreement. The litigation became long and protracted and generated substantial acrimony and animosity between the debtor in possession and its attorney on the one hand and the creditors committee on the other, which the committee attributed to the debtor in possession's breach of fiduciary duty in seeking a risky higher recovery in the litigation rather than a certain settlement. After exclusivity ended, the committee filed a plan that incorporated its proposed settlement amount. The attorney sought fees based on that amount. The order approving the attorney's employment did not specifically reference section 328 but was sufficiently clear that employment was approved on a pre-determined contingency basis rather than a reasonableness standard under section 330. The court could therefore reduce fees only based on circumstances that could not have been anticipated, not on circumstances that simply were not anticipated. Here, acrimony between the debtor in possession and its creditors is anticipatable in any chapter 11 case, as is the attorney's taking direction from its client the debtor in possession. Finally, the court did not find any breach of fiduciary duty. Therefore, the firm was entitled to its full contingent fee. *Riker, Danzig, Schere, Hyland & Perretti LLP v. Official Committee of Unsecured Creditors (In re Smart World Techs., LLC)*, 383 B.R. 868 (S.D.N.Y. 2008).

13.2.z. Section 504 fee sharing prohibition applies to a sale of a contingent interest in a contingent fee. The estate hired a law firm on a contingent fee basis to prosecute an action. The estate obtained a substantial judgment at trial, which would entitle the law firm to a substantial fee. The defendant appealed. While the appeal was pending, the law firm requested court approval to enter into a "hedge" transaction with a financial institution, under which the financial institution would pay the law firm an undisclosed amount and the law firm would pay the financial institution the first $10 million in fees (if any) it received after conclusion of all appeals. The agreement would take effect, and money would change hands, only after the bankruptcy court awarded the law firm fees. To prevent the financial institution from exercising influence over the case, it agreed not to object to any proposed settlement of the underlying action. The agreement violates section 504, under which a professional receiving compensation from the estate "may not share or agree to share … any such compensation … with any other person". Section 504's purpose is to prevent referral fees and other sharing that removes

bankruptcy court control over fees or that undermines the bankruptcy proceeding's integrity. This agreement does none of that but nevertheless qualifies within the literal meaning of "share" and so is prohibited. *In re Winstar Comm'ns, Inc.*, 378 B.R. 756 (Bankr. D. Del. 2007).

13.2.aa. Attorneys are entitled to fees for a successful appeal from denial of fees for filing an involuntary petition. The attorneys successfully represented the petitioning creditors in an involuntary petition and sought fees under section 503(b)(4). The bankruptcy court denied the request. The B.A.P. reversed. Section 503(b)(4) uses the same standard for awarding attorney's fees as section 330(a)(1), "reasonable compensation for professional services … based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title". Although section 503(b)(4) is silent on allowance of fees for preparing and prosecuting a fee application, denial would dilute an attorney's fee recovery. Therefore, such fees are allowable, as long as the services for which the fees are sought satisfy the requirements of section 503(b)(4), and the case "exemplifies a 'set of circumstances' where the time and expense incurred by the litigation is 'necessary'", just as under section 330(a). Here, the creditors' attorney's fees for the appeal meet these requirements, because the underlying services are compensable, and the appeal was necessary to correct the bankruptcy court's and then the B.A.P.'s error in denying fees at the two different stages. *N. Sports, Inc. v. Knupfer (In re Wind N' Wave)*, 509 F.3d 938 (9th Cir. 2007).

13.2.bb. Court disqualifies law firm for failure to disclose a claim under an opinion letter. The debtor's law firm represented the company for many years before the chapter 11 case. During its representation, it had issued an opinion letter to bondholders that the bonds were enforceable in accordance with their terms. Although the law firm disclosed its prior representation of the debtor, it did not disclose the "connection" with the bondholders arising from the opinion letter. During the case, the law firm, on behalf of the debtor in possession, challenged the allowability of the claims under the bonds. The bondholders asserted an indemnification claim against the law firm under the opinion letter. The law firm promptly turned the allowability litigation over to counsel for the committee, which the bondholders controlled, but neither the law firm nor committee counsel disclosed the connection nor the litigation transfer until six months later, after litigation over the disclosure statement brought all the facts to light. The nondisclosure requires disqualification of the law firm, as its motives would remain suspect if its role were simply limited. However, the best interest of creditors requires the appointment of a trustee to restore creditor confidence in the system and to eliminate any lingering taint from the law firm's role. The court also criticizes committee counsel for its role, raising questions over whether counsel can adequately examine the bondholders' claims when they control the committee, and suggests that committee counsel may be motivated by a desire to protect its referral sources in a manner reminiscent of the "'opprobrious' bankruptcy ring and the cronyism that Congress decried in … 1978." The court similarly criticizes bondholder counsel, who actively participated, to the exclusion of committee counsel, in the settlement of litigation in a manner that would advantage the bondholders under their subordination clause at the expense of other unsecured creditors, who never appeared in court until the disclosure dispute arose, and "During the four years of this case, … operated in the shadows." *In re SONICblue Inc.*, 2007 WL 926871 (Bankr. N.D. Cal. Mar. 26, 2007).

13.2.cc. Law firm is not liable for failing to give business advice. The trustee sued directors, officers, and lawyers for breaches of fiduciary duty and deepening insolvency, among other things, based on the debtor's cozy relationship with its principal lender and the directors' and officers' self-dealing. He alleged that the law firm defendants committed malpractice, because they knew or should have known that numerous transactions on which they gave advice would have deepened the debtor's insolvency, that directors breached their fiduciary duty by approving the increased debt, and that the law firm failed to advise the debtor of the effects of the increased debt. A law firm owes no duty to provide business advice and is not responsible for its client's business decisions. It does, however, owe an obligation to inform a client of a breach of fiduciary duty. Because acquisition of additional debt or deepening insolvency is not by itself a tort or a breach of fiduciary duty, the law firm did not commit malpractice by approving the transactions and issuing opinion letters without advising its client of the effects of the increased debt. Moreover, the law firm did not have an obligation to verify the factual assumptions in the opinions. By stating that the facts are assumed, the law firm gives adequate notice that it is not vouching for their accuracy. However, if the law firm certifies to the accuracy of certain facts (or states it has no reason to know that they are not accurate), then the client may

rely on them and has a claim against the law firm if they were not accurate. *Alberts v. Tuft (In re Southeast Cmty. Hosp. Corp.)*, 353 B.R. 324 (Bankr. D.D.C. 2006).

13.2.dd. Court denies bonuses to counsel in solvent case. The plan resulted in payment of all creditors in full and a substantial return to equity. Counsel for the debtors in possession and committees sought bonuses. To merit a bonus, not only must the result be excellent, but counsel must provide exceptional efficiency and must guide its client in the exercise of the client's fiduciary duties. In addition, where counsel with a lower hourly rate provides services of comparable quality to counsel with a higher hourly rate, enhancement is more justifiable. Here, counsel did not provide services efficiently (as evidenced in part by the number of non-participating attorneys present in court at hearings and the presence of more than one law firm per client at most hearings) and did not counsel its client adequately in pursuing its fiduciary responsibilities in the chapter 11 case. Counsel should not be penalized for following its client's instructions, but it should not be rewarded for overplaying its hand or pursuing overly aggressive positions. The court therefore denies the bonuses. *In re Mirant Corp.*, 354 B.R. 113 (Bankr. N.D. Tex. 2006).

13.2.ee. Plan exculpation provision does not violate state bar rules. The plan provided an injunction against any action against the debtors, the committee, the principal lender, the indenture trustee, and any of their directors, officers, employees, and professionals and limited their liability for any matters related to the chapter 11 case or the plan process except for acts or omissions resulting from fraud, gross negligence, or willful misconduct. State bar rules prohibit an attorney from prospectively limiting liability to a client for malpractice and prohibit an attorney from settling a liability claim before advising the client to consider seeking independent advice. The plan exculpation provision does not violate the state bar rules, because it exculpates only for past acts, not prospectively, and does not involve a settlement of any claim. *In re Winn-Dixie Stores, Inc.*, 356 B.R 239 (Bankr. M.D. Fla. 2006).

13.2.ff. *Lamie* prohibits use of trust account security retainer to pay postpetition fees. Debtor's counsel received a $5,000 retainer, which it deposited in its trust account before the petition. As of the date of the filing of the petition, $2,600 remained in the trust account. Counsel acknowledged that the trust account funds were property of the estate but claimed a lien on the funds to secure payment for his postpetition services to the debtor. The court denies his claim. State law recognizes the lien, but *United States v. Lamie*, 540 U.S. 526 (2004), permits payment for postpetition services only from a flat fee retainer, not from a retainer in which counsel has only a security interest, because the security retainer remains property of the estate. Although state law recognizes the lien, section 330 prohibits payment and preempts state law. *In re Hill*, 355 B.R. 261 (Bankr. D. Or. 2006). *Accord*, *Redmond v. Lentz & Clark, P.A. (In re Wagers)*, 355 B.R. 268 (10th Cir. B.A.P. 2006), *aff'd* 514 F.3d 1021 (10th Cir. 2007).

13.2.gg. Fees for a dismissed case are unenforceable without court approval. The attorney represented the debtor and debtor in possession in a chapter 11 case that was dismissed. After dismissal, the debtor signed a promissory note to the attorney for the unpaid fees incurred during the case. The court did not approve the post-dismissal debtor's agreement to pay. In a subsequent bankruptcy, the trustee sued to recover a fraudulent transfer. Whether the debtor was insolvent at the time of the transfer depended on the enforceability of the note. Section 330 requires approval of fees, and section 329 permits a court to consider and order disgorgement of fees paid outside of bankruptcy, even by a third party. Approval of fees is a core proceeding and is part of the bankruptcy case. The court therefore retains jurisdiction to approve fees even after a case is dismissed. Neither dismissal nor a private agreement abrogates the court's exclusive authority to review fees. Because the court in the first case did not approve the fees, the note is unenforceable. *Dery v. Cumberland Cas. & Sur. Co. (In re 5900 Ass'ns, Inc.)*, 468 F.3d 326 (6th Cir. 2006).

13.2.hh. Services rendered after conversion from chapter 11 to chapter 7 are not compensable from a security retainer. Counsel had been retained with approval of the court to represent the debtor and debtor in possession. It performed services for the debtor in connection with but after the conversion, including handling a motion to amend the case caption upon the debtor's name change, the conversion motion itself, attendance at the 341 meeting after conversion to chapter 7, consultation with the chapter 7 trustee about transition, and final fee application preparation. Counsel received a prepetition retainer

that had not been fully applied when the debtor's chapter 11 case converted to chapter 7. None of the retainer could be applied to the post-conversion services. In a narrow reading of *Lamie v. United States Trustee*, 540 U.S. 526 (2004), the court concludes that the representation of the debtor in possession terminates upon the conversion to chapter 7, that chapter 11-related services rendered after conversion are not authorized by counsel's employment order after conversion, and that the Supreme Court's mention of a prepetition retainer to compensate counsel for necessary services to a chapter 7 debtor refers only to a fixed fee retainer, not a security retainer. Once the case converts, a security retainer becomes property of the estate, and any state law lien on the retainer in favor of the attorney is superseded by the Bankruptcy Code as interpreted by *Lamie*. *Morse v. Ropes & Gray, LLP (In re CK Liquidation Corp.)*, 343 B.R. 376 (D. Mass. 2006).

13.2.ii. Final fees awarded after plan confirmation need not be disgorged after conversion. The debtor confirmed a chapter 11 plan. The court awarded and the reorganized debtor paid its counsel final compensation for its chapter 11 work. Eighteen months after confirmation, the debtor failed, and its chapter 11 case converted to chapter 7. The trustee sought disgorgement of counsel's fees to equalize distributions of chapter 11 administrative expenses under section 726(a)(1). However, section 105(a) does not provide roving authority to fill a gap in section 726(a), which does not provide for recovery of chapter 11 payments. Section 549 authorizes recovery of postpetition transfers, but only if not authorized by the Code or the court. Interim compensation paid to professionals may differ from payment of other, authorized administrative expenses, because section 331 requires disgorgement of interim compensation to the extent it exceeds the final award. Absent that, however, the court does not have a statutory basis to order disgorgement. Because the fees here were awarded as final compensation, they need not be disgorged. *In re St. Joseph Cleaners, Inc.*, 346 B.R. 430 (Bankr. W.D. Mich. 2006).

13.2.jj. Vermont bankruptcy court specifies detailed standards for allowance of fees and expenses. Under *In re S.T.N. Enters., Inc.*, 70 B.R. 823 (Bankr. D. Vt. 1987), the Vermont bankruptcy court had limited compensation to hourly rates charged in the community. The court overrules the *S.T.N.* decision but imposes detailed requirements for allowance of compensation and reimbursement of expenses, based on the requirements of section 330. The professional much "conscientiously set forth the hours expended on each task and the nature of the services rendered at a level of specificity that would allow the Court to evaluate the application." The application must "clearly identify each discrete task billed to the estate" and "include a specific analysis of each task for which compensation is sought." For "meetings and conferences among multiple professionals, … the professional must demonstrate the benefit [to] the estate and document consistent amounts of time by all participants ... or set forth an explanation for any differential." Otherwise, "the question is raised as to whether the compensation requested by *any* of the meeting participants is reasonable." Time charged for review and response to email must "identify the participants, describe the substance of the communication, explain its outcome and justify its necessity." Non-working travel time may be billed at only 50% of hourly rates. Reimbursement for out-of-town meals is permitted only if the applicant shows "there were no other reasonable alternative available that would have been less expensive." Computer-assisted legal research costs are reimbursable if "the applicant: (1) demonstrates that the use charges incurred were reasonable and necessary (which necessarily includes a description of the research topic and the length of time spent on each topic); … and (3) certifies the invoiced cost from the vendor." Although the court awards compensation for reasonable time preparing fee applications, it does not indicate whether and to what extent the record keeping requirements imposed by the opinion would be compensable in situations where they exceed the time spent on the substantive task. *In re Fibermark, Inc.,* 349 B.R. 385 (Bankr. D. Vt. 2006).

13.2.kk. Bankruptcy law does not limit postpetition attorney's fees on an unsecured claim in a solvent case. The bankruptcy court awarded an unsecured creditor attorney's fees only for enforcing the debt contract itself and disallowed fees for the creditor's bankruptcy case participation. It reasoned that section 506(b), which denies postpetition fees to an undersecured creditor, implies that an unsecured creditor is not entitled to such fees. However, section 506(b) does not limit postpetition interest on undersecured or unsecured claims when the debtor is solvent. By analogy, it does not deny fees in a solvent case. The contract terms and applicable nonbankruptcy law determine the extent to which the creditor may collect fees. *Official Comm. of Unsecured Creditors v. Dow Corning Corp. (In re Dow Corning Corp.)*, 456 F.3d 668 (6th Cir. 2006).

13.2.ll. Unsecured creditor's postpetition attorney's fees are not allowable. The indenture required the debtor to pay the indenture trustee's attorney's fees. The indenture trustee filed a proof of claim for fees incurred postpetition, arguing that its statutorily imposed fiduciary duty to bondholders supports allowance. The court disallows the fees, unpersuaded that the claim for attorney's fees incurred after bankruptcy are contingent, unliquidated claims as of the petition date. If they were, then every unsecured creditor with an attorney's fees clause in a contract would be able to continue to incur fees, effectively at the expense of the estate, for continued monitoring of the case and for defending its claim. A bar date would not be effective, because the claims amount would keep increasing, and those creditors with an attorney's fees clause would receive better treatment in the case than those without. Section 506(b) does not require a different result. By expressly authorizing postpetition fees for an oversecured creditor, it should be read to imply disallowance of postpetition fees for all other creditors. *Global Indus. Techs., Inc. v. J.P. Morgan Trust Co., N.A. (In re Global Indus. Techs., Inc.)*, 344 B.R. 382 (Bankr. W.D. Pa. 2006).

13.2.mm. Fees and costs are not allowable pre-BAPCPA on a statutory lien claim. The creditor performed work on the debtor's oil well under an agreement that did not provide a security interest to secure payment of the work's cost. When the debtor failed to pay, the creditor obtained a lien on the well under the state's statutory materialmen's lien law. Section 506(b) provides, "To the extent that an allowed secured claim is [oversecured], there shall be allowed to the holder of such claim … any reasonable fees, costs, or charges provided under the agreement [or State statute] under which such claim arose." (BAPCPA added the bracketed language.) Although the creditor's claim arose under an agreement, the lien did not; it arose under the state statute. The court reads "such claim" narrowly to refer to the "allowed secured" portion of the phrase, rather than just the "claim" alone. Therefore, the lien did not arise "under the agreement," and the fees were not allowable. The result would differ under BAPCPA. *Bridgeport Tank Trucks v. Lien Agent (In re EnRe LP)*, 457 F.3d 493 (5th Cir. 2006).

13.2.nn. Security retainer does not disqualify counsel and is not subject to disgorgement. The debtor's chapter 11 counsel took a prepetition retainer, which it applied (with court permission) to its chapter 11 fees and expenses. After the case converted to chapter 7, the court ordered counsel to disgorge the retainer to permit pro rata distribution among chapter 11 administrative claims. The B.A.P. reverses. A security retainer provides a security interest to counsel to secure postpetition fees. It does not render counsel disinterested, however, because it does not make counsel a creditor, which is defined as an entity holding a prepetition claim. If the retainer secures only postpetition fees, then counsel is not a "creditor." The priority scheme of section 726(a) and case law permitting disgorgement under that section apply only to the unencumbered assets of the estate and to unsecured claims. Disgorgement is not permitted here, because the retainer is counsel's collateral, and counsel's claim is secured. A dissent argues that security retainers are never permitted, because they defeat the pro rata distribution principle among administrative claims. *Rus, Miliband & Smith, APC v. Yoo (In re Dick Cepek, Inc.)*, 339 B.R. 730 (9th Cir. B.A.P. 2006).

13.2.oo. Counsel for second lien creditor disqualified from representing first lien creditors. The law firm advised a creditor who held both first and second lien bonds about the relative rights of the liens. The creditor terminated the engagement shortly after the debtor filed bankruptcy. A committee of first lien creditors, not including the former client, retained the law firm to advise and represent it in protecting the position of the first lien holders against the second lien holders. On the former client's motion, the law firm is disqualified from representing the first lien holders. The matters are substantially related under Model Rule 1.9(a), because the subject of the first representation was the debtor's prepetition debt structure. By representing the creditor in that matter, the law firm gained confidential information about the debtor's debt and Stanfield's position, which could benefit the first lien holders if the representation continues. The law firm could continue to represent the first lien holders only with the informed written consent of the former client, which it did not have. *In re Meridian Auto. Systems-Composite Operations, Inc.*, 340 B.R. 740 (Bankr. D. Del. 2006).

13.2.pp. Court allows fees for defending fee application. The liquidating trustee sought an across-the-board 7% fee reduction from the professionals in the case. When one law firm refused, the trustee filed an objection to its fees. The bankruptcy court awarded the firm 95% of the fees claimed and 86% of the fees to which the trustee objected. The fees incurred for defending the fee application were allowable,

consistent with the policy that professionals in bankruptcy cases should receive compensation comparable to those outside. The absence of benefit to the estate here does not require that the fees be disallowed. Otherwise, parties would have an unhealthy incentive to object to fees because requiring the professional to bear the cost of the objection would be no different from cutting the fees. *Hennigan, Bennett & Dorman LLP v. Goldin Assocs. L.L.C. (In re Worldwide Direct Inc.)*, 334 B.R. 108 (D. Del. 2005).

13.2.qq. Attorney need not segregate "advance payment retainer." The chapter 13 attorney took a prepetition fee from his debtor client, which he characterizes as payment for preparation of the chapter 13 petition and which the client forfeits if the client determines not to file the case. Such a retainer is an "advance payment retained" under Texas law, which is a flat fee paid for services to be rendered that passes to counsel upon payment, with the client retaining no interest. It differs from a "classic retainer," which is a payment in consideration for counsel's employment rather than services rendered, and from a "security retainer," which merely secures payment of the attorney's fees once services are rendered. Despite a local bankruptcy rule requiring that prepetition advance payment retainers be placed in the attorney's client trust account and not drawn without court approval, counsel is not required to do so, because the property is not property of the debtor upon filing and does not become property of the estate. In a footnote, the court suggests that such a rule is not generally followed in chapter 11 cases and if it were, it might deprive many chapter 11 debtors of competent counsel. Disclosure and reasonableness, both required under section 329, provide an adequate policing device. *In re Barron*, 432 F.3d 590 (5th Cir. 2005).

13.2.rr. Debtor in possession may hire counsel to represent employees in connection with an investigation. Because the FBI and the U.S. Attorney's office started an intense investigation of the debtor shortly after the bankruptcy filing, the debtor in possession retained one law firm to represent all the employees who were to be interviewed or required to produce documents. The firm would not continue to represent any employee who later became a target of the investigation. Section 363(b) authorizes the retention. Even though section 327 touches on employment of attorneys at the expense of the estate, it addresses representation of the estate, not third parties, such as employees. The fact that another section touches a subject does not exclude the use of section 363(b) to authorize the transaction. Here, the debtor in possession showed good business judgment in retaining the law firm, because it reassured employees who were being interrogated and thereby facilitated the production of information and helped retain the employees for the chapter 11 case, and it reduced cost by concentrating the effort in a single law firm, who could coordinate all investigations, among other reasons. *Official Comm. of Unsecured Creditors v. Enron Corp. (In re Enron Corp.)*, 335 B.R. 22 (S.D.N.Y. 2005).

13.2.ss. Undisclosed interest in potential purchaser requires fee disallowance. The debtor in possession's section 327(e) counsel was actively involved in representing the DIP in negotiations to sell the debtor's business, including supporting the DIP's preference for a particular buyer, which the debtor's CEO had created, and litigating against and threatening other potential buyers. When counsel applied for compensation at the end of the case, it was discovered that counsel was negotiating with the CEO-sponsored buyer to provide it financing to complete the sale. The negotiations were ultimately unsuccessful, so the CEO-sponsored buyer withdrew its offer, and the DIP supported the sale to an unaffiliated third party. Section 327(e) does not permit special counsel to hold or represent an interest adverse to the estate, which counsel did by supporting the buyer financially. In addition, Rule 2014 requires disclosure of the connection, even though it arose after counsel was first retained. Therefore, denial of compensation was mandatory. *I.G. Petroleum, L.L.C. v. Fenasci (In re West Delta Oil Co.)*, 432 F.3d 347 (5th Cir. 2005).

13.2.tt. Court interprets section 327(e) narrowly and includes firm's prepetition conduct in the analysis. The debtor's prepackaged chapter 11 plan was to be funded by recoveries from claims against insurers related to asbestos liabilities. The debtor employed an insurance coverage law firm as special insurance counsel to provide strategic advice on insurance issues related activities, including pursuing claims against the insurers. The firm participated extensively in the prepetition plan negotiation and formulation. The firm frequently served as co-counsel with asbestos plaintiffs firms in other asbestos cases, representing large numbers of asbestos claimants, many of whom also had claims against this debtor. Finally, the firm owned a 70% interest in an asbestos claims screening firm, which would process

and review claims against the debtor in this case. The insurers, even though not creditors in the chapter 11 case, had standing to raise the conflict issue, based on the duty of bar members to police the profession. The New Jersey Rules of Professional Conduct prohibit the law firm from representing the debtor without the informed written consent of its claimant clients, which it did not have. In addition, the firm may not be employed as special counsel under section 327(e). Whatever its postpetition role, the court should look at the firm's entire involvement before and during a prepackaged case, because the important work in a prepackaged case occurs before the filing, and the protections that section 327(a) imposes are equally important then to the integrity of the bankruptcy process. Therefore, the firm could not be employed under section 327(e); its work was too central to the entire case and the plan. It could not be employed under section 327(a) either, because it was not disinterested. Its involvement as co-counsel to plaintiffs asbestos firms and its ownership of the claims processing firm prevented it from being completely loyal to the debtor. *Century Indem. Co. v. Congoleum Corp. (In re Congoleum Corp.)*, 426 F.3d 675 (3d Cir. 2005).

13.2.uu. Nondisclosure of representation of creditors in unrelated matters results in fee disgorgement. After the chapter 11 case was filed and counsel filed its disclosure statement under Rule 2014, counsel became aware of the claims of two major creditors, which counsel represented in unrelated matters. Counsel represented the estate in pursuing claims against the first creditor for four months before disclosing the connection and handing the matter over to the committee to pursue. The disclosure came too late. The late disclosure required the estate to incur additional fees in the matter's transition to committee counsel. Counsel objected to the second creditor's claim and litigated its motion to compel assumption of its lease without disclosure of the connection, through "an inadvertent oversight." Nevertheless, there was an actual conflict. The court orders counsel to disgorge all fees received for the work related to those two creditors. *In re eToys, Inc.*, 331 B.R. 176 (Bankr. D. Del. 2005).

13.2.vv. Bankruptcy court does not have jurisdiction over post-confirmation committee, liquidating trustee and their professionals. The confirmed plan provided for a Plan Administrator to administer the remaining estate assets and a Post-Effective Date Committee. The Administrator had been the debtor in possession's chief executive officer. As Administrator, he retained the debtor's counsel. The plan provided that the Administrator could retain and compensate professionals without court approval. The court's post-confirmation jurisdiction is limited and does not extend to the issue of replacement of professionals for a plan administrator or a post-confirmation committee because it does not have such a significant impact on the estate to be "related to" the bankruptcy case. *In re eToys, Inc.*, 331 B.R. 176 (Bankr. D. Del. 2005).

13.2.ww. Attorney may be employed under section 327(e) even for core functions of chapter 11. The debtor's law firm had represented the creditors committee in the debtor's prior chapter 11 case and was therefore not disinterested and was disqualified for employment under section 327(a). Nevertheless, the court could approve the law firm's employment under section 327(e) for the purposes of negotiating and implementing a cash collateral agreement with the lender, conducting the debtor's "going out of business" asset sale, and negotiating a key employee retention plan. Although these functions were central to the conduct of the chapter 11 case, they did not constitute "represent[ing] the trustee in conducting the case," which section 327(e) prohibits special counsel from doing. The court does not, however, provide a definition of the quoted clause or a general test to determine whether it has been met. *Stapleton v. Woodworkers Warehouse, Inc. (In re Woodworkers Warehouse, Inc.)*, 323 B.R. 403 (D. Del. 2005).

13.2.xx. Attorney with unpaid prepetition bill, secured by a cash retainer, is not disinterested. The debtor's attorney took an adequate prepetition retainer to cover prepetition services and some postpetition services. He did not, however, withdraw funds from the retainer to pay for all outstanding amounts immediately before bankruptcy, but allowed the retainer to sit pending final fee applications in the case. The court strictly follows *United States Trustee v. Price Waterhouse*, 19 F.3d 138 (3d Cir. 1994) (unsecured prepetition claim for nonbankruptcy services) and determines that the attorney's status as a secured creditor, despite the contrary *In re Martin*, 817 F.2d 175 (1st Cir. 1987) (secured claim for prepetition bankruptcy services), disqualifies the attorney from representing the debtor in possession. As a sanction, the court disallows the attorney's claim for prepetition services. *In re Lackawanna Med. Group, P.C.*, 323 B.R. 626 (Bankr. M.D. Pa. 2005).

13.2.yy. Security retainer cannot be applied to a chapter 7 debtor's attorney's postpetition fees without court approval of the attorney's employment. The debtor's attorney took a prepetition retainer and placed it in his client trust account. Before bankruptcy, he drew a portion of the retainer, representing the billed amount but not including incurred but unbilled prepetition fees. He performed postpetition services as well. Upon his final application for fees in the case, he was entitled to apply the retainer to the unbilled prepetition fees. The retainer became property of the estate upon the filing, and the attorney retained a lien on it to secure the prepetition fees, which could be paid from the retainer. However, the retainer could not be used to pay for the attorney's postpetition services. Property of the estate may not be used to pay a debtor's attorney unless his employment has previously been approved by the court. *Fiegen Law Firm, P.C. v. Fokkena (In re On-Line Servs. Ltd.)*, 324 B.R. 342 (B.A.P. 8th Cir. 2005).

13.2.zz. Liquidating chapter 11 corporation retains attorney-client relationship with former counsel. The debtor sold all its assets in its chapter 11 case and then confirmed a liquidating plan. The plan authorized the creditors committee to bring the estate's avoiding power actions on behalf of the debtor in possession. In one such action, the committee moved to disqualify defendants' counsel, who had previously represented the debtor on related matters. Because the beneficial owner of the actions was the same entity that counsel had previously represented, counsel was disqualified from representing the defendants in the avoiding power actions, even though the debtor had been completely liquidated, no longer had any business operations, and had changed its name. It was the same corporate entity and therefore retained the attorney-client relationship and privilege that underlie the conflicts rules. *Post-Confirmation Committee v. The Feld Group (In re I Successor Corp.)*, 321 B.R. 640 (Bankr. S.D.N.Y. 2005).

13.2.aaa. Use of company email does not necessarily waive personal attorney-client privilege. Before bankruptcy, individual officers of the debtor communicated over the company's email system with their personal attorneys. A trustee was appointed immediately upon the filing of the bankruptcy petition and ordered the officers not to return to their offices and to turn over their keys immediately to the trustee. The trustee later sued the officers on various causes of action and sought discovery, including copies of the individual emails between the officers and their personal attorneys. The fact that the emails were transmitted unencrypted over the company's email system did not per se waive any attorney-client privilege. However, if the company had an express policy denying confidentiality to email traffic on the company's system, the privilege would not apply. *In re Asia Global Crossing, Ltd.*, 322 B.R. 247 (Bankr. S.D.N.Y. 2005).

13.2.bbb. General partnership debtor in possession's lawyer may owe duty to pursue actions against debtor's general partners. Counsel for the general partnership chapter 11 debtor and debtor in possession also represented the partnership's two individual general partners. Before bankruptcy, counsel had assisted the general partners in transferring their assets to family limited partnerships, at least in part to shield their assets from creditors, but counsel did not disclose the representation in its employment application. The partnership's sole asset was real property that declined in value rapidly after the chapter 11 case was filed. After bankruptcy, counsel represented to the court that the property had declined in value, that the debtor could be reorganized without significant capital contributions from the general partners, and that the general partners were able to answer any necessary capital calls. Counsel did not conduct any investigation of the latter two representations, both of which counsel should have known, based on the nature of the debtor's assets and counsel's work in setting up the family limited partnerships, were false. Counsel was liable to the trustee for malpractice. Although the debtor in possession had ceased to exist, the cause of action belonged to the estate, not to the debtor in possession, and the chapter 7 trustee was the proper estate representative to bring the action. Counsel had a duty to the partnership debtor in possession, including the duty to maximize the value of the estate and the recovery of property for the estate. Counsel breached the duty by not rendering its services free of any conflict of interest — the simultaneous representation of a partnership and its general partners "almost invariably entails a plain conflict of interest" — and by not filing or threatening to file a contribution action against the general partners. The court comes close to imposing a duty on counsel for a debtor in possession to make decisions about whom to sue on behalf of the estate, thus transferring to counsel the apparent duty to act as the client, although the court may have suggested such a duty only in a case such as this, where a conflict of interest may have effectively prevented the debtor in possession from making the decision on its own. *Bezanson v. Thomas*, 402 F.3d 257 (1st Cir. 2005).

13.2.ccc. Substantial contribution attorney's fees are allowable even if the creditor/client is not liable for them. In a prepackaged asbestos case, the claimants' attorney asserted a "substantial contribution" claim for fees under section 503(b)(4). The asbestos claimant clients were not liable to the attorney for any fees incurred. Section 503(b)(3)(D) grants administrative priority to expenses, other than attorney's fees, "incurred by … (D) a creditor … in making a substantial contribution" in the case. Section 503(b)(4) grants administrative priority to a claim for attorney's fees "of an entity whose expense is allowable under paragraph (3) …." The court reads the latter provision as not requiring that the fees be incurred by the creditor and allows the fees against the estate. *In re Western Asbestos Co.*, 318 B.R. 536 (Bankr. N.D. Cal. 2004).

13.2.ddd. Disgorgement of professional fees is mandatory in an insolvent estate. Rejecting the decision of the Sixth Circuit Bankruptcy Appellate Panel in *In re Unicast*, 219 B.R. 741 (B.A.P. 6th Cir. 1998), that disgorgement of professional fees is discretionary with the bankruptcy court, the Sixth Circuit rules that disgorgement is mandatory, at least where the trustee seeks disgorgement. In this case, a failed chapter 11 that was converted to a chapter 7, counsel for the debtor in possession had received a retainer and was awarded chapter 11 fees on a final fee application heard during the chapter 7 case. The Sixth Circuit nevertheless characterizes the fee award as interim compensation and notes that "retainers are held in trust," although the court does not say whether the retainer was paid before or after the petition. As the retainer is property of the estate, it is available to all administrative claimants. They are entitled to share equally, because section 726(b) provides that claimants at the same level of priority "shall" receive pro rata distribution. The court does not indicate whether a trustee is required to seek disgorgement, whether from professional fee claimants, ordinary administrative creditors, or both. *Specker Motor Sales Co. v. Eisen*, 393 F.3d 659 (6th Cir. 2005).

13.2.eee. Rule 2019 permits court to order disclosure of referral and fee information. The bankruptcy court ordered attorneys for thousands of asbestos claimants to file statements under Rule 2019, disclosing the agreements with their clients and, more importantly, with their forwarding counsel, including all fee-sharing provisions in those agreements. The court had subject matter jurisdiction to do so, even though the agreements were among nondebtors, because the relationships may have a significant effect on the conduct of the case and the court's evaluation of the good faith and fairness of any plan. The order's scope, requiring disclosure of referral fee information, was permissible for the same reason. Rule 2019's purpose is to ensure openness and fairness in process and result, not simply to ensure that attorneys have the requisite authority to represent the clients they purport to represent. Finally, the court does not require that the information need be kept confidential. *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm.*, 321 B.R. 147 (D.N.J. 2005).

13.2.fff. Allowed interim fees may be reviewed at any time. The bankruptcy court allowed interim fees in the full amount requested, but limited payment to 75%. At the end of the case, upon the final fee application, the court cut the fees substantially. The prior interim allowance does not restrict the court's authority to reduce the fees upon a final fee application, because interim fees are by their nature interlocutory and subject to review at any time. *Leichty v. Neary (In re Strand)*, 375 F.3d 854 (9th Cir. 2004).

13.2.ggg. Attorney is responsible for fees incurred. The trustee's attorney pursued an action against the IRS that foreseeably would have only minimal benefit to the estate. In the absence of any evidence that the client trustee had insisted on pursuing the action despite the attorney's contrary recommendation, the attorney is ultimately responsible, and it is not unfair to deny the attorney fees for an action that the client requested he pursue. If the attorney believes it should not be pursued, counsel should seek to withdraw or at least recommend that the client get a second opinion. *Leichty v. Neary (In re Strand)*, 375 F.3d 854 (9th Cir. 2004).

13.2.hhh. Evergreen retainers permitted, with limits. The court permits an evergreen retainer, but limits interim compensation requests to once every 120 days, rather than once every 60 days as it would have permitted in the absence of the retainer, even in this mid-sized case. The court reasons that the evergreen retainer is a risk-minimizing device, just as interim compensation payments are. The debtor in

possession should not be required to take on all of the risk of the reorganization; counsel should bear some of the risk too. *In re Pan Am. Hosp. Corp.*, 312 B.R. 706 (Bankr. S.D. Fla. 2004).

13.2.iii. Debtor's settlement of claims does not prevent attorney's fees for administering estate. The debtor made fraudulent transfers, which the chapter 7 trustee pursued. Before the claims went to trial, the debtor settled with all of its creditors, so that the fraudulent transfer recoveries would not have benefited them at all. The trustee still pursued the avoidance claims and trustee's counsel filed an application for the fees incurred in pursuing the action. The debtor objects, arguing that the avoidance would not be "for the benefit of the estate." The court awards the fees. It reasons that the estate is not synonymous with "unsecured creditors," that the estate encompasses other interests as well, such as administrative claimants. This was not a case where the trustee pursued the claims only to generate fees or where there would be no net benefit to the estate, because the unsecured claims had not been settled when the claims were brought, and the claims may have pressured the settlement. The debtor's settlement may not thwart the professionals' efforts to collect fees for their work to administer the estate. *Stalnaker v. DLC, Ltd.*, 376 F.3d 819 (8th Cir. 2004).

13.2.jjj. Court awards substantial contribution fees for proposing confirmed plan. The debtor, in a bitter dispute with two of its major creditors, did not file a plan. After exclusivity expired, they did, and it provided for waiver of their claims and full payment for all creditors. They sought substantial contribution fees under section 503(b)(3) and (4) over the debtor's objection. The court grants the fees. It notes the circuit split on whether a creditor's pursuit of its self-interest disqualifies it from receiving substantial contribution fees—the Third and the Tenth hold that it does; the Fifth and Eleventh hold that it does not—but does not reach the issue. It notes that there will rarely if ever be a case in which a creditor does not have at least some self-interest in the outcome, but in this case, the benefits to the estate outweighed the benefit to the creditors. *Cellular 101, Inc. v. Channel Comm., Inc. (In re Cellular 101, Inc.)*, 377 F.3d 1092 (9th Cir. 2004).

13.2.kkk. Prepetition retainer may be used to pay post-conversion chapter 7 fees. Debtor's counsel had taken a prepetition retainer. Its fees during the chapter 11 case were paid from a debtor in possession financing carve out. After conversion of the case to chapter 7, counsel incurred additional fees. Under *Lamie v. United States Trustee*, 540 U.S. 526 (2004), debtor's counsel could not be compensated at the expense of the estate unless the bankruptcy court had approved its employment. But *Lamie* specifically permitted post-conversion fees to be paid from a prepetition retainer, which the bankruptcy judge permitted here. *In re Channel Master Holdings, Inc.*, 309 B.R. 855 (Bankr. D. Del. 2004).

13.2.lll. DIP financing carve out does not limit professional fees. Under the debtor in possession financing order, the court approved a carve out for professional fees, which was separately allocated to the debtor in possession's professionals and the committee's professionals. The committee's professionals incurred and requested compensation in excess of the carve out amount. The court had authority to allocate the total fees allowed under the carve out and had approved the financing with that limitation. In addition, the court has authority to order disgorgement of fees paid to some professionals so as to equalize the distribution to all professionals in an insolvent administration. *In re Channel Master Holdings, Inc.*, 309 B.R. 855 (Bankr. D. Del. 2004).

13.2.mmm. Debtor's attorney denied fees in chapter 7. The 1994 amendment to section 330(a) deleted "or the debtor's attorney" from the lead-in to section 330(a) but left the word "attorney" in section 330(a)(1)(A) and in section 331. The courts of appeals had split over whether this created an ambiguity on the issue of whether the debtor's attorney could be compensated from the estate for services rendered in a chapter 7 case. The Supreme Court rules that the section cannot be found to be ambiguous based on the pre-amendment version. Rather, the plain language of the section as it currently exists must determine its meaning. Despite the provision's awkward and ungrammatical construction, the meaning as written is plain, and the internal inconsistency does not appear to arise from scrivener's error. Therefore, section 330(a) does not authorize payment from the estate of the debtor's attorney for services rendered in a chapter 7 case, unless the bankruptcy court has previously approved the attorney's employment in the chapter 7 case. *Lamie v. United States Trustee*, 540 U.S. 526 (2004).

13.2.nnn. Non-disclosure of limitation in conflict waiver letter results in denial and disgorgement of fees. The debtor retained Perkins Coie to represent it in its chapter 11 case. The debtor's prepetition secured lender and DIP lender was a Wells Fargo affiliate. Wells Fargo was a client of Perkins Coie. Perkins obtained a conflict waiver which acknowledged a conflict of interest and provided a waiver, but prohibited Perkins from representing the debtor "in litigation directly adverse to Wells." Despite Perkins' statements under Rule 2014 that it would disclose all connections and update the court regularly on any new connections that it discovered, it did not disclose the limitation on its conflict waiver with Wells Fargo. When the limitation was disclosed after the business failed and litigation against Wells ensued, Perkins withdrew from representing the debtor in the litigation. Nevertheless, the court denied Perkins all fees and ordered disgorgement of all fees and expenses already paid (with minor exceptions). Rule 2014(a) requires complete disclosure. Perkins violated the rule by failing to disclose the litigation limitation on its conflict waiver. The court has discretion to deny fees *in toto*, which it did in this case. *In re Jore Corp.*, 298 B.R. 703 (Bankr. D. Mont. 2003).

13.2.ooo. Debtor's counsel is disqualified because of bank representation. Sonnenschein, Nath & Rosenthal occasionally represented Bank of America, which accounted for less than 0.3% of Sonnenschein's annual revenues. It was retained by the debtor, whose principal secured creditor was Bank of America. In response to the debtor in possession's application to employ Sonnenschein, a creditor objected under section 327(c). Because the bank has been a Sonnenschein client for at least two years, the court concludes that Sonnenschein has a predisposition to bias in favor of the bank and is therefore not disinterested. The court is concerned that Sonnenschein would not be able to take an aggressive position on behalf of the estate against the principal secured creditor. *In re Premier Farms, L.C.*, 305 B.R. 717 (Bankr. N.D. Iowa 2003).

13.2.ppp. Attorney client privilege limited. The individual debtor in a chapter 11 case communicated with one of her attorneys (whose employment had not been approved by the court) regarding the formation of a new corporation, which might have resulted in a transfer or dissipation of property of the estate. After the case was converted to chapter 7, the trustee sought information from the attorney for the debtor in possession regarding the new corporation. The trustee may waive the attorney-client privilege as to those communications. As the chapter 11 debtor in possession, the individual debtor was the representative of the estate and owed fiduciary duties to creditors and the estate. The chapter 7 trustee succeeded as the representative of the estate and therefore could waive the privilege, but only with respect to communications surrounding the formation of the corporation that occurred while the debtor served as chapter 11 debtor in possession. The trustee may also waive the privilege for communications regarding a malpractice claim against the attorney that the debtor listed as an asset of the estate on her schedules. In addition, because of section 329(a), all communications between the debtor and counsel, including prepetition communications, regarding retention and compensation are not privileged. *In re Eddy*, 304 B.R. 591 (Bankr. D. Mass. 2004).

13.2.qqq. Debtor's attorney's prepetition retainer is discharged. Before bankruptcy, the consumer debtor signed a retainer agreement with his lawyer, promising to pay the fee in installments beginning before bankruptcy and ending after bankruptcy. The debtor's discharge under section 727(b) discharges the fees. Section 329(b), which gives the bankruptcy court authority to determine the reasonableness of the promised fees, does not detract from the broad reach of the discharge. What is more, the retainer can not be divided into pre- and post-petition portions, permitting nondischargeability of the post-petition portion, because the retainer agreement itself did not provide either for such division or for hourly services, and the Bankruptcy Code treats the agreement as one claim. The court notes the split with the Ninth Circuit's decision in In re Biggar, 110 F.3d 685 (9th Cir. 1997). *Bethea v. Robert J. Adams & Assoc.,* 352 F.3d 1125 (7th Cir. 2003).

13.2.rrr. Court allows evergreen retainer. Counsel for the debtor provided for an evergreen retainer, that is, a retainer that would be held as security for the payment of fees until the end of the case. Despite the presence in the case of additional risk minimizing devices, such as a carve-out and an interim compensation procedure, the court approves the evergreen retainer as reasonable under section 328. However, the court requires clear disclosure of an evergreen retainer, as well as a copy of the engagement agreement. *In re Insilco Technologies, Inc.*, 291 B.R. 628 (Bankr. D. Del. 2003).

13.2.sss. Attorney's fees allowed in full despite unanticipated circumstances. The bankruptcy court approved employment of an attorney on a contingent fee. The attorney's success in obtaining judgment and collecting was far easier than anticipated, although the parties had argued at the time of approval that the case might not be difficult. The bankruptcy court reduced the attorney's fee. The Fifth Circuit reversed, holding that the language of section 328(a) permits the bankruptcy court to reduce allowed compensation only for circumstances that could not have been anticipated. In this case, the circumstances were not anticipated, but they could have been, so the lawyer should be allowed the entire fee as originally approved. *Daniels v. Barron (In re Barron)*, 325 F.3d 690 (5th Cir. 2003).

13.2.ttt. Fees not recoverable from attorney under section 330. After the case was converted to chapter 7, the debtor's wife paid fees to the debtor's bankruptcy lawyer and the debtor's criminal lawyer. Before the fees were paid, the trustee advised the attorneys that he was investigating whether the source of the funds might be recoverable under one of the avoiding powers. After the fees were paid and the trustee completed his investigation, the trustee sought recovery from the attorneys of the fees paid on the grounds that they came from property of the estate. He claimed that they were paid by a Cook Islands asset protection trust, where the debtor had established more than one year before bankruptcy, to the wife, who paid them to the attorneys. Finally, the court concludes that the criminal attorney did not need to file a statement under section 329, because that section applies only to fees paid "for services rendered or to be rendered in contemplation of or in connection with the case." *Wasserman v. Bressman (In re Bressman)*, 327 F.3d 229 (3d Cir. 2003).

13.2.uuu. Secured creditor need not file fee application to recover attorneys fees. A secured creditor seeking attorneys fees under section 506(b) may include the amount in its proof of claim, even if the fees are incurred postpetition, and need not file a fee application under Bankruptcy Rule 2016. *Atwood v. Chase Manhattan Mortgage Co. (In re Atwood)*, 293 B.R. 227 (9th Cir. B.A.P. 2003).

13.2.vvv. Disinterestedness conflicts check is compensable. Following the courts of appeals decisions that allow compensation for time spent preparing fee applications, the court rules that the time spent checking disinterestedness and providing disclosure and otherwise complying with the requirements of Bankruptcy Rule 2014(a) is compensable under section 330. However, time spent on initial conflicts checks as required under applicable state law is not compensable. *In re Sterling Chemicals Holdings, Inc.*, 293 B.R. 701 (Bankr. S.D. Tex. 2003).

13.2.www. Section 328 employment is not disfavored. Counsel had been employed on a contingent fee under an order that required counsel to submit a fee application to the court for approval. After the court determined that a section 330 reasonableness standard, rather than the contingent fee agreement contained in the employment order, should apply, counsel appealed. The Sixth Circuit B.A.P. rules that a requirement in an employment order to file a fee application or a provision that the fees are subject to review by the court is not a sufficient statement that the fees will be reviewed under a section 330 reasonableness standard rather than based on the terms and conditions of employment under section 328. The B.A.P. specifically rejects the Ninth Circuit rule, expressed in *In re Circle K Corp*, 279 F.3d 669 (9th Cir. 2002), which requires specific reference to section 328 in the application and order, as a mere housekeeping rule it will not follow, because there is no presumption in the statute that the section 330 reasonableness rule should take precedence over the section 328 terms and conditions rule unless the order specifies otherwise. The B.A.P. directs the courts to determine what arrangement the court approved, not to look for any particular magical words in the order. *Nischwitz v. Airspect Air, Inc. (In re Airspect Air, Inc.)*, 288 B.R. 464 (6th Cir. B.A.P. 2003).

13.2.xxx. Allowance of fees precludes later malpractice claim. After his bankruptcy case, the debtor sued his former law firm for malpractice. The Fourth Circuit rules that the claim is barred on grounds of *res judicata*. The award of fees was a final prior judgment. The debtor was in privity with the estate, because the debtor's liability for non-dischargeable taxes would have been reduced by disallowance of the fees. Finally, the malpractice claim is based on the same cause of action involved in the fee application, because both relate to the nature and quality of the legal services that the law firm rendered. *Grausz v. Englander*, 321 F.3d 467 (4th Cir. 2003).

13.2.yyy. Unsecured creditor may be awarded attorney's fees for litigating state law issue. After prevailing on its appeal on the enforceability of a swap agreement, which required the defaulting party to pay attorney's fees incurred "by reason of the enforcement or protection of its rights under this agreement," the bank sought an award of attorney's fees incurred in connection with the appeal. The Ninth Circuit awards the fees to the extent that state law both governs the substantive law issue and authorizes the court to award fees. In this case, there were both bankruptcy law and state contract law issues. The fees were awarded only to the extent of the litigation with respect to the state law issue. *Thrifty Oil Co. v. Bank of America N.T. & S.A.*, 322 F.3d 1039 (9th Cir. 2003).

13.2.zzz. Preference recipient is disqualified from employment. The debtor's counsel had received substantial payments in the ninety-day period before the chapter 11 case. The district court approved employment on the condition that if the firm was determined to have received a preference, it promptly return the preference and waive any unsecured claim arising from the return. The Third Circuit rules that the conditions were not adequate. If indeed the firm had received a preference, it was not disinterested and could not be employed. Therefore, the bankruptcy court had to determine whether it had received a preference before it could authorize the employment. *In re Pillowtex, Inc.*, 304 F.3d 246 (3d Cir. 2002).

13.2.aaaa. Court allows debtor's attorney fees for litigating fee application. The Ninth Circuit reaffirms its prior ruling that the 1994 amendment to section 330 did not prohibit allowance of fees for a debtor's attorney, even after the appointment of a trustee. The court looks to section 330(a)(4)(A) to determine that fees for a debtor's attorney must be for services that were not unnecessarily duplicative, reasonably likely to benefit the estate, and necessary for the administration of the case. In this case, the court goes further to permit allowance of fees for a debtor's attorneys for litigation of his fee application over the objection of the debtor and permits allowance of fees for outside counsel that the attorney hired to defend the objection to the fee application. *Smith v. Edwards & Hale, Ltd. (In re Smith)*, 305 F.3d 1078 (9th Cir. 2002).

13.2.bbbb. DIP's attorney does not owe fiduciary duty to the estate or creditors. A dispute arose between counsel for the DIP and the holder of the principal secured claim over funding for the plan, which included payment of part of the attorney's fees from a carve-out and the balance as administrative expenses under the plan. As a result of the dispute, the plan could not be consummated, and the case was converted to chapter 7. In an action by the secured creditor against DIP counsel, the court rules that counsel does not owe a fiduciary duty to the estate or creditors. Relying on *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434 (D. Utah 1998), the court rules that counsel owes its duty only to the debtor-in-possession. Because of the conflicting and competing interests of the debtor, secured creditors, unsecured creditors, and other parties, counsel for the DIP could not owe duties to all parties in interest. The court distinguishes cases that have stated that DIP counsel is a fiduciary of the estate and an officer of the court on the grounds that they dealt with direct conflicts of interest and other breaches of statutory provisions, not breach of fiduciary duty to the estate. *ICM Notes, Ltd. v. Andrews & Kurth, L.L.P.*, 278 B.R. 117 (S.D. Tex. 2002).

13.2.cccc. Fourth Circuit denies fees to chapter 7 debtor's attorney. Recognizing the split in the circuits and the ambiguity in section 330(a), the Fourth Circuit concludes that the ambiguous 1994 amendment to section 330(a) should be read literally to deny a debtor's attorney fees from a chapter 7 estate. What is more, the court concludes that a pre-petition retainer that the attorney held could not be applied to fees incurred after conversion of the case to chapter 7, because the retainer was property of the estate, which could not be used to pay fees for a debtor's attorney. *United States Trustee v. Equipment Services, Inc. (In re Equipment Services, Inc.)*, 290 F.3d 739 (4th Cir. 2000).

13.2.dddd. Disqualified counsel may be compensated under section 503(b)(3). Counsel for a creditor had brought a prepetition action against the debtor's principals to recover fraudulently transferred property. After bankruptcy, the trustee retained the law firm as special counsel at the expense of the estate, with fees contingent upon recovery from the debtor's principal, but without disclosing that the creditor was continuing to pay counsel. When a dispute arose regarding approval of a settlement between the trustee and the debtor's principals (negotiated by the trustee's general counsel), the detailed facts regarding special counsel were revealed to the court. Although these facts disqualified counsel from

representing the trustee (section 327(e) does not apply to a creditor's counsel), the B.A.P. rules that the disinterestedness requirement of section 327 does not apply in a section 503(b)(3)(B) creditors suit and that the creditor could seek reimbursement from the estate for attorney's fees incurred in prosecuting the action if the result was a substantial contribution to the case. *Com-1 Info, Inc. v. Wolkowitz (In re Maximus Computers, Inc.)*, 278 B.R. 189 (9th Cir. B.A.P. 2002).

13.2.eeee. Attorney's files are subject to turn-over. The buyer of the debtor's assets joined the debtor in seeking turn-over from the debtor's lawyers of their papers relating to litigation against the buyer's affiliate. The Purchase Agreement provided for the buyer to have access to the documents. Rejecting the lawyers' arguments, the court rules that section 542(e) applies to the files, even though all of the debtor's assets have been sold to the buyer, because section 542(e) applies regardless of whether the documents are property of the estate. In addition, the lawyers did not have liens on the files and were required by state bar rules to turn over client files upon termination of an engagement. Therefore, the court ordered turn-over without payment of any of the lawyers' claims. *American Metrocomm Corp. v. Duane Morris & Heckscher LLP (In re American Metrocomm Corp.)*, 274 B.R. 641 (Bankr. D. Del. 2002).

13.2.ffff. Bankruptcy bar admission not governed by state bar rules. In a case in which the lawyer was admitted to the bar of the bankruptcy court but not the state bar, the Sixth Circuit rules that the lawyer may practice before the bankruptcy courts (including counseling clients outside of court), even though he is not admitted to the local state bar. In this case, the local bankruptcy court rules permitted admission to the bar as long as the lawyer was admitted before a court of record in any state, not just the state where the bankruptcy court sits. *Rittenhouse v. Delta Home Improvement (In re Desilets)*, 291 F.3d 925 (6th Cir. 2002).

13.2.gggg. Chapter 7 debtor's attorney's fees may be allowed under Section 330. The Sixth Circuit B.A.P. joins the Second and Ninth Circuits and departs from the rule in the Fifth and Eleventh Circuits in construing section 330(a) to permit a payment from the estate of the attorney's fees of the debtor in a chapter 7 case. In this case, the debtor's attorney defended a creditor's motion to dismiss the bankruptcy case, assisted in the preparation of the schedules and statement of affairs, and attended the first meeting of creditors. The B.A.P. reaches its conclusion based upon the "drafting error" in the 1994 amendment to section 330(a). *Unites States Trustee v. Eggelston Works Loudspeaker Co. (In re Eggelston Works Loudspeaker Co.)*, 253 B.R. 519 (6th Cir. B.A.P. 2000).

13.2.hhhh. Debtor's attorney may be compensated under section 330. Following the Second and Ninth Circuits, the Third Circuit concludes that the attorney for the debtor may be compensated under section 330, despite the garbled 1994 amendment to that section. Nevertheless, the court requires compliance with section 330(a)(4)(A), which permits compensation only for services that are reasonably likely to benefit the estate. *In re Top Grade Sausage, Inc.*, 227 F.3d 123 (3d Cir. 2000).

13.2.iiii. Court denies "employment gap" fees to disqualified lawyer. The law firm for the debtor in possession also represented the debtor's sister corporation, which owed the debtor $78,000. The law firm had first claim on the proceeds of the sale of the sister corporation, creating an interest adverse to the estate of the debtor. The law firm fully disclosed all of this information and so was disqualified after rendering services to the debtor in possession for about 20 days. The law firm applied for fees for that "employment gap" period. Although the bankruptcy court awarded the fees, the Seventh Circuit reversed on the ground that section 503(b)(2) was the sole source of authority to pay professional fees (excluding section 503(b)(1)(A)) and section 503(b)(2) referred to sections 327 and 330, which prohibited fees to counsel whose employment was not approved by the court. *In re Milwaukee Engraving Co., Inc.*, 219 F.3d 635 (7th Cir. 2000).

13.2.jjjj. Creditors' motive is irrelevant to determination of "substantial contribution." Although an attorney's extraordinary efforts toward negotiating a consensual plan in a chapter 11 case were conducted on behalf of his clients and not for the particular benefit of the estate, the attorney still qualified for an award of compensation under section 503(b)(3)-(4) for making a substantial contribution to the case. *Speights & Runyan v. Celotex Corp. (In re Celotex Corp.)*, 227 F.3d 1336 (11th Cir. 2000).

13.2.kkkk. State bar admission required as condition to regular practice in the bankruptcy court. The attorney maintained an office in Michigan. Though not admitted to the Michigan bar, he was admitted to the Federal District Court, where he regularly filed bankruptcy petitions on behalf of local clients. The District Court upheld an order requiring him to disgorge fees on the grounds that he was not properly admitted to practice law in Michigan, where he advised his clients. The bankruptcy court could rely on state law standards in determining whether the lawyer was an "attorney" as defined in section 101(1). *Rittenhouse v. Delta Home Improvement, Inc.*, 255 B.R. 294 (W.D. Mich. 2000).

13.2.llll. Attorney denied *nunc pro tunc* employment approval. The trustee retained counsel and sought immediate approval from the bankruptcy court under section 327. Several weeks later, the approval was denied. The court refused to allow the attorney compensation for the services rendered while the court was considering the application. The court also refused compensation under section 503(b)(1)(A) (actual and necessary expenses of administration) and on equitable grounds. *In re Albrecht*, 245 B.R. 666 (10th Cir. B.A.P. 2000).

13.2.mmmm. Law firm may keep fees despite disinterestedness challenge. Before bankruptcy, a partner in the law firm was an assistant secretary to the debtor. The law firm represented the debtor in possession. The former assistant secretary performed no services during the case. The United States trustee challenged the law firm's employment on disinterestedness grounds, but its objection was overruled and its appeal was dismissed as interlocutory. When the case concluded, the court awarded the firm fees, and the U.S. trustee appealed from the final order. The Ninth Circuit holds that even though the appeal was not equitably moot, it would be inequitable to require the law firm to disgorge the fees after the services were rendered because of the difficult ethical dilemma it would create for counsel. The court notes that the law firm fully disclosed the relationship and acted entirely properly during the case. *S.S. Retail Stores Corp. v. Ekstrom (In re S.S. Retail Stores Corp.)*, 216 F.3d 882 (9th Cir. 2000).

13.2.nnnn. Failure to disclose hiring of law clerk is not malpractice. The law firm hired the law clerk of a bankruptcy judge before whom the firm was appearing. The law firm did not inform the client or opposing counsel. The judge did not fully insulate the clerk from the matter on which the law firm was appearing and ultimately recused herself based on appearance of impropriety. The matter was tried to a new judge, where the client did not fare as well as it expected it would fare before the original judge. As a result, the client sued the law firm for malpractice for failure to disclose the employment of the law clerk. The Ninth Circuit rules that the law firm did not commit malpractice, because the duty is on the Judge and the law clerk to prevent lapses of the sort that occurred in this case. *First Interstate Bank v. Murphy Weir & Butler*, 21 F.3d 983 (9th Cir. 2000).

13.2.oooo. Bankruptcy fees should be based on non-bankruptcy practices. In determining whether to allow compensation for travel time, the bankruptcy court failed to determine whether and to what extent counsel would have charged non-bankruptcy clients for such time. Such a determination is the benchmark to carry out the congressional intent to eliminate the differential between compensation for bankruptcy and non-bankruptcy work. *In re Raytech Corp.*, 241 B.R. 785 (D. Conn. 1999).

13.2.pppp. Debtor's attorney may be compensated in a chapter 7 case. Joining the Second Circuit in construing an ambiguity in Section 330(a)(1) created by the 1994 amendments, the Ninth Circuit holds that a debtor's attorney may be compensated for work performed during a chapter 7 case. The decision is contrary to the decisions of the Fifth Circuit on the same issue. *United States Trustee v. Garvey, Schubert & Barer (In re Century Cleaning Services, Inc.)*, 195 F.3d 1053 (9th Cir. 1999).

13.2.qqqq. Debtor's chapter 11 attorney not entitled to payment from the estate. Following the Fifth Circuit and disagreeing with the Ninth Circuit, the Eleventh Circuit holds that the 1994 amendment to section 330(a) eliminates the authority for the debtor's attorney to be paid from the estate. *Inglesby, Falligant, Horne, Courington & Nash, P.C. v. Moore (In re American Steel Product, Inc.)*, 197 F.3d 1354 (11th Cir. 1999).

13.2.rrrr. All you ever wanted to know about disinterestedness. In an opinion whose footnotes far exceed the length of the text, and which might cite every bankruptcy case ever decided on the issue of

disinterestedness and conflict of interest, the court ruled that the chapter 7 trustee may employ counsel who represents both the corporate debtor and its president and certain related entities in a legal malpractice action against another attorney. *In re Covenant Financial Group*, 243 B.R. 450 (Bankr. N.D. Ala. 1999).

13.2.ssss. A preferee is disqualified as a professional. Counsel for the debtor in possession accepted prepetition payment of its invoices in property of the debtor other than cash. Holding that the transaction was not in the ordinary course of business and was therefore an avoidable preference, the Third Circuit, without analysis, rules that a law firm that has received a preference is not disinterested, citing *In re BH&P, Inc.*, 949 F.2d 1300 (3d Cir. 1991). *United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.)*, 180 F.3d 504 (3d Cir. 1999)

13.2.tttt. Total disgorgement ordered for nondisclosure. Counsel took a prepetition security retainer from the debtor's president and postpetition replenishment of the retainer from the debtor. Counsel withdrew amounts from the retainer postpetition, contrary to the bankruptcy court's order and without disclosure until substantially later. The bankruptcy court's order ordering disgorgement of all fees received was not an abuse of discretion and was upheld. *Miller v. U.S. Trustee (In re Independent Engineering Company, Inc.)* 197 F.3d 13 (1st Cir. 1999).

13.2.uuuu. Trustee and his counsel denied compensation for egregious conflict. The successor trustee was appointed in large part to investigate the actions of the initial trustee. He retained a counsel who also represented the prior trustee in an unrelated case. Counsel failed to disclose the representation, and the trustee made no specific inquiry. Counsel was denied all compensation in the case. The trustee was denied compensation for the period after he learned of the conflict. In addition, the trustee was removed. *Kagen v. Stubbe (In re San Juan Hotel Corp.)*, 239 B.R. 635 (1st Cir. B.A.P. 1999).

13.2.vvvv. Standing orders reducing fees in chapter 13 cases without hearings are overruled. The bankruptcy judges in the District of Colorado did not permit hearings on fee applications in chapter 13 cases, instead routinely reducing fees by use of a "check the box" order which listed a variety of reasons for reduction of fees. In reversing the procedure, the District Court criticizes the assembly line, non-hearing approach to fees and orders the bankruptcy judges to develop a procedure that is more consistent with the statute and with the need for customized, personal services to chapter 13 debtors. *In re Ingersol*, 238 B.R. 202 (D. Colo. 1999).

13.2.wwww. Bankruptcy court wrongly fails to evaluate individual debtor's attorney-client privilege claim. The individual debtor and his counsel opposed turnover of documents to the trustee on both attorney-client privilege and Fifth Amendment grounds. The parties agreed, and therefore the court did not decide, that the trustee succeeds to an individual debtor's claim of privilege. Against that background, the Court of Appeals held that the bankruptcy court should have evaluated the individual documents as to which privilege was claimed, in balancing the interests of the debtor and the interest of the trustee, rather than balancing only the general interest of the estate in recovering assets against the interest of the debtor in protecting the privilege. *Foster v. Hill (In re Foster)*, 188 F.3d 1259 (10th Cir. 1999).

13.2.xxxx. Counsel disqualified for bias. Because trustee's counsel made very intemperate remarks about the debtor's credibility before ever meeting or examining the debtor, the bankruptcy court concluded that counsel was biased and that counsel's independent judgment had been seriously compromised. The court disqualified counsel and his entire law firm under the disinterestedness test and under the rules of professional responsibility. *In re Vebeliunas*, 231 B.R. 181 (Bankr. S.D.N.Y. 1999).

13.2.yyyy. Bankruptcy courts have the inherent power to disbar attorneys. An attorney signed a bankruptcy petition as a petition preparer rather than as attorney for the debtor and failed to disclose all fees received. As a sanction, the bankruptcy court ordered disgorgement of the fees and disbarred the attorney from the bankruptcy court in that district. The district court, although not finding an adequate record for disbarment, affirmed the bankruptcy court's power to disbar from practice within the bankruptcy court in a district. *In re M.P.M. Enterprises, Inc.*, 231 B.R. 500 (E.D.N.Y. 1999).

13.2.zzzz. Employment under section 327(e) limits scope of conflict of interest inquiry. The Second Circuit reads the adverse interest provision of section 327(e) narrowly, so that potential conflicts must be evaluated only with respect to the scope of the proposed retention. Thus, counsel's representation of one creditor does not necessarily disqualify counsel from representation of the trustee in an action against other creditors who are at risk to the first creditor. *Bank Brussels Lambert v. Coan (In re Arochem Corp.)*, 176 F.3d 610 (2d Cir. 1999).

13.2.aaaaa. Bankruptcy court awards compensation based on value billing. Starting with the lodestar test but relying heavily on *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974), the bankruptcy court criticizes undue reliance on hourly rates and grants fees based on the value of the services rendered to the estate. In a lengthy opinion analyzing the many aspects of determination of fees, the bankruptcy court concludes that the amount of a fee in excess of the hourly rate is not a "bonus" or "enhancement," but rather is part of a reasonable fee based on the value of the services. *In re Vista Foods U.S.A., Inc.*, 234 B.R. 121 (Bankr. W.D. Okla. 1999).

13.2.bbbbb. Court limits secured creditor reimbursement of fees and expenses. The real estate lender was oversecured and included within its claim under section 506(b) a consultant's fee, attorney's fees, and fees of salaried employees. The court disallowed them all, the attorney's fees on the ground that most "were based on time spent on making and litigating its unreasonable demands." *First Bank of Ohio v. Brunswick Apartments of Trumble County, Ltd. (In re Brunswick Apartments of Trumble County, Ltd.)*, 169 F.3d 333 (6th Cir. 1999).

13.2.ccccc. Out-of-state attorney may collect fees. An attorney had no residence or office in Arizona and was not a member of the State Bar, but was admitted to practice in the United States District Court by local District Court rule. That admission satisfies Bankruptcy Code section 101(4), which defines attorney as one "authorized under applicable law to practice law." Thus, the attorney was entitled to fees for the chapter 13 case, notwithstanding his non-admission to the Arizona State Bar. *Brown v. Smith (In re Mendez)*, 231 B.R. 36 (9th Cir. B.A.P. 1999).

13.2.ddddd. A mortgage servicer involved in a bankruptcy case engages in the unauthorized practice of law. The bankruptcy court dismissed objections to confirmations of chapter 13 plans brought by lawyers representing mortgage servicers, on the grounds that the mortgage servicers, having procured the services of the attorneys on behalf of the true parties in interest (the mortgagees), the servicers were engaged in the unauthorized practice of law. In addition, the attorneys were referred to the state bar for possible disciplinary proceedings. *In re Morgan*, 225 B.R. 290 (Bankr. E.D. N.Y. 1998).

13.2.eeeee. Attorney-client privilege prevents objection to discharge. While an attorney was representing a client in a dissolution proceeding, the client admitted that he had concealed assets. The client failed to pay the lawyer and filed bankruptcy, again hiding the same assets. The lawyer objected to discharge, but the bankruptcy appellate panel ruled that the lawyer learned of the concealment by a privileged conversation, which could not be revealed in pursuing an objection to discharge. *Dubrow v. Rindlisbacher (In re Rindlisbacher)*, 225 B.R. 180 (9th Cir. B.A.P. 1998).

13.2.fffff. Court approval not required for Chapter 11 debtor's attorney. Once a trustee is appointed, the debtor is ousted of possession and is not required to obtain court approval to employ an attorney. On that basis, the court denied the motion, but noted that the debtor's attorney remained subject to the disclosure obligations of section 329(a) and Rule 2016(b). *In re The Apollo Group* 224 B.R. 48 (E.D. Mich. 1998)

13.2.ggggg. Debtor's attorney may not be paid after the appointment of a chapter 11 trustee. Strictly construing the 1994 amendment to section 330(a)(1), the Fifth Circuit holds that the debtor's attorney may not be paid for any work performed after the appointment of a chapter 11 trustee, no matter what the contribution to the case. *Andrews & Kurth L.L.P. v. Family Snacks, Inc. (In re Pro-Snax Distributors, Inc.)*, 157 F.3d 414 (5th Cir. 1998).

13.2.hhhhh. An attorney may not be disqualified on appearance of conflict alone. The trustee's counsel represented a creditor on an unrelated matter and had an unconditional waiver from the creditor. Such a relationship was not disqualifying. The court must disqualify counsel when there is an actual conflict of interest, may disqualify counsel when there is a potential conflict of interest, and may not disqualify when there is only an appearance of conflict. *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463 (3d Cir. 1998).

13.2.iiiii. Attorney fees slashed for appearance of conflict of interest. The trustee retained a law firm to investigate potential causes of action against the defendant. The law firm had occasionally represented the potential defendant in the past. While representing the trustee, the law firm opened numerous new matters for the potential defendant, without further disclosure to the trustee or the court. The court disallowed all fees for the investigation, holding that the failure to disclose and the appearance of partiality created by the firm's extensive work for the potential defendant so tainted the investigation that it was worthless, and the firm therefore could not be compensated. *In re Granite Partners, L.L.P.*, 219 B.R. 22 (Bankr. S.D.N.Y. 1998).

13.2.jjjjj. Court defines and limits fiduciary duties of counsel for the debtor in possession. In a lengthy, thorough, and well reasoned opinion, the district court in Utah rules that the client of counsel for the debtor in possession is the debtor in possession, not the estate as a new entity. The court also debunks prior case law that suggested that counsel owed a fiduciary duty to creditors and shareholders rather than just to the debtor in possession client. *Hansen, Jones & Leta, P.C. v. Segal*, 220 B.R. 434 (D. Utah 1998).

13.2.kkkkk. Section 329 requirement of reasonable fees may not be measured by agreement. A consumer debtor lawyer charged clients for simple no-asset chapter 7 cases a flat fee of two to four times the going rate in the area. Although the clients had agreed to the fees, the court upholds an order requiring disgorgement of the excess, even though there was no evidence of over-reaching or evidence that the excess fee would benefit the estate. *In re Geraci*, 138 F.3d 314 (7th Cir. 1998).

13.2.lllll. Non-refundable retainer permitted. A law firm took a non-refundable retainer from a debtor that was about to be subject to civil liability and criminal prosecution for check-kiting to a credit union. As long as the amount of the retainer was reasonable in light of the services expected to be rendered, the law firm did not act in bad faith in taking the retainer, and for purposes of the Federal Credit Union Act, "acceptance of a non-refundable retainer from a bankrupt is improper only if the retainer was excessive or a means of hiding assets of the bankrupt." *National Credit Union Administration Board v. Johnson*, 133 F.3d 1097 (8th Cir. 1998).

13.2.mmmmm. A retainer may be applied to post-petition fees. An attorney for the debtor may be paid only from property of the estate where the Bankruptcy Code specifically authorizes. Property that an attorney holds as a retainer pre-bankruptcy becomes property of the estate upon the filing of the petition. Nevertheless, the retainer may be used to satisfy post-petition fees under an attorney's charging lien which can secure obligations arising from the performance of services in the future. *United States Trustee v. Garvey, Schubert & Barer (In re Century Cleaning Services, Inc.)*, 215 B.R. 18 (9th Cir. B.A.P. 1997).

13.2.nnnnn. Mortgage for post-petition fees is invalid as of the petition date. The tax attorney took a mortgage on the debtor's residence to secure fees related to tax refunds. Under Missouri law, the mortgage is terminated as to future advances when the lender receives notice. The Eighth Circuit construes the bankruptcy petition as just such a notice, analogizing the mortgage to a cash security retainer, which requires bankruptcy court approval of the application before it may be drawn. *Snyder v. Dewoskin (In re Mahendra)*, 131 F.3d 750 (8th Cir. 1997).

13.2.ooooo. Attorneys' fees allowed for substantial contribution, even though creditor incurs no other expense. Section 503(b)(4) permits recovery of attorneys' fees "of an entity whose expense is allowable under paragraph (3) [the substantial contribution provision]." If the creditor incurs no allowable expense under paragraph (3), may attorneys' fees nevertheless be reimbursed? The 9th Circuit B.A.P. holds "yes," suggesting however, that if the creditor was not liable to the attorney for the fees in the first

place, then section 503(b)(4) does not impose that obligation on the estate. *Law Offices of Neil Vincent Wake v. Sedona Institute (In re Sedona Institute)*, 220 B.R. 74 (9th Cir. B.A.P. 1998).

13.2.ppppp. Court approves fixed fees in advance. In a complex chapter 11 case, the bankruptcy court authorizes attorneys' employment on a fixed fee basis with fixed monthly draws, based on estimates of the amount of work required to complete matters in the case. The court also permits modification of the fees under section 328, based on events that were unanticipatable at the time the fees were fixed. *In re Home Express, Inc.*, 213 B.R. 162 (Bankr. N.D. Cal. 1997).

13.2.qqqqq. Counsel may be awarded fees for protecting the estate, despite the client's contrary instructions. After the filing of a chapter 11 case, the unperfected secured creditor exercised its stock voting power, ousted management, and directed counsel to seek dismissal of the case, so that the creditor could perfect its security interest. Counsel refused and opposed the creditor's motion to dismiss the case. The court may properly award fees for such effort. More important, counsel for the debtor in possession may not simply resign where the client refuses counsel's advice on the fiduciary duties of the debtor in possession, but must inform the court in some manner. *Zeisler & Zeisler, P.C. v. Prudential Ins. Co. of America (In re JLM, Inc.)*, 210 B.R 19 (2d Cir. B.A.P. 1997).

13.2.rrrrr. Bankruptcy court authorization of employment does not guarantee fees. The bankruptcy court authorized employment of criminal counsel for the debtor in a chapter 11 case, but denied any compensation at the expense of the estate, finding that the services provided did not benefit the estate. The Third Circuit, in a divided opinion, affirmed. *Ferrara & Hantman v. Alvarez (In re Engel)*, 124 F.3d 567 (3d Cir. 1997).

13.2.sssss. Professional fees may be reduced if the professional fails to exercise billing judgment. Where counsel for the creditor's committee continued to incur fees and expenses in pursuing a sale that had little or no possibility of recovery for the unsecured creditors, the firm's fees could be reduced because the firm failed to exercise appropriate billing judgment. *Lobel & Opera v. U.S. Trustee (In re Autoparts Club, Inc.)*, 211 B.R. 29 (9th Cir. B.A.P. 1979).

13.2.ttttt. Bankruptcy Court lacks jurisdiction to review fees after dismissal of case. The debtor's schedules and statement of affairs and the attorney's employment application and affidavit were substantially inaccurate regarding pre-petition payments to the attorney. Nevertheless, the court approved the attorney's employment. After the case was dismissed, the attorney sued in state court for recovery of fees earned during the chapter 11 case. The debtor reopened the Bankruptcy Court to seek disallowance of fees. The Bankruptcy Appellate Panel rules that the Bankruptcy Court does not have jurisdiction after the dismissal of the case to grant new relief. Judge Russell, in a very strong dissent, argues that the ethical violations require the Bankruptcy Court to set aside the order authorizing employment and disallow all fees, despite the dismissal of the case. *Elias v. Lisowski Law Firm, Chtd. (In re Elias)*, 97 D.A.R. 15617 (9th B.A.P. Oct. 27, 1997).

13.2.uuuuu. Appeal from fee disgorgement is not moot. The bankruptcy court ordered a law firm to disgorge fees that it had paid. The disgorged amount was distributed to creditors. On the law firm's appeal, the B.A.P. held that the appeal was not moot, because "turnabout is fair play" and the court could require the same disgorgement from creditors who receive the fees." *Lobel & Opera v. U.S. Trustee (In re Autoparts Club, Inc.)*, 211 B.R. 29 (9th Cir. B.A.P. 1979).

13.2.vvvvv. Service as a director creates a potentially disqualifying interest for a lawyer. A lawyer served on the board of directors of a company when the board approved a particular transaction, but resigned shortly thereafter. When litigation ensued after the transaction, the lawyer and his entire law firm were disqualified from representing the adverse party, because the lawyer held a fiduciary relationship to the company, and there was an irrebuttable presumption he received confidential information in approving the transaction. The possession of the information was imputed to the entire law firm. *Value Property Trust v. Zim Co. (In re Mortgage & Realty Trust)*, 195 B.R. 740 (Bankr. C.D. Calif. 1996).

13.2.wwwww. A disqualified lawyer does not necessarily disqualify his law firm. Service by a lawyer as an assistant secretary of a corporation disqualifies the lawyer as not disinterested under section 101(14) to serve as counsel for a chapter 11 debtor, but his status will not be attributed to his law firm, who can continue to serve as counsel for the debtor. *United States Trustee v. S. S. Retail Stores Corporation* (In re S.S. Retail Stores Corporation), 211 B.R. 699 (9th Cir. B.A.P. 1997).

13.2.xxxxx. Pre-petition attorneys' fees are dischargeable. The attorney for the debtor was to receive his fees in installments after the filing of the debtor's chapter 7 petition. The Ninth Circuit holds that the debtor's obligation to the attorney was dischargeable. *Hessinger & Associates v. U.S. Trustee (In re Biggar),* 110 F.3d 685 (9th Cir. 1997).

13.2.yyyyy. Court of appeals orders disgorgement of attorney's fees. The debtor's attorney failed to disclose the fees he received from a third party after a commencement of the chapter 11 case; he did not file the statement required under section 329(a) or Bankruptcy Rule 2016. The bankruptcy judge sanctioned the attorney by requiring him to return one-half of the fees paid. The court of appeals reversed, making mandatory as a sanction for such an egregious violation a return of all fees paid, affirming the inherent power of bankruptcy courts, like Article III courts, to sanction parties for improper conduct. *Mapother & Mapother, P.C. v. Cooper (In re Downs)*, 103 F.3d 472 (6th Cir. 1996).

13.2.zzzzz. Post-petition retainer ordered disgorged. A bankruptcy court has inherent authority to order an attorney for the debtor to disgorge fees received post-petition in a chapter 11 case without conducting an inquiry into the reasonableness of the fees received. In this case, the attorney failed to comply with the disclosure requirements of Rule 2016(b) and falsely stated in his employment application that the fees received post-petition were, in fact, received pre-petition. *Law Offices of Nicholas A. Franke v. Tiffany (In re Lewis)*, 113 F.3d 1040 (9th Cir. 1997).

13.2.aaaaaa. Lack of knowledge of source of funds is not a defense to a turnover proceeding. A law firm received a deposit from a corporation, which filed bankruptcy four days later. The corporation's principal asked for a return of the money, advising the law firm (who knew about the bankruptcy) that the money had come from the individual. The law firm returned the funds to the individual, but was later required to account for the value of the funds to the bankruptcy trustee because the law firm had enough knowledge to place a reasonable person on notice that the property might have belonged to the debtor. *Boyer v. Carlton, Fields, Ward, Emmanuel, Smith & Cutler, P.A. (In re U.S.A. Diversified Products, Inc.)*, 100 F.3d 53 (7th Cir. 1996).

13.2.bbbbbb. Creditor allowed fees for substantial contribution. The Fifth Circuit orders the award of fees and expenses for a substantial contribution, even though the creditor was acting only in its own self-interest, ruling "that a creditor's motive in taking actions that benefit the estate has little relevance whether the determination whether the creditor has [made] a substantial contribution to a case." Moreover, the creditor is not required to give advance notice before confirmation of the debtor's plan of its intent to seek substantial contribution fees and expenses. *Hall Financial Group, Inc. v. DP Partners Ltd. Partnership (In re DP Partners Ltd. Partnership)*, 106 F.3d 667 (5th Cir. 1997).

13.3 Committees

13.3.a. A committee is not a governmental actor. The debtor archdiocese transferred substantial funds about three years before bankruptcy to a separate trust to provide for the perpetual care of the debtor's cemetery property. The creditors committee, which had been granted derivative standing on behalf of the estate, asserted that the property was property of the estate or that the transfer was an avoidable fraudulent transfer. The Religious Freedom Restoration Act (RFRA) generally forbids the "government" from substantially burdening religion. "Government" is defined to include a "branch, department, agency, instrumentality, and official" of the United States. The committee comprises five creditors, appointed by the U.S. trustee, subject to court approval, and is entitled to limited judicial immunity. Still, the committee neither acts on behalf of the government, under the government's direct supervision nor in concert with the government. Therefore, RFRA does not apply to the committee's

actions. *Listecki v. Official Committee of Unsecured Creditors (In re Archdiocese of Milwaukee)*, 485 B.R. 385 (Bankr. E.D. Wis. 2013).

13.3.b. *Barton v. Barbour* applies to protect creditors committee. The debtor brought an action in district court, without leave of the bankruptcy court, against members of the creditors committee for wrongs allegedly committed against the debtor during their service on the committee. *Barton v. Barbour*, 104 U.S. 126 (1881), deprives a court of subject matter jurisdiction over an action against a trustee or receiver appointed by a federal court unless the plaintiff has first obtained leave of the appointing court to sue. Its purpose is to centralize litigation related to a case's administration and assist the appointing court in supervising its appointees. The doctrine has been expanded to apply to litigation against trustees in bankruptcy cases and, more generally, against any officer appointed by a bankruptcy court, for acts done in the officer's official capacity. Although creditors committee members are appointed by the U.S. trustee, their appointments are subject to the court's approval under section 1102(a)(4) and are thus functionally equivalent to court-appointed officers. The action here was based on the members' conduct on the committee. Therefore, the court lacks subject matter jurisdiction and dismisses the action. *Blixseth v. Brown*, 470 B.R. 562 (D. Mont. 2012).

13.3.c. Court disbands committee after trustee's appointment. The chapter 11 case was essentially a liquidation. The court ordered the appointment of a trustee. After the appointment, the committee continued to participate in the case, taking extensive discovery ostensibly to protect creditors' interests but not contributing to case's progress. Section 1102 requires the appointment of a committee to represent unsecured creditors' interests, whether or not a trustee is appointed. A chapter 11 trustee's role is also to represent unsecured creditors' interests. Section 105 permits the court, on its own motion, to issue an order "as the court deems appropriate to ensure that the case is handled expeditiously and economically" unless inconsistent with another Code provision. The Code does not provide for a committee in a chapter 7 case. This case is essentially a liquidation case, though under chapter 11. The trustee here adequately represents unsecured creditors' interests, and the committee is causing an increase in administrative burden in the case. Therefore, the court disbands the committee. *In re Pacific Ave., LLC*, 467 B.R. 868 (Bankr. W.D.N.C. 2012).

13.3.d. Plan may provide for reimbursement of legal fees of ad hoc committees pursuing its members' own interests. Numerous ad hoc committees heavily litigated a chapter 11 case, at times using scorched earth tactics. All the litigation was designed only to benefit each committee's members, not the estate. Ultimately, all parties settled. The settlement required the plan to provide for reimbursement of the committees' reasonable legal fees and expenses incurred during the case. Sections 503(b)(3) and (4) permit allowance of fees and expenses that a creditor or a committee incurs in making a substantial contribution in a case. However, section 503(b) is not exclusive. Section 1129(a)(4) conditions confirmation on the court's finding that "[a]ny payment made … for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case" is subject to court approval, suggesting that the Code contemplates payments other than those allowed under section 503(b). Section 1123(b)(6) permits a plan to include "any other appropriate provision not inconsistent with the applicable provisions of this title". A provision is "appropriate" when it does not violate any case law or a nonbankruptcy statute. Although payment of creditors' fees and expenses for pursuing their own recoveries may not be sound policy, it is not clearly against public policy. Therefore, the court allows the reimbursement of reasonable fees and expenses as provided under the plan. Fees and expenses for pursuing overly aggressive or scorched earth litigation tactics are not reasonable and may not be reimbursed. *In re Adelphia Commun's Corp.*, 2010 Bankr. LEXIS 3915 (Bankr. S.D.N.Y. Nov. 18, 2010).

13.3.e. Committee must maintain website to comply with section 1102(b)(3) obligation. The debtor had about 70 priority claimants and 150 general unsecured claimants, with claims exceeding $36 million. The debtor's schedules listed assets of over $25 million. The creditors committee proposed to meet its obligation under section 1102(b)(3) to "provide access to information" for represented creditors by establishing a call center to which committee counsel would respond and not by establishing a website, which would cost from $500 to $3,000 per month. The only prior reported decision on section 1102(b)(3), *In re Refco Inc.*, 336 B.R. 187 (Bankr. S.D.N.Y. 2006), required a website. Although this case is smaller, it is still substantial enough to warrant a website, and the relatively insignificant expense

should be given little weight against the creditors' need for current information. *In re S & B Surgery Center, Inc.*, 421 B.R. 546 (Bankr. C.D. Cal. 2009).

13.3.f. Court denies equity committee appointment in apparently insolvent case. An active ad hoc equity committee moved for appointment under section 1102(b) of an official equity committee. The hearing was held after the debtor's filing of a plan and disclosure statement that provided no recovery for equity. In determining whether to order the appointment of an equity committee, courts may consider the number of shareholders, the case's complexity, whether a committee's cost significantly outweighs the concern for adequate representation, whether there is a substantial likelihood of a meaningful equity distribution and whether shareholders are unable to represent their interests in the case without an official committee. The latter two considerations predominate. Here, the debtor was not likely to prove solvent, so there would not likely be any distribution to equity. In addition, the ad hoc committee had represented equity's interests adequately during the case, so there was no need to order the appointment of an official committee to provide adequate shareholder representation. Therefore, the court denies the motion. *In re Spansion, Inc.*, 2009 Bankr. LEXIS 3958 (Bankr. D. Del. Dec. 18, 2009).

13.3.g. Standards for appointing an equity committee. The debtor appeared solvent. The debtor's board comprises eight outside directors, several insiders and the founder, who holds 62% of the debtor's stock (which is publicly traded), loaned substantial sums to the debtor and guaranteed the banks' secured claims. An ad hoc shareholders group sought appointment of an equity committee. The creditors committee alleged that a member of the group and its counsel had engaged in misconduct in recruiting the ad hoc group and seeking the equity committee appointment. Section 1102(a)(2) authorizes a court to order the appointment of an equity committee. Four factors govern the decision: apparent solvency, adequate representation, case complexity and likely cost. Any misconduct in the process of bringing the matter to the court does not affect application of these factors as necessary to protect shareholders but can be addressed in the U.S. Trustee's selection of committee members and the court's approval of committee counsel's employment. Here, the debtor appears solvent. The business and valuation issues make the case complex. The complexity and the other forces at work in negotiations prevent the board from acting as an adequate representative of the shareholders in recovering value under a plan. The founder's multiple roles and the debtor's motivation to get its senior lenders' consent to a plan, as well as the demands on management of operating the debtor and preserving its value prevent them from adequately representing the shareholders in seeking maximum valuation of the debtor and maximum recovery for the shareholders. The duty to maximize value does not require, and differs from any duty, to press for a higher valuation that would enhance shareholder recoveries. Therefore, the debtor's shareholders, directors and officers do not adequately represent the equity, and appointment of a committee is appropriate. However, to address the cost factor, the court warns the committee not to duplicate the creditors committee role and to focus primarily on valuation and plan negotiation and fixes a tentative budget for committee professionals. *In re Pilgrim's Pride Corp.*, 407 B.R. 211 (Bankr. N.D. Tex. 2009).

13.3.h. Bankruptcy court may withdraw derivative standing. During the case, the court granted the equity committee derivative standing to pursue the estate's claims against certain creditors. The plan vested the claims in a litigation trust, which divested the committee of derivative standing to pursue the claims. Derivative standing does not transfer ownership of the claims, which remains with the estate. The bankruptcy court must regulate the derivative prosecution of litigation and therefore may withdraw the grant of derivative standing in its discretion. The bankruptcy court did not abuse its discretion in doing so here, because the transfer of the claims to the litigation trust was an integral part of a confirmed plan and because the equity committee had threatened disruptive tactics as against other interests of the estate in connection with pursuing the litigation. *Official Comm. of Equity Sec. Holder v. Official Comm. of Unsecured Creditors (In re Adelphia Comm'ns Corp.)*, 544 F.3d 420 (2d Cir. 2008).

13.3.i. Committee may not pursue an equitable subordination claim for the estate's benefit without court approval. The committee sought to bring an equitable subordination claim against a major creditor who had improved its position from unsecured to secured by lending additional funds shortly before bankruptcy. The chapter 11 trustee concluded the subordination claim lacked merit and refused to bring it. The court refuses to permit the committee to bring it, because the claim was for injury the debtor may have suffered. An individual creditor might have standing to bring such a claim if the claim were

directed to a particularized injury the creditor may have suffered. But the committee does not have its own interest in subordination separate and apart from the estate's interest, which the trustee represents. *Official Comm. of Unsecured Creditors v. Halifax Fund, L.P. (In re Applied Theory Corp.)*, 493 F.3d 82 (2d Cir. 2007).

13.3.j. Court may revoke a committee's derivative standing. The court granted the equity committee derivative standing to pursue claims against the debtor's banks. Seventeen months later, after the committee had brought litigation against the banks on behalf of the estate, the court confirmed a chapter 11 plan that vested the claims in a litigation trust and deprived the committee of authority to pursue the claims any longer. To confer derivative standing, the court must find that doing so is in the best interest of the estate and necessary and beneficial to the fair and efficient resolution of the case. Once those conditions no longer exist, the court may withdraw derivative standing. The estate, acting through the debtor in possession, continues to own the claims, despite the court's grant of derivative standing to the committee to pursue them, thus presenting no obstacle to the withdrawal. *In re Smart World Techs. LLC*, 423 F.3d 166 (2d Cir. 2006), does not suggest otherwise. There, the court of appeals reversed the bankruptcy court's grant to the committee of derivative standing to settle a claim that the debtor in possession controlled. *Smart World* should be read as confirming the DIP's continued ownership of the claim, despite the grant of derivative standing, not (as others might suggest) as prohibiting the court from allowing a party in interest other than the named plaintiff to settle an action or from granting derivative standing after the action had been brought. (Interestingly, this judge had ruled in another proceeding in the same case that a creditors' committee would likely prevail on its claim on appeal that the debtor in possession could not settle an adversary proceeding that the committee was pursuing under derivative standing. *ACC Bondholder Group v. Adelphia Comm'ns Corp. (In re Adelphia Comm'ns Corp.)*, 2007 U.S. Dist. LEXIS 7416 (S.D.N.Y. Jan. 24, 2007)). *Official Comm. of Equity Sec. Holders v. Adelphia Comm'ns Corp. (In re Adelphia Comm'ns Corp.)*, 371 B.R. 660 (S.D.N.Y 2007).

13.3.k. Debtor in possession may not settle committee's claim. The court granted the unsecured creditors committee standing, jointly with the debtor in possession, to pursue claims belonging to the estate. After extensive litigation and a mediation, the debtor in possession, but not the committee, agreed to a settlement with the defendants. Relying on *In re Smart World Techs. LLC*, 423 F.3d 166 (2d Cir. 2005), which prohibited a committee from settling claims belonging to the estate that only the debtor in possession was authorized to pursue, the bankruptcy court approved the settlement. In the context of a motion for a stay pending appeal, the district court rules that it was likely error for the bankruptcy court to approve the settlement without the committee's approval. The committee was an authorized party to the litigation, and the debtor in possession's agreement to a settlement could not deprive the committee of its rights as a plaintiff without its consent, in the same way that the committee in *Smart World* could not deprive the debtor in possession of its rights as plaintiff. *ACC Bondholder Group v. Adelphia Commc'ns Corp. (In re Adelphia Commc'ns Corp.)*, 2007 U.S. Dist. LEXIS 7416 (S.D.N.Y. Jan. 24, 2007).

13.3.l. A committee pursuing an estate cause of action does not succeed to the debtor's attorney-client privilege. The bankruptcy court gave the committee authority to pursue a fraudulent transfer action against the debtor's controlling shareholder, who also controlled the debtor's management. In response to committee discovery requests, the debtor asserted attorney-client privilege. The committee moved to compel discovery, based on *CFTC v. Weintraub*, 471 U.S. 343 (1985), arguing that as a plaintiff in an avoiding power claim, it succeeded to the debtor's attorney-client privilege, the same as a trustee does. The court rejects the argument. A conflict between the debtor and the estate does not by itself transfer control of the privilege to the committee. A committee's interests are narrower than a trustee's, as a committee represents only a segment of parties in interest. Control of the privilege remains with the debtor's management if the debtor remains in possession. *Official Comm. of Asbestos Claimants v. Heyman*, 342 B.R. 416 (S.D.N.Y. 2006).

13.3.m. Committee's attorney's privileges apply only to work for the committee as a whole. Because of a seemingly intractable dispute between the debtor and the creditors committee and among committee members, the parties agreed to the appointment of an examiner. The court authorized the examiner to have access to attorney-client and work product privileged documents for the purpose of preparing the report, without waiving the privileges as to third parties, and temporarily sealed the report

pending a determination of whether it should be sealed to protect privilege or as required under section 107(b). The report was sharply critical of some committee members, who asked that the report be sealed. The privileges for committee counsel apply only when counsel is advising the committee as a whole, not any of its individual members, because the committee exists to represent all creditors' interests, not just the interests of its individual members, and only on legal issues, not on matters of business strategy, such as the post-confirmation division of corporate governance powers among committee members. Information protected by the attorney-client privilege and the work-product privilege of a committee counsel do not fall within the ambit of section 107(b)(1)'s definition of "confidential research, development, or commercial information" because it does not relate to competitive advantage or commercial operations. *In re Fibermark, Inc.*, 330 B.R. 460 (Bankr. D. Vt. 2005).

13.3.n. Committee member owes fiduciary duty to other members, even as to non-estate property. The debtor was the recipient of a prepetition HUD housing grant. When the debtor encountered management problems, a competitor nonprofit agency agreed to provide management services. After the competitor terminated its services, the debtor filed chapter 11. The competitor had a claim and was appointed to the creditors' committee. While serving on the committee, the competitor, without disclosure to other committee members, obtained a transfer of the HUD grant to itself. Once the debtor lost the grant, it became liable to matching fund donors for the return of their contributions, thereby increasing unsecured claims against the estate. The court of appeals had previously determined that the HUD grant was not property of the estate. Still, the competitor owed a fiduciary duty to other members of the committee in dealing with the grant. Committee service is to be used to advance the interests of unsecured creditors generally, not to advance the particular interests of the committee member. By taking advantage of what it learned during its committee service, the competitor breached its fiduciary duty to the committee's other members. It should have advised the committee of its intent to pursue the grant and obtained court approval, because of the potential adverse effect on the estate. If the committee determined that it would not have an adverse effect on unsecured creditors, court approval might not have been required. In these circumstances, however, the competitor breached its fiduciary duty and was liable to the trustee. *Westmoreland Human Opportunities, Inc. v. Walsh*, 327 B.R. 561 (W.D. Pa. 2005).

13.3.o. Committee may pursue equitable subordination claim. A committee may bring an action to subordinate another creditor's claim under section 510(c) directly, in its own right, and not derivatively through the estate. *Official Comm. of Unsecured Creditors of Grand Eagle Cos. v. Asea Brown Boveri, Inc.*, 312 B.R. 219 (N.D. Ohio 2004).

13.3.p. Committee may not pursue derivative action once trustee acts. The committee brought an action, as authorized by a cash collateral order, against the lender to avoid prepetition transfers. After a trustee brought an action asserting the same claims, the committee no longer could sue derivatively, because a condition for a derivative action is that the trustee refuses to bring the action. In addition, an agreement between the trustee and the committee that the trustee would not settle the action without the committee's consent was enforceable, because the action vested solely in the trustee, and the committee no longer had any right to control it. The committee represents only general unsecured creditors, while the trustee owes a fiduciary duty to the entire estate and all interests. Given the potential conflict between those positions, the committee may not control the trustee's discretion. *Official Comm. of Unsecured Creditors of Grand Eagle Cos. v. Asea Brown Boveri, Inc.*, 312 B.R. 219 (N.D. Ohio 2004).

13.3.q. Court may authorize creditors' committee to sue on behalf of the estate. The creditors' committee, with the consent of the debtor's Bahamian liquidator (who had all the rights and powers of a trustee in the U.S. case), sued the debtor's officers and directors for breach of fiduciary duty and mismanagement. In response to the defendants' challenge to the standing of the creditors' committee to sue, the Second Circuit rules that the committee may sue if it has the consent of the trustee and if the court finds that suit by the committee is both in the best interest of the estate and necessary and beneficial to the fair and efficient resolution of the bankruptcy case. *Commodore Intl. Ltd. v. Gould (In re Commodore Intl. Ltd.),* 262 F.3d 96 (2d Cir. 2001).

13.3.r. Equity Committee allowed to purchase liability insurance. Equity Committee members threatened to resign unless they were authorized to purchase a liability insurance policy. The bankruptcy

court approved the purchase as an administrative expense. The District Court affirmed, ruling that the expense was permissible if the existence of the Equity Committee was beneficial to the case, the Committee could not function without the expenditure, and the expenditure was reasonable under the totality of circumstances of the case. *McDow v. Official Committee of Equity Security Holders (In re Criimi Mae Inc.)*, 247 B.R. 146 (D. Md. 1999).

13.3.s. Creditors' committee member may receive reimbursement of attorney's fees. The 1994 amendments to section 503(b) authorize a committee member to receive reimbursement for attorney's fees for its separate attorney for services rendered in connection with the member's performance of its duties as a member of the committee. *First Merchants Acceptance Corp. v. J.C. Bradford & Co.,* 198 F.3d 394 (3d Cir. 1999).

13.3.t. Cash collateral order granting committee time to object is not authority to sue. In the usual cash collateral order, the creditors committee was given 30 days to challenge the banks security interest. The committee did so by filing an adversary proceeding to avoid the security interest. The court rules that the "authority to object" language in the order did not authorize the committee to commence an adversary proceeding. Nevertheless, the court authorized the adversary proceeding *nunc pro tunc*. *Official Committee Of Unsecured Creditors Of America's Hobby Center, Inc. v. Hudson United Bank (In re America's Hobby Center Inc.)*, 223 B.R. 275 (Bankr. S.D.N.Y. 1998).

13.3.u. Securities purchase rescission claimants may not serve on an equity committee. The United States trustee appointed a committee consisting of stockholders and class action claimants who were former stockholders and who asserted claims for rescission or damages relating to purchases of equity securities. The court disbanded the committee because it was composed of both equity security holders and creditors, even though the claims of the creditors were subordinated under section 510(b) to a level equal to the priority of common stock. *In re Mercury Finance Co.,* 224 B.R. 380 (Bankr. N.D. Ill. 1998).

13.3.v. Committee granted authority to sue on behalf of the estate. After the unsecured creditors' committee brought an action on behalf of the estate for violation of the automatic stay, the debtor stipulated to the committee's representation of the estate for that purpose. The bankruptcy appellate panel approves the retroactive authorization, subject to court approval, of the committee representation of the estate. *Liberty Mutual Insurance Co. v. Official Unsecured Creditors' Committee of Spaulding Composites Co. (In re Spaulding Composites Co., Inc.)*, 207 B.R. 899 (9th Cir. B.A.P. 1997).

13.3.w. Creditors' committee lacked standing to sue for debtor's fraudulent conduct. The sole shareholder of the debtor looted the debtor, making numerous fraudulent transfers. After the statute of limitations had expired for the estate to bring a fraudulent transfer action under section 544(b), the creditors' committee brought an action on behalf of the estate against the transferees on state law grounds of breach of duty and misappropriation of corporate assets. Because of the participation by the debtor's principal in the transfers, the debtor would not have been authorized to bring the action against the transferees. As a result, the creditors' committee was not authorized to bring the action on behalf of the estate. *The Mediators, Inc. v. Manney (In re The Mediators)*, 105 F.3d 822 (2d Cir. 1997).

13.4 Other Professionals

13.4.a. Section 330 does not determine fees based only on financial benefit to the estate. The debtor's plan appointed a "Distribution Agent" who was also responsible for investigating and pursuing claims, objecting to creditors' claims and administering the post-confirmation assets. The Agent performed these tasks, resulting in limited creditor recoveries. A disappointed creditor objected to the Agent's fee application. Section 330 authorizes the court to allow reasonable fees for actual, necessary services, based on factors set forth in the section and in caselaw. A court may consider whether services benefit the estate. Services may be necessary to estate administration without providing financial benefit and may therefore benefit the estate without increasing creditor distributions. A court should not use hindsight to determine whether services were necessary. The standard is whether the services had a reasonable likelihood of benefitting the estate when provided. Otherwise, all bankruptcy compensation would be de

facto contingent fees, which section 330 does not require. Because the Agent did not perform unnecessary services, adequately documented them and applied appropriate billing judgment, the court allows the fees. *In re Blue Stone Real Estate*, 487 B.R. 573 (Bankr. M.D. Fla. 2013).

13.4.b. Court imposes high bar to revise compensation approved under section 328(a). The debtor in possession employed a financial advisor. The engagement agreement provided a list of services to be rendered and for a fixed monthly fee for two years, a lower monthly fee thereafter and a transaction fee. At the time, the DIP and the financial advisor anticipated that the advisor's role would be limited, because the estate's assets would be sold quickly. The bankruptcy court approved the fee agreement under section 328(a). The DIP later requested that the court approve additional compensation, based on a substantial increase in the advisor's work, but the court denied the request. The work increase resulted from a substantial increase in the length of the case, serious deficiencies in management capabilities and internal reporting systems, the departure of the board and the CEO and an unusual employee exodus. As a result, the advisor performed many services not covered by the agreement, essentially filling the management void. At the end of the case, the bankruptcy court awarded the advisor additional compensation for these services. Section 328(a) permits a court to approve terms and conditions of employment and later to allow different compensation "if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of fixing such terms and conditions". Section 328(a) permits a court to approve terms and conditions without pre-approving final compensation, such as where a court approves an hourly rate but not the number of hours. But where the court approves terms and condition, the bar to revision at the case's end is very high. They may not be reviewed under section 330(a), only under the "not capable of being anticipated" standard of section 328(a). Developments are capable of being anticipated if the fee agreement contemplates their possibility. Here, the agreement provided for a monthly fee over a long period, so it anticipated that the chapter 11 case would not be just a quick sale. The advisor also could have contemplated that a company filing a chapter 11 case might have deficiencies in management and internal controls that would make reorganization more difficult. If the advisor did not know of these problems before agreeing to the fee, it could have sought compensation instead under section 330(a). Therefore, the advisor is not entitled to additional compensation for the extra work. *Ararco, L.L.C. v. Barclays Capital, Inc. (In re Asarco, L.L.C.)*, 702 F.3d 250 (5th Cir. 2012).

13.4.c. Court denies disqualification of expert witness for lack of specific conflict information. In unrelated class action litigation alleging that the defendants manipulated the natural gas markets, a fraudulent transfer adversary proceeding defendant had employed an expert to consult and testify on the defendant's risk management practices in connection with natural gas investments. The defendant's counsel deemed communications with the expert to be privileged and confidential for the purpose of assisting counsel in providing legal services, and the expert received numerous "confidential" and "highly confidential" documents from the defendant and its counsel. After the class action litigation settled, the adversary proceeding plaintiff (the trustee) sought to employ the same expert to testify on the defendant's due diligence processes in making investments with the Ponzi scheme debtor. The defendant objected on conflicts grounds but did not specify in any detail, even *in camera*, exactly what confidential information the expert had received. A federal court's power to disqualify an expert is based on its duty to protect the integrity of the legal process. To disqualify an adverse expert based on a prior relationship, the objector must show that it was objectively reasonable for it to conclude that it had a confidential relationship with the expert and that it disclosed relevant confidential information to the expert. The defendant here showed that it had a confidential relationship with the expert and that it was objectively reasonable for the defendant to believe that the information it provided to the expert was given in confidence. However, the defendant did not show that the information was relevant to the adversary proceeding. Without specifying what information the expert had received, the defendant had not shown that information about gas markets post-investment risk management practices were relevant to real estate pre-investment due diligence. Therefore, the court overrules the objection. *In re Dreier LLP*, 482 B.R. 863 (Bankr. S.D.N.Y. 2012).

13.4.d. 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).

13.4.e. Fee-shifting statute limitations do not apply to bankruptcy fee awards. The Court of Appeals for the Fifth Circuit has previously held that bankruptcy courts must determine fee awards based first on the lodestar principle (the number of hours reasonably spent times the prevailing hourly rate for similar work), which is subject to adjustment based on section 330(a) and on the 12 factors set forth in *Johnson v. Ga. Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974), including time and labor, novelty and difficulty, required skill, customary fee, whether the fee is contingent, amount involved and results obtained and awards in similar cases. The lodestar subsumes four *Johnson* factors (novelty and complexity, counsel's skill, quality of the representation and results), so the court may make an adjustment based on results only in a rare and exceptional case. In *Perdue v. Kenny A. ex rel. Winn*, 130 S. Ct. 1662 (2010), the Supreme Court rejected use of the *Johnson* factors in cases involving fee shifting statutes and limited consideration to the lodestar. The Court of Appeals concludes that *Perdue* does not effectively overrule its prior precedents in bankruptcy cases. Although Congress has not defined what constitutes a "reasonable fee" in a fee-shifting case, it has done so through section 330 in bankruptcy cases. Therefore, *Perdue*'s conclusions about reasonableness in a fee-shifting case do not apply in a bankruptcy case. On that basis, over the U.S. Trustee's *Perdue*-based objection, the Court affirms the bankruptcy court's 15% ($1 million) fee enhancement to the debtor's chief restructuring officer in a case that resulted in a 100% return to all creditors and $450 million in value to the debtor's shareholders. *CRG Partners Group, L.L.C. v. Neary (In re Pilgrim's Pride Corp.)*, 690 F.3d 650 (5th Cir. 2012).

13.4.f. Court denies expert witness fees because testimony did not provide identifiable, tangible, material benefit to the estate. The debtor retained an expert witness to testify at confirmation in support of its plan. The court denied confirmation without mentioning the witness's testimony. The witness assisted the debtor in preparing for the confirmation hearing on an amended plan, which the court confirmed. The witness requested compensation of $27,475 under section 330. To be compensable under section 330, the services "must be necessary to the administration of, or beneficial at the time" rendered, and in retrospect, the services "must result in an identifiable, tangible, and material benefit to the bankruptcy estate". A quantifiable or monetary return is not required. Here, the expert witness services were prospectively necessary to the administration of the case, and the witness did prepare and testify. However, because the court refused to confirm the plan and did not even mention the witness's testimony in its findings or ruling, the services did not result in an identifiable, tangible and material benefit to the estate. The court denies the fee application. *In re IRH Vintage Park Partners, L.P.*, 456 B.R. 673 (Bankr. S.D. Tex. 2011).

13.4.g. Retained nonattorney professional's legal fees may be allowed. The debtor in possession retained a compensation consultant under section 327. The engagement agreement provided for reimbursement of the consultant's legal fees and expenses incurred in connection with the engagement. The court approved the engagement and the agreement. The consultant sought fees and expenses, including reimbursement for legal fees it had incurred in prosecuting approval of its retention and of its fee application. Section 327 requires prior court approval of employment of a professional by the estate. It does not, however, require prior court approval of employment of an attorney that does not represent the estate. It authorizes reimbursement of actual, necessary expenses of a retained professional. Because the Code and the Rules impose substantial obligations on a retained professional in connection with approval of its employment and of its fees, its employment of an attorney to represent it in carrying out those obligations may be necessary, and its legal expenses incurred therefore may be compensable, subject to ordinary reasonableness constraints. *In re Borders Group*, 456 B.R. 195 (Bankr. S.D.N.Y. 2011).

13.4.h. Estate-employed appraiser is entitled to quasi-judicial immunity. The individual chapter 11 debtor co-owned real property with a third party, who had agreed to pay a portion of the appraised value to the estate in settlement of disputes. The debtor in possession retained an appraiser under section 327, with court approval, to value the property. Based on the valuation and the resulting payment, the debtor confirmed a plan that paid all creditors in full. The court approved the appraiser's fees. Later, the debtor sued the appraiser for fraudulent misrepresentation, gross negligence and willful and deliberate wrongful acts. A debtor in possession has the same role in a chapter 11 case as a trustee. A trustee would have had the role of valuing the property and determining the treatment of creditors. Those duties require judgment, for which a trustee is entitled to quasi-judicial immunity, because the judgment occurs in the exercise of a discretionary function and is functionally comparable to that of a judge. The same applies to an appraiser that a trustee or debtor in possession hires to perform similar judgmental duties. The appraiser is therefore entitled to the same immunity to which a chapter 11 trustee is entitled. *McClelland v. Grubb & Ellis Consulting Servs. Co. (In re McClelland)*, 418 B.R. 61 (Bankr. S.D.N.Y. 2009).

13.4.i. Court disallows custodian's fees and expenses incurred in opposing an involuntary bankruptcy petition. The state court appointed a liquidator for a partnership. One of the partners filed an involuntary petition against the partnership; the other opposed. The liquidator also opposed the petition. The bankruptcy court ultimately granted the order for relief. The custodian sought reimbursement of fees and expenses for its work. A state court liquidator is a "custodian". Section 543(b) requires a custodian to deliver property to the trustee and file an accounting. Under section 543(c), the bankruptcy court must provide for reasonable compensation and reimbursement of expenses for the custodian. Section 503(b)(3)(E) grants administrative expense priority to "the actual, necessary expenses … incurred by … a custodian … and compensation for the services of such custodian". The words "actual, necessary" import a benefit to the estate requirement. Therefore, a custodian may not be compensated or reimbursed except for services that provide a benefit to the estate. Opposing the involuntary petition did not provide such a benefit and is not among a custodian's enumerated duties in section 543(b). Therefore, the court denies compensation or reimbursement to the custodian for opposing the involuntary petition. *Szwak v. Earwood (In re Bodenheimer, Jones, Szwak, & Winchell L.L.P.)*, 592 F.3d 664 (5th Cir. 2009).

13.4.j. Court denies section 328(a) employment of committee financial advisors who proposed large nonrefundable fees. The debtor proposed a plan that left equity without any recovery. The equity committee believed that equity might be worth $200 million and sought to retain a financial advisor to value to the debtor and testify at the confirmation hearing. The equity committee rejected use of a favorable valuation that an individual shareholder had already obtained, because the valuation firm was not an industry expert nor in the valuation business. The proposed engagement provided for a nonrefundable initial fee of $500,000, a nonrefundable expert witness fee of $25,000 per day of testimony, and an extended assignment fee of $100,000 per month starting seven weeks after the engagement. The equity committee represented that it had investigated a dozen other firms and negotiated seriously with three of them, with a range of compensation arrangements, but selected this firm because of its attractive fee level and industry expertise. In response to the potential valuation litigation from the equity committee, the creditors committee also retained a financial advisor. The proposed engagement provided for a nonrefundable initial fee of $500,000 covering the initial two-week period, two additional nonrefundable fees of $100,000 for each of the next two two-week periods. The committee testified that the fee was the product of robust negotiations. Both employment applications sought fee approval under section 328(a). All testimony about market rates was conclusory, without specific examples. The debtor in possession would have to pay both sets of fees from cash collateral but had not been authorized to use cash collateral for that purpose, and the secured lender objected. Because section 328(a) applications bind the estate absent extraordinary circumstances, the court must act as a gate keeper on such applications. The court should consider the market, the sophistication of the parties, the best interest of the estate, creditor opposition and the reasonableness of the size relative to the size of the case. In this case, market data was insufficient to support the fees, and testimony about arms'-length bargaining over the fees was insufficient. The court must apply the section 330 hindsight best interest test to section 328 applications to prevent evasion of section 330's requirements. The evidence was insufficient to show a tangible, material benefit to the estate from the employment. Finally, the amounts, especially the per-day witness fee, were unreasonable. Therefore, the court denies the applications to approve employment. *In re Energy P'ners, Ltd.*, 409 B.R. 211 (Bankr. S.D. Tex. 2009).

13.4.k. Turnaround manager's and counsel's fees qualify for 506(c) surcharge on collateral. The debtor's secured lender had a lien on all of the debtor's assets. Upon filing its chapter 11 case, the debtor operated its business as a debtor in possession for about six weeks after bankruptcy, until a trustee was appointed. A liquidating trustee, who succeeded to the chapter 11 trustee's rights and claims, later sought to surcharge the secured creditor's collateral under section 506(c) for the costs and expenses incurred by the debtor in possession's turnaround management firm and the debtor in possession's counsel. Section 506(c) permits surcharge for "the reasonable, necessary costs and expenses of preserving, or disposing of, [collateral] to the extent of any benefit to the holder of the [secured] claim". Section 506(c) does not require that the estate actually have expended funds as a prerequisite to surcharge. Incurring the cost or expense suffices. The cost or expense must be necessary and reasonable. The cost of turnaround management, who takes over upon the CEO's unexpected resignation and maintains the business until it can be sold, is necessary to preserving and disposing of the secured creditor's collateral as a going concern. The debtor's law firm's services in filing and prosecuting the chapter 11 case are also necessary, because chapter 11's powers and protections allow the debtor in possession to maintain business operations and get the business ready for sale. The costs and expenses must be intended primarily to benefit, and must provide a direct benefit to, the secured creditor, as distinguished from the generalized benefits of chapter 11 to the estate, although the existence of incidental benefits to the estate does not disqualify the costs and expenses from eligibility for surcharge. Here, the effort to preserve the business and position it for sale in the six weeks before the trustee's appointment, and the costs and expenses of the turnaround manager and the debtor in possession's counsel, could qualify as costs and expenses incurred primarily for the secured creditor's benefit. *Rifkin v. CapitalSource Fin. LLC (In re Felt Mfg. Co., Inc.)*, 402 B.R. 502 (Bankr. D.N.H. 2009).

13.4.l. Committee retains standing even when its members no longer have unsecured claims. The debtor confirmed a chapter 11 plan, which vested in the unsecured creditors committee the right to bring actions for recovery of claims the estate owned. During the course of one such action, all but one of the committee members had resigned. The remaining committee member's claim had been disallowed. The remaining committee member appointed substitute members (later confirmed by the U.S. Trustee) and resigned. Section 1102 requires that committee members hold unsecured claims when they are appointed, but does not require that they continue to do so during their service on the committee (even though the better practice is for them to do so or resign). A committee appointed under section 1102 has fiduciary duties independent of any obligations of individual committee members and a role that is separate from the role or standing of any individual committee member. Therefore, the remaining committee member's failure to have an allowed unsecured claim during most of the litigation did not affect the committee's standing to prosecute the litigation. *Official C'tee of Unsecured Creditors v. Qwest Comm'ns Corp.*, 405 B.R. 234 (E.D. Mich. 2009).

13.4.m. Court authorizes patient care ombudsman to employ counsel and medical advisor. The U.S. Trustee appointed a patient care ombudsman under section 333, who sought approval to employ counsel and his own hospital consulting firm as a medical operations advisor. Section 333 requires the appointment of a patient care ombudsman. Unlike other estate professionals, an ombudsman's interest may be adverse to the estate, and professional expenses that an ombudsman incurs will not necessarily benefit the estate. Still, section 333 contemplates that an ombudsman may be required to file and advocate motions, which requires the assistance of counsel. Therefore, employment of counsel is authorized for the limited purpose of assisting the ombudsman with legal issues and appearing in court. The ombudsman may also employ his consulting firm as an advisor, because the scope of services required of the ombudsman may be in excess of those that can be performed by one person. In such circumstances, the U.S. Trustee should consider appointing a firm, rather than an individual. But because the ombudsman here is an individual, the court authorizes limited employment of the consulting firm. *In re Renaissance Hospital-Grand Prairie, Inc.*, 399 B.R. 442 (Bankr. N.D. Tex. 2008).

13.4.n. In pari delicto defense is available to estate professionals. The debtor reorganized based on faulty financial projections that the debtor and its professionals knew were stale. Six months later, the debtor failed and filed another bankruptcy case. The trustee sued the professionals in the first case for their gross negligence and breach of fiduciary duty in presenting the faulty financial information in support of confirmation. The in pari delicto defense bars a claim by a wrongdoer that is at least equally culpable with the defendants and where its application would not contravene public policy. The debtor knew as well

as the professionals that the financial information supporting the confirmation order was faulty and therefore was at least equally culpable. The debtor's responsibility is not diminished by the defendants' being professionals the debtor retained. Finally, application of the defense is consistent public policy that courts should not resolve disputes among wrongdoers nor pardon the plaintiff's conduct by holding the defendant liable for actions for which the plaintiff is at least equally at fault. *Gray v. Evercore Restructuring L.L.C.*, 544 F.3d 320 (1st Cir. 2008).

13.4.o. Bankruptcy court may apply lodestar analysis to financial advisor's fees. The debtor in possession sought to retain its financial advisor on a fixed fee basis. The bankruptcy court authorized employment only subject to fee review for reasonableness under section 330 at the end of the case. Having done so, the bankruptcy court may apply a lodestar analysis in determining a reasonable fee, despite the initial fixed fee agreement. *Miller, Buckfire & Co., LLC v. Citation Corp. (In re Citation Corp.)*, 493 F.3d 1313 (11th Cir. 2007).

13.4.p. Plastic surgery practice debtor is a "health care business". The professional corporation debtor operates a plastic surgery practice, in which the sole physician performs some surgeries in his medical office. The debtor is a health care business, as defined in section 101(27A)(A), because it offers "services" to "the general public" for the "treatment of injury, deformity, or disease" and for "surgical care" and has a "surgical treatment facility", as included under section 101(27A)(B)(i)(II), even though none of the treatment involves hospitalization, in-patient care, or a hospice, nursing, intermediate care, assisted living, or domiciliary care facility. Nevertheless, the physician had practiced for over 20 years with an unblemished medical record and carefully maintained patient records, and the debtor in possession projected positive cash flow during the case. Therefore, the court declines to order the appointment of a patient ombudsman, relying on the exception in section 333 that excuses appointment if the appointment "is not necessary for the protection of patients under the specific facts of the case". *In re William L. Saber, M.D., P.C.*, 369 B.R. 631 (Bankr. D. Colo. 2007).

13.4.q. Financial advisor does not typically owe fiduciary duties to its client. The debtor retained a financial advisor to advise on "strategic alternatives" under a common form of financial advisory services contract. Its duties included identifying possible strategic alternatives, evaluating them, presenting them to the debtor, assisting the debtor in narrowing the scope of alternatives, and assisting in execution. The debtor was running out of cash. Nevertheless, with full knowledge and based on the financial advisor's advice, it selected a merger candidate that itself was short on cash and only expected to be able to raise funding to support the merged entity. After the merger failed and the debtor filed bankruptcy, the trustee sued the financial advisor for breach of fiduciary duty. The financial advisor did not owe the debtor a fiduciary duty. Its contract did not give it authority to act as an agent for the debtor, it was not the debtor's broker, managing the debtor's funds or other assets, and its advisory services were just that—advisory. They did not rise to the level of an involvement in the business, financing, or merger that would give rise to fiduciary duties to the debtor. *e2 Creditors Trust v. Stephens, Inc. (In re e2 Commc'ns, Inc.)*, 354 B.R. 368 (Bankr. N.D. Tex. 2006).

13.4.r. Despite criticizing their performance, court awards financial advisors bonuses. The plan resulted in payment of all creditors in full and a substantial return to equity. The financial advisors for the debtors in possession and the committees did not, however, contribute significantly to that success. They did not adequately perceive market shifts that led to higher valuations and stubbornly defended lower valuations. As a result, their positions delayed agreement in plan negotiations. In addition, they contributed little to formulating the plan's post-confirmation simple capital structure. Nevertheless, they had negotiated success fees in their engagement agreements, and the court could not find that the agreements should be modified in light of circumstances that were not capable of being anticipated at the time. Therefore, the court awards the fees. It notes, however, that subsequent information showed that some financial advisors agree to serve estate fiduciaries under section 330's standards to be determined after the services are rendered. The court notes the inappropriateness in future cases of awarding compensation without regard to either time spent (lodestar) or the result achieved, the benefit to the estate, and the financial advisor's contribution to the result (contingency). *In re Mirant Corp.*, 354 B.R. 113 (Bankr. N.D. Tex. 2006).

13.4.s. Court denies substantial contribution fees to an ad hoc committee. The plan resulted in payment of all creditors in full and a substantial return to equity. Counsel for several ad hoc committees sought fees under section 503(b)(4) for making a substantial contribution to the case. Although courts have often required it for a section 503(b)(4) award, the section does not require a showing of benefit to the estate, only of a substantial contribution to the case, which the court in this case applies to mean a contribution to the proper allocation of value among stakeholders. Second, section 503(b)(4) permits an award even if the creditor did not work for the benefit of all parties in the case, as long as the creditor worked for the benefit of all members of its class. Third, the creditor must not have taken the action primarily for the purpose of receiving compensation, but rather for the purposes of benefiting the case, its class, or recoveries. Fourth, the award's cost must not exceed the benefit conferred. Fifth, the creditor's efforts must not have duplicated the efforts of an estate-compensated party, such as an official committee. In addition, the cost of participation in the case of a distressed debt buyer who made a substantial investment profit by its participation is a cost of doing business, not a cost to be borne by creditors and shareholders generally. Here, the court denies fees for an ad hoc committee, formed to provide a voice for creditors who did not want to serve on the official committee and become restricted, for work which largely duplicated the official committee's work (but did so more aggressively and therefore may have delayed the case's resolution or otherwise increased costs). The court also denies fees for expert witnesses, because section 503(b)(4) mentions only attorneys and accountants. *In re Mirant Corp.*, 354 B.R. 113 (Bankr. N.D. Tex. 2006).

13.4.t. British Virgin Islands liquidator succeeds to debtor's attorney-client privilege. The debtor was in a liquidation proceeding in the British Virgin Islands. The liquidator filed an ancillary proceeding under section 304. Based on the reasoning of *CFTC v. Weintraub*, 471 U.S. 343 (1985), that "the actor whose duties most closely resemble those of management should control the privilege in an insolvency proceeding," the court determines that the liquidator, whose powers and duties are comparable to those of a chapter 7 trustee, controls the privilege. *In re Gold & Appel Transfer S.A.*, 342 B.R. 386 (Bankr. D.D.C. 2006).

13.4.u. Court may reduce a professional's fee under an approved engagement agreement only based on unanticipatable improvidence. The bankruptcy court authorized the debtor in possession's employment of a financial advisor at a fixed monthly fee and a fixed restructuring fee, determining that the requested fees were reasonable, but subject to final review under sections 328 and 330. Section 328(a) provides that the court may not reduce the previously approved fee unless the "terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions." Upon final application, despite the reservation of section 330 review in the initial employment, the court may not re-determine reasonableness under section 330(a) at the end of the case without compliance with section 328(a). *Lazard Freres & Co. v. NorthWestern Corp. (In re NorthWestern Corp.)*, 344 B.R. 40 (D. Del. 2006).

13.4.v. Court denies indenture trustee's and its counsel's fees. The assets in a chapter 11 case were sold in a section 363 sale, and a plan was subsequently confirmed to distribute the cash and remaining assets. The indenture trustee, who served on the creditors' committee, sought compensation for itself and its counsel as an administrative expense for a substantial contribution in the case and as an unsecured claim against the debtor under the indenture. The court denies a substantial portion of the request. The indenture trustee acts as a fiduciary for its noteholders. It may be allowed fees for a substantial contribution only to the extent it demonstrates that its services actually benefited the estate, rather than only the noteholders. Its service on the committee does not qualify as such a benefit, because committee members are not entitled to compensation for their service for the estate. The trustee and its counsel were allowed substantial contribution claims only for their work on the plan and other aspects of the case that covered matters that committee counsel would normally handle but that did not duplicate committee counsel's work. Moreover, its counsel's fees for attending committee meetings would be denied under the substantial contribution standard and as an unsecured claim, because most of the time was spent accompanying the indenture trustee's representative, who was inexperienced in reorganization cases, to committee meetings and acting, in effect, as an additional committee member. That is not a proper role for counsel. *In re Worldwide Direct Inc.*, 334 B.R. 112 (Bankr. D. Del. 2005).

13.4.w. Examiner's report should not be sealed under section 107(b). Several individuals who were discussed in an examiner's report asked the bankruptcy court to seal the report under section 107(b)(2), which requires sealing of any document filed in a bankruptcy case that contains scandalous or defamatory material. Because section 107 addresses public access to documents filed in a bankruptcy case, it supplants the common right of access to court records. Therefore, section 107 completely abrogates the common law process of first determining whether the document is a "judicial record" and, if so, balancing the public interest against privacy interests. Section 107(b)(2) permits sealing of defamatory material only if the statements in the material would alter a person's reputation in a reasonable person's eyes and the material is untrue or potentially untrue and is either irrelevant to the proceeding in which the material is filed or is included in the material for an improper purpose. The material in the examiner's report may be potentially untrue, because the examiner notes that his conclusions are not final and may be changed by further investigation. But the statements are relevant and included for a proper purpose in that the report and its scope were ordered by the bankruptcy court. Therefore, the court does not seal the report. *Gitto v. Worcester Telegram & Gazette Corp. (In re Gitto Global Corp.)*, 422 F.3d 1 (1st Cir. 2005).

13.4.x. Examiner's report should not be sealed under section 107(b). Because of a seemingly intractable dispute between the debtor and the creditors committee and among committee members, the parties agreed to the appointment of an examiner. The court authorized the examiner to have access to attorney-client and work product privileged documents for the purpose of preparing the report, without waiving the privileges as to third parties, and temporarily sealed the report pending a determination of whether it should be sealed to protect privilege or as required under section 107(b). The report was sharply critical of some committee members, who asked that the report be sealed. When a party has consented to the appointment of an examiner, the party cannot object to the publication of the report on the grounds that the report contains information unfavorable to the party. Section 107(b)(2)'s "scandalous or defamatory" exception to disclosure does not encompass statements in an examiner's report that may be inflammatory or intemperate, as the examiner's report reflects opinion and advice, not determination of facts, and the court should not need to determine whether the examiner's report should be adopted as the findings of the court before it may be placed in the public record. Nevertheless, it is appropriate to include a cautionary legend on each page of the report. *In re Fibermark, Inc.*, 330 B.R. 460 (Bankr. D. Vt. 2005).

13.4.y. Bankruptcy court may impose hourly rates on financial advisor who normally bills monthly. The court had previously ordered that all professionals in the case must keep time records and that fees would be based primarily on time spent and hourly rates. The creditors committee still applied to employ a financial advisor at a monthly rate. The financial advisor agreed at the employment hearing that its fees would be subject to reasonableness review at the case's end. On the final fee application, the bankruptcy court disallowed the monthly rate and imposed an hourly rate. Doing so was well within the bankruptcy court's discretion, because there was no prior agreement that the financial advisor was entitled to monthly rates. In addition, section 330 looks to the time spent on an engagement. It does not require hours as the unit of time measurement, but hours is a useful measure of the effort devoted to an engagement. Therefore, the advisor's monthly fees are disallowed in favor of a calculation based on hours spent. *Houlihan Lokey Howard & Zukin Capital v. Unsecured Creditors' Liquidating Trust*, 427 F.3d 804 (10th Cir. 2005).

13.4.z. Bankruptcy court may not reduce compensation approved under section 328(a) except upon unforeseeable circumstances. The bankruptcy court approved the employment of the creditors committee's financial advisor under section 328(a) on a monthly and transaction fee basis. Upon the advisor's final fee application, the court reduced the monthly fee by 50%, based on the duplication of effort by the committee's and the debtor's financial advisors. The two advisors' engagement letters clearly set forth the services of each, much of which overlapped. Therefore, the duplication of effort was "capable of being anticipated at the time of the fixing of [the] terms and conditions" of employment and could not form the basis for reducing the fee. *In re Northwestern Corp.*, 332 B.R. 534 (D. Del. 2005).

13.4.aa. Debtor in possession's officers must disclose potential conflicts relationships. Shortly after bankruptcy, the debtor in possession hired a new president to oversee the liquidation. The president was a 50% partner in a company whose other partner was a senior partner in the law firm representing the creditors committee. There was no actual conflict of interest, as the company was not involved in the

chapter 11 case at all, nor was disclosure required by Rule 2014 or by section 327(a), which apply only to professionals. Nevertheless, the court announces that failure to disclose such relationships, involving potential conflicts, in future cases may subject the officer to review and possible compensation disgorgement. *In re eToys, Inc.*, 331 B.R. 176 (Bankr. D. Del. 2005).

13.4.bb. Court denies indenture trustee's substantial contribution claim. The indenture trustee acted on behalf of bondholders in the chapter 11 case, achieving a better recovery for them as compared to the recovery of the general unsecured creditors. It also assisted in communications with bondholders, including in noticing, voting, and distribution procedures. The court denies a claim for reimbursement of the indenture trustee's attorneys' fees under section 503(b)(4) for making "a substantial contribution in the case." The applicant's motive in performing the services is irrelevant, as long as the services foster and enhance the progress of the case. But the applicant has made a substantial contribution only if the estate would not have received the benefit but for the applicant's efforts. In addition, the benefit must be conferred on the estate, not only to a limited class of creditors. Expected or routine activities do not qualify. Here, the indenture trustee's activities on behalf of the bondholders, to whom it owed a fiduciary duty, do not constitute a substantial contribution. Protecting the rights of the bondholders in plan negotiations and litigation is not a contribution that benefits the estate. The communications procedures were both routine and expected and also primarily for the benefit of the bondholders. Fulfilling fiduciary duties does not benefit the estate. Finally, a provision in the indenture granting administrative expense priority to such expenses establishes only a contractual right; it has no bearing on the substantial contribution analysis. Therefore, the fees were denied. *In re American Plumbing & Mech., Inc.*, 327 B.R. 273 (Bankr. W.D. Tex. 2005).

13.4.cc. Court denies equity holders' substantial contribution claim. The debtor's founders participated actively in negotiating a plan and contributed to a consensual resolution of the case. These activities do not justify an award of attorneys' fees for making "a substantial contribution in a case." Negotiation is an expected activity in a chapter 11 case. Reaching settlement requires more than one party to agree. Finding one party's agreement to constitute a substantial contribution would require finding all other parties' agreements to constitute a substantial contribution as well, ultimately entitling all participating creditors to attorneys' fees. Therefore, the fee application is denied. *In re American Plumbing & Mech., Inc.*, 327 B.R. 273 (Bankr. W.D. Tex. 2005).

13.4.dd. Financial advisor's transaction fee is limited, based on amount of debt restructured. The debtor engaged a financial advisor's prepetition, who obtained investors for a restructuring plan. After bankruptcy, the debtor in possession moved for court approval of the engagement, with a fixed transaction fee if the plan were consummated and a reasonable fee to be determined if an alternative, stand-alone plan that did not involve a new money investment were consummated instead. The court granted the application under section 328. Upon consummation of the latter plan, the advisor sought a transaction fee equal to the fee approved for the new money plan. The court approves a lower transaction fee, based on a percentage of the amount of debt actually restructured — that is, that received a recovery under the plan — rather than on the total amount of the debtor's debts. In doing so, the court notes that "success" is not required to support a transaction fee; the market should determine reasonableness. *In re XO Communications, Inc.,* 323 B.R. 330 (Bankr. S.D.N.Y. 2005).

13.4.ee. Financial advisor's success fee is paid only from recovery of benefited class. The U.S. trustee appointed a bondholders committee and a trade creditors committee. The court approved the trade committee's employment of a financial advisor, but required that the advisor's success fee be paid only from trade creditor recoveries, not as a general administrative expense. Section 328(a) permits employment "on any reasonable terms and conditions." The restriction on the payment of the advisor's fees is reasonable under the circumstances of this case. Therefore, the court of appeals rules that the bankruptcy court did not abuse its discretion in imposing it. *In re Farmland Indus., Inc.*, 397 F.3d 647 (8th Cir. 2005).

13.4.ff. Examiner with undisclosed personal interest is denied all fees. Shortly after his appointment, the examiner negotiated secret, private deals with at least one unsecured creditor for payment of his fees based on a percentage of increased recoveries to the creditor. Despite Rule 2016(a),

the examiner did not disclose the arrangements or the negotiations in any of his interim fee applications. His conduct prevented him from being disinterested, because he had a personal stake in the recovery of selected creditors. Second, he violated his disclosure obligation by failing to disclose the arrangement. Third, he violated his duty of loyalty to the estate by misrepresenting his actions to the court and the parties during his negotiations. For his conduct and his personal interest in the outcome, he was denied all fees and ordered to disgorge all fees that he had previously received. Although the court does not formally require it, it suggests that such a denial and disgorgement order is required if a fiduciary such as an examiner or a trustee is not disinterested at any time during his service to the estate. *United States v. Schilling (In re Big Rivers Electric Corp.)*, 355 F.3d 415 (6th Cir. 2004).

13.4.gg. Financial advisor's fees are disallowed for nondisclosure. During the chapter 11 case, individual principals of the financial advisor conducted negotiations with an individual major stockholder and creditor of the debtor over an unrelated joint venture investing in troubled companies. The joint venture might use the services of the financial advisor in connection with those investments. One of the principals was named as the person responsible for the financial advisor's engagement by the debtor but charged less than 1% of the financial advisor's time. The court rules that the negotiations constituted a "connection" that must be disclosed under Bankruptcy Rule 2014 and ordered disgorgement of approximately two-thirds of the financial advisor's fees. *In re Condor Systems, Inc.*, 302 B.R. 55 (Bankr. N.D. Cal. 2003).

13.4.hh. Bankruptcy court may impose monthly fee cap on a professional. The equity committee sought to retain a financial advisor. The bankruptcy court approved the employment, but imposed a monthly cap of $30,000 and required the advisor to use accounting and other financial information generated by the debtor's financial advisor. Such a decision was proper. Section 328 permits employment on "any reasonable terms and conditions." The bankruptcy court is permitted by that section to impose limits. Moreover, requiring the committee's financial advisor to rely on data generated by other financial advisors does not create a conflict of interest under section 1103, because obtaining such information does not amount to representation of another entity in connection with the case. *Committee of Equity Securityholders v. Official Committee of Unsecured Creditors (In re Federal Mogul-Global Inc.)*, 348 F.3d 390 (3d Cir. 2003).

13.4.ii. A nursing home consultant is not a section 327 professional. The U.S. Trustee objected to fees paid to nursing home consultants who developed operating protocols, helped restructure the salary scale, and consulted on dietary, housekeeping, and laundry services. The U.S. Trustee argued that the employment had not been previously approved under section 327. The court traces the history of the use of the term "professional" and the case law construing it and concludes that it should be applied principally to those whose position in a reorganization case "could be leveraged into questionable commitments for future work [in bankruptcy] based on factors other than qualification." As a result, the court overrules the objection. *Office of U.S. Trustee v. McQuaide (In re CNH, Inc.)*, 304 B.R. 177 (Bankr. M.D. Pa. 2004).

13.4.jj. Third Circuit approves financial advisor indemnification. The Third Circuit approves as reasonable a financial advisor's retention agreement under which the debtor in possession indemnifies the financial advisor for losses other than those resulting from the advisor's gross negligence, bad faith, willful misfeasance, or reckless disregard of its obligations, but including those caused by the advisor's ordinary negligence. In doing so, however, the court defines a new standard of negligence for financial advisors, based on the standard applicable to corporate directors under Delaware law. Under the new standard, financial advisors may be indemnified against liability "when they (1) have no personal interest (2) have a reasonable awareness of available information after prudent consideration of alternative options, and (3) provide that advice in good faith." Failure to meet that standard amounts to "gross negligence" for which the advisor may not be indemnified. The advisor also may not be indemnified for losses resulting from its own breach of the engagement agreement nor limit the gross negligence exclusion to losses caused "solely" by gross negligence. *In re United Artists Theatre Co.*, 315 F.3d 217 (3d Cir. 2003).

13.4.kk. Court rejects indemnification for committee financial advisor. The committee sought to employ a financial advisor, with a provision in the engagement agreement that the debtor would indemnify

the financial advisor for all acts except gross negligence, willful misconduct, breach of fiduciary duty, bad faith, or self dealing. The bankruptcy court found that the indemnification was not reasonable under the circumstances of the case, particularly because the debtor/indemnitor had no control over or direct relationship with the financial advisor/indemnitee. On appeal, the Eighth Circuit B.A.P. concludes that the bankruptcy court did not adopt a *per se* rule against indemnification and that the court did not abuse its discretion in denying indemnification in this case. *Unsecured Creditors Committee v. Pelofsky (In re Thermadyne Holdings Corp.)*, 283 B.R. 749 (8th Cir. B.A.P. 2002).

13.4.ll. Nondisclosure of fee negotiations renders examiner not disinterested, requires disgorgement. Though disinterested at the time he was appointed, the examiner subsequently attempted to get certain major creditors to pay his fees directly if he was not paid from the estate at the conclusion of the case. Once one of the creditors agreed, the examiner promptly disclosed it. The court rules, however, that his prior negotiations rendered him not disinterested, because a disclosure of the negotiations would have removed his neutrality and the appearance of impartiality that is required under the disinterestedness standard, especially for an examiner. As a result, because the negotiations happened early in the case, before the examiner had received any fees, he was not disinterested at all relevant times, and, under section 328(c), the court required him to disgorge all fees received. *In re Big Rivers Electric Corp.*, 284 B.R. 580 (W.D. Ky. 2002).

13.4.mm. Pre-approval of a professional's terms of employment require express reference to section 328 in the application. Section 327 permits a trustee to employ professionals, while section 328 permits approval of the terms and conditions of employment and restricts the court from revising the terms and conditions at the end of the case or from examining the fees for reasonableness under section 330. In this case, although the professional's employment application provided for the specific terms and conditions of employment and the fees to be paid, it did not specifically refer to section 328. Because of that omission, the bankruptcy court could examine the fees for reasonableness under section 330, without regard to the terms and conditions upon which the professional was originally employed. The court of appeals adds that it is the better practice for the employment order as well as the application to make specific reference to section 328. *Circle K Corp. v. Houlihan, Lokey, Howard & Zukin, Inc. (In re Circle K Corp.)*, 279 F.3d 669 (9th Cir. 2002).

13.4.nn. Liquidating trust has fiduciary duty to creditors. The confirmed plan provided for the establishment of a liquidating corporation to liquidate the assets of the estate and distribute them to creditors. The liquidating corporation refused to account to the creditors on collection and disbursements. Its refusal constituted a breach of fiduciary duty to the creditors to provide an accounting. The absence of the word "trust" from the plan language did not detract from the liquidating corporations fiduciary to creditors. *Pioneer Liquidating Corp. v. United States Trustee (In re Consolidated Pioneer Mortgage Entities)*, 264 F.3d 803 (9th Cir. 2001).

13.4.oo. Court upholds broad indemnity provision for financial advisor. Rejecting the United States trustee's argument that a financial advisor may not be indemnified at all, let alone for negligence, the court approves a broad financial advisor indemnity provision that carves out only bad faith, gross negligence, and willful misconduct. The court rejects a *per se* rule based on the ability of a fiduciary to obtain indemnity for negligence, finding that the common law and corporate statutes permit indemnification of fiduciaries, such as trustees and corporate officers and directors, for negligence. Based on the facts of the case, the court finds the retention agreement reasonable. *In re Joan and David Halpern, Inc.*, 248 B.R. 43 (Bankr. S.D.N.Y. 2000).

13.4.pp. Professionals disqualified for inadequate disclosure. In its employment application, Pricewaterhouse disclosed its engagement by the plaintiff in a state court prepetition action against the debtor only in general terms, without naming the creditor. When the creditor later objected to PricewaterhouseCoopers' employment, the court disqualified PricewaterhouseCoopers for its inadequate disclosure under Bankruptcy Rule 2014. Hale and Dorr also represented the same plaintiff, but not in the state court litigation. It was involved, however, in the transaction that gave rise to the plaintiff's claim against the debtor. Once again, it described its involvement too generally, without specifics such as the fact that three of Hale and Dorr's partners had been called as deposition witnesses in the litigation. The

court disqualified Hale and Dorr for both nondisclosure and nondisinterestedness reasons, blending together a single standard that encompasses nondisinterestedness and holding or representing a material adverse interest. *In re Filene's Basement, Inc.*, 239 B.R. 845, 850 (Bankr. D. Mass. 1999).

13.4.qq. A creditor is denied standing to object to examiner's fees. A creditor who would not be affected by the amount of compensation paid to an examiner in a chapter 11 case was denied standing to object to the fees. Only the reorganized debtor, which would actually pay the fees, had standing to object. *In re Big Rivers Electric Corp.*, 233 B.R. 754 (Bankr. W.D. Ky. 1999).

13.4.rr. Agreed fees allowed in full. An investment banker was retained with an agreement under section 328 fixing its compensation. At the conclusion of the case, the bankruptcy court reduced the allowed compensation. The Fifth Circuit reversed, holding that an agreement under section 328 takes priority over the reasonableness standard of section 330. *Donaldson, Lufkin & Jenrette Securities Corporation v. National Gypsum Company (In re National Gypsum Company)*, 123 F.3d 861 (5th Cir. 1997).

13.5 United States Trustees

13.5.a. U.S. Trustee has standing to appeal an order striking a petition. The debtor filed her voluntary petition without obtaining the credit briefing (counseling) that section 109(h) requires. The bankruptcy court struck the petition. The U.S. Trustee appealed. Ordinarily, an appellant must be a "person aggrieved", which requires that the appellant be directly and adversely pecuniarily affected by the order on appeal. However, the pecuniary interest standard is not the sole test for bankruptcy appellate standing. Section 307 provides that the U.S. Trustee may raise and may appear and be heard on any issue in a case. It evidences a Congressional intent that the U.S. Trustee represent the public interest in bankruptcy cases and therefore in appeals. The U.S. Trustee therefore has standing to appeal the bankruptcy court's dismissal order. *Adams v. Zarnel (In re Zarnel)*, 619 F.3d 156 (2d Cir. 2010).

13.5.b. U.S. Trustee is entitled to chapter 11 fees for any quarter in which the estate makes no disbursements. The debtor confirmed a chapter 11 plan, but the case remained open pending resolution of an adversary proceeding.. The debtor made no disbursements during the post-effective date period. It sought an order closing the case. The U.S. Trustee requested payment of quarterly fees for the post-effective date period. Section 1930(a)(6) provides that a quarterly fee "shall be paid" to the U.S. Trustee in a chapter 11 case "for each quarter … until the case is converted or dismissed" or closed. The minimum fee is payable for each quarter "in which disbursements total less than $15,000". Zero is less than $15,000, and the statute provides that the fee "shall be paid" for each quarter. Therefore, according to its plain meaning, the statute requires the payment of the minimum fee even for quarters during which there is no disbursement. *Clippard v. Ky. Processing Co. (In re Ky. Processing Co.)*, 418 B.R. 217 (E.D. Ky. 2009).

13.5.c. United States trustee has standing to bring equitable subordination action. The United States trustee brought an adversary proceeding alleging that the defendants' actions had resulted in an improper diminution in the estate's value, to the detriment of creditors, including the United States government. The United States trustee also claimed to be a creditor of the estates. The United States trustee has standing to bring this action. A creditor has standing to bring an adversary proceeding to equitably subordinate a claim. In addition, the United States trustee may act in the public interest in bringing an action, relying on its standing under section 307 to raise and appear and be heard on any issue in a case. *Clippard v. LWD, Inc. (In re LWD, Inc.)*, 342 B.R. 514 (Bankr. W.D. Ky. 2006).

13.5.d. Post-confirmation U.S. Trustee fees are based on all disbursements made by a reorganized debtor. The quarterly United States trustee fee payable under 28 U.S.C. § 1930(a)(6) is based on disbursements. The Ninth Circuit holds that the phrase is not limited to disbursements from the bankruptcy estate but includes payments made by a reorganized debtor during the post-confirmation period. *Tighe v. Celebrity Duplicating Services, Inc. (In re Celebrity Duplicating Services, Inc.)*, 210 F.3d 996 (9th Cir. 2000).

13.5.e. U.S. trustee fees granted priority. Following the decision of the Eighth Circuit, the Ninth Circuit rules that the unpaid quarterly chapter 11 fees of the United States trustee share pro rata with chapter 7 administrative expenses in a case that is converted from chapter 11 to chapter 7. *U.S. Trustee v. Endy (In re Endy)*, 104 F.3d 1154 (9th Cir. 1997).

14. TAXES

14.1.a. Unemployment tax rating may not follow buyer in sale free and clear. The trustee sold an operating business. The order approving the sale provided that the sale was "free and clear of all liens, claims, encumbrances and interests" and that the sale would not cause the purchaser "to be deemed a successor in any respect to the Debtors' businesses within the meaning of any … state … tax … law, rule or regulation." After the sale, the state department of labor applied the debtors' experience rating to the purchaser for the purpose of determining the purchaser's unemployment tax rate. The purchaser moved in the bankruptcy court to enforce the sale order against the labor department. Section 363(f) allows the trustee to sell property of the estate "free and clear of any interest in such property." "Interest" includes any obligation that arises from the property being sold. The department of labor's attempt to transfer the unemployment insurance compensation rating is an attempt to collect money that the debtor would have paid if it had not sold its assets, so the asset transfer, rather than the continuation of the business, triggers the imposition of the higher experience rating and therefore violates the sale order. *In re Tougher Indus., Inc.*, ___ B.R. ___, 2013 Bankr. LEXIS 1228 (Bankr. N.D.N.Y. Mar. 27, 2013).

14.1.b. Shareholders' agreement to pay taxes provides reasonably equivalent value to a Subchapter S corporate debtor in exchange for tax dividends. The debtor corporation's shareholders agreed to make a Subchapter S election for the corporation, and in exchange, the shareholders' agreement was revised to require the debtor to declare a dividend each year to each shareholder in an amount equal to the taxes that the shareholder owes on the debtor's income for the preceding year. A Subchapter S election results in a corporation's income being taxed only to the shareholders, relieving the corporation of income tax liability. After the debtor filed bankruptcy, its liquidating trustee sued one of the shareholders to avoid and recover a dividend that the debtor declared and paid to the shareholder in accordance with the shareholders' agreement's terms. A trustee may avoid a transfer of the debtor's property for less than reasonably equivalent value if the debtor was insolvent when it made the transfer. In determining whether the debtor received reasonably equivalent value, benefit to creditors is not the test; whether creditors are worse off is. Here, the debtor would have had to pay income taxes if it had not elected Subchapter S treatment and in exchange agreed to pay dividends equal to the shareholders' tax liabilities. It received value by the shareholders' agreement to pay the income taxes attributable to the debtor's income, for which the debtor would have been liable without the Subchapter S election. Therefore, the court dismisses the trustee's complaint. *Crumpton v. Stephens (In re Northlake Foods, Inc.)*, 483 B.R. 247 (M.D. Fla. 2012), *aff'd sub nom. Crumpton v. McGarrity (In re Northlake Foods, Inc.)*, ___ Fed. Appx. ___, 2013 WL 1603442 (11th Cir. Apr. 16, 2013).

14.1.c. 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).

14.1.d. Bankruptcy court may determine tax refund claim under section 505(a) as long as the trustee makes a refund request to the IRS at least 120 days before the determination. The

corporate debtor did not file a federal income tax return for a 2001 “stub period” between January 1 and the date of the filing of the petition, because of uncertainty over which other corporation was its parent and responsible for including it in the parent’s return. After bankruptcy, it filed a return for the “short period” remainder of 2001 but did not seek a prompt determination under section 505(b) of the tax due for the short period. It filed 2002 and 2003 returns with section 505(b) prompt determination requests. The IRS did not complete its examination of those returns before the section 505(b) deadlines. The debtor in possession also amended the debtor’s 1998 return to seek a refund, based on net operating loss carrybacks and filed an unsigned return for the 2001 stub period. The IRS rejected the refund request. The IRS filed a request for payment of administrative expense for interest and penalties for the 2001 short period. The liquidating trustee under the debtor’s confirmed plan objected to the request, sought to carry forward and carry back losses against the short period income, recover the disallowed 1998 refund and recover a refund of taxes paid with the 2001 short period return. Later, the trustee requested a refund from the IRS for 1998 and for the 2001 short period. Section 505(a) permits the court to determine the amount or legality of any tax, including a tax refund, brought on behalf of a bankruptcy estate except “before the earlier of (i) 120 days after the trustee properly requests such refund” or a determination of the request. Section 106(a) waives the United States’ sovereign immunity for determination of a tax refund by an estate by listing section 505(a) as a triggering section. Although plan confirmation terminates the estate, where the plan specifically provides for transfer of estate claims to a liquidating trust, the trustee represents the remainder of the estate, and the refund claim is brought on behalf of the estate. The “properly request” provision requires exhaustion of administrative remedies; its focus is not on whether it is a trustee in bankruptcy who requests the refund. A liquidating trustee may fill the role. Finally, on the facts of this case, where the trustee requested the refund from the IRS after commencing the claims objection and refund litigation in the bankruptcy, the bankruptcy court may determine the claim. Some cases permit a bankruptcy court to determine the refund claim without a prior refund request where the claim is a counterclaim to an IRS proof of claim or administrative expense request. However, the statutory language still requires a refund request. But the bankruptcy court may “determine” the refund claim as long as the refund request is made at least 120 days beforehand. Therefore, section 505(a) applies to this action. *United States v. Bond*, 486 B.R. 9, (E.D.N.Y. 2012).

14.1.e. The IRS’s failure to respond to a section 505(b) determination request prevents the IRS from using any amount owing to offset any liability to the taxpayer. The corporate debtor did not file a federal income tax return for a 2001 “stub period” between January 1 and the date of the filing of the petition, because of uncertainty over which other corporation was its parent and responsible for including it in the parent’s return. After bankruptcy, it filed a return for the “short period” remainder of 2001 but did not seek a prompt determination under section 505(b) of the tax due for the short period. It filed 2002 and 2003 returns with section 505(b) prompt determination requests. The IRS did not complete its examination of those returns before the section 505(b) deadlines. The debtor in possession also amended the debtor’s 1998 return to seek a refund, based on net operating loss carrybacks and filed an unsigned return for the 2001 stub period. The IRS rejected the refund request. The IRS filed a request for payment of administrative expense for interest and penalties for the 2001 short period. The liquidating trustee under the debtor’s confirmed plan objected to the request, sought to carry forward and carry back losses against the short period income, recover the disallowed 1998 refund and recover a refund of taxes paid with the 2001 short period return. Later, the trustee requested a refund from the IRS for 1998 and for the 2001 short period. The court granted the refund claims and disallowed the IRS’s prepetition and administrative expense claims. The plan barred setoff and recoupment rights that arose before confirmation. A plan may not bind the IRS unless the United States has waived sovereign immunity. Section 106(a) lists section 1141 as a waiver section, but section 1141(a) applies only to “creditors”, that is, holders of prepetition claims, not to holders of administrative expense claims. However, the IRS’s failure to respond to the trustee’s section 505(b) determination request discharged the liability of the trustee and the estate for the tax. Because neither the trustee nor the estate was liable, there was nothing for the IRS to offset against its liability to the trustee. *United States v. Bond*, 486 B.R. 9, (E.D.N.Y. 2012).

14.1.f. Subchapter S debtor’s payment of shareholders’ income taxes is not a fraudulent transfer. The Subchapter S debtor agreed with its shareholders that it would reimburse them for the additional income taxes for which they were liable as a result of the corporation having made the Subchapter S election and passing through its income to the shareholders for tax purposes. The corporation paid some

but not all of such taxes to the IRS before bankruptcy. The trustee may avoid a transfer that the debtor made while insolvent and without receiving reasonably equivalent value in exchange. Value may include value that comes from someone other than the transferee, as long as the estate is no worse off. Here, the corporation derived a benefit by paying its shareholders' Subchapter S liabilities. By electing Subchapter S treatment, the corporation in this instance reduced its own taxes by at least as much as it paid to the IRS for the shareholders' taxes. The shareholders' assumption of the tax burden provided reasonably equivalent value to the corporation. G*old v. U.S. (In re Kenrob Info. Tech. Solutions, Inc.)*, 474 B.R. 799 (Bankr. E.D. Va. 2012).

14.1.g. "Tax priority stripping" provision of section 1222(a)(2)(A) does not apply to a chapter 12 postpetition 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 that arises from a property sale and 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*, 566 U.S. ___, 132 S. Ct. 1882 (2012).

14.1.h. Nondebtor parent's postpetition revocation of its own subchapter S status is an avoidable transfer. A qualified subchapter S corporation (QSub) is not treated as a separate taxable entity, and its income and losses are passed through to its ultimate owner. A corporation may be a QSub only if its parent corporation is a subchapter S corporation. As of the petition date, the debtor was a QSub, and its parent was a subchapter S corporation that was wholly owned by an individual, who reported all the debtor's income and losses on his own income tax return. After bankruptcy, the individual revoked the parent's subchapter S status, resulting in the debtor's loss of its QSub status. Section 541(a) defines property of the estate very broadly, to include something that can be used to satisfy claims. The ability not to pay taxes has a value, and an estate has a property interest in the benefit that status affords. The revocation of that ability diminishes the estate's ability to satisfy claims. Therefore, even though the ability depends on the individual's election as to the parent, the estate has a property interest in the election. The revocation disposed of that property interest. Therefore, the revocation was an avoidable postpetition transfer. *The Majestic Star Casino, LLC v. Barden Dev., Inc. (In re The Majestic Star Casino, LLC)*, 466 B.R 666 (Bankr. D. Del. 2012).

14.1.i. Estate may sell property free and clear of state's right to impose unemployment tax rate on asset purchaser based on debtor's claims history. The debtor in possession sold all of its assets free and clear, under section 363(f), of any claims that might arise under state unemployment compensation laws. The sale order provided that the purchaser would not assume or be obligated to pay any liabilities, including claims that might arise under such laws. After the closing, the state division of unemployment assistance (DUA) treated the purchaser as a successor employer and assessed a high unemployment compensation rate, based on the debtor's prior unemployment claims history. Section 363(f)(5) permits a sale free and clear of interests in property of the debtor if the interest holder "could be compelled … to accept a money satisfaction of such interest". The statute does not define "interest", so the court must examine the relationship between the contribution rate and the unemployment tax rate to determine whether it is an "interest". The state's right to tax a successor employer according to the predecessor's experience rating is grounded in part on the fact that the same assets were used by the debtor. There is a relationship between the state's right to tax at the higher rate and the use to which the assets have been put. Therefore, the right is an interest in the property. The interest is a right of taxation, which is satisfied by the payment of money, and the DUA could be compelled to accept a money satisfaction of the interest. Therefore, the sale was free and clear of the DUA's right to impose a tax based on the debtor's history, and it may tax the purchaser only at the lower rate. *In re PBBPC, Inc.*, 467 B.R. 1 (Bankr. D. Mass. 2012).

14.1.j. Section 505(a) proceeding against a state does not violate sovereign immunity. The state imposed a tax on the debtor's receipts. Before its chapter 11 case, the debtor paid the tax but challenged whether collections that it was required by statute to remit to third parties are included in "receipts". It sought a refund from the state of the excess taxes. After bankruptcy, the debtor in possession brought a

motion under section 505(a) for a determination of the legality of the taxes. Section 505(a) permits a bankruptcy court to determine "the amount or legality of any tax … whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." It confers jurisdiction on the bankruptcy court to determine federal and state tax claims, not to enjoin a state in its tax collection. Therefore, a section 505(a) motion does not seek an *in personam* injunction against the state, which might violate the state's sovereign immunity. Rather, it seeks a determination of issues concerning property of the estate by asking the court to determine whether the estate must keep making tax payments based on gross collections. As an *in rem* action relating to property of the estate, the motion does not violate the state's sovereign immunity. Similarly, the motion does not violate the Tax Injunction Act, which prohibits a federal court from enjoining the assessment or collection of a state tax, because the TIA does not affect a bankruptcy court's subject matter jurisdiction under section 505(a). *In re Indianapolis Downs, LLC*, 462 B.R. 104 (Bankr. D. Del. 2011).

14.1.k. The estate's entitlement to a tax refund is pro rata based on the number of prepetition days in the year. The debtor filed bankruptcy on September 25, 268 days or 73% into the year. The debtor's income had been relatively constant for the prepetition period and remained so for the rest of the year. After the first of the next year, the debtor received a tax refund resulting from excess withholding. Section 541(a)(1) determines what constitutes property of the estate as of the petition date. An asset that is rooted in the prebankruptcy past is property of the estate, even if received after bankruptcy. Although the debtor's tax liability is not determined or fixed until the end of the taxable year on December 31, the "pro rata by days" method fairly allocates a tax refund between the prepetition and postpetition periods. Therefore, the debtor must turn over 73% of the tax refund, reduced by any applicable exemption, to the trustee. *In re Meyers*, 616 F.3d 626 (7th Cir. 2010).

14.1.l. 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.m. "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*, 617 F.3d 1161 (9th Cir. 2010).

14.1.n. "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).

14.1.o. Tax sale certificate purchaser is not entitled to "tax claim" treatment under section 511. The creditor purchased a tax sale certificate from the taxing agency at a taxing agency's sale of tax liens. State law grants the purchaser only a lien on the underlying property, which the purchaser may foreclose. The property owner was a chapter 11 debtor, which proposed a plan to pay the tax sale certificate holder over time with interest at a market rate. Section 511 requires that interest on a "tax claim" be paid at the nonbankruptcy statutory interest rate on the tax. State law determines the nature of a claim. Because the tax sale certificate here does not give its holder the same rights against the property and the taxpayer as the taxing agency has, the tax sale certificate is not a "tax claim" within the meaning of section 511. *In re Princeton Office Park, L.P.*, 423 B.R. 795 (Bankr. D.N.J. 2010).

14.1.p. Section 505(a)(2)(C) prohibits court determination of tax liability after expiration of state law deadline. The local taxing agency assessed taxes on the debtor's real property. The deadline for a state court challenge expired 30 days after bankruptcy. The state court challenge involved a de novo hearing, not an appeal or review. Accordingly, section 108(a), which applies to the commencement of an action and extends the statute of limitation for two years after bankruptcy, applies, rather than section 108(b), which applies to taking action in a pending proceeding, such as filing a notice of appeal or review, and extends the deadline for only 60 days. However, section 505(a)(2)(C) prohibits the bankruptcy court from determining an ad valorem property tax if the applicable period for contesting the amount under nonbankruptcy law "has expired". But section 505(a)(2)(C) does not specify when the court must measure whether the contest period has expired. Measuring as of the petition date would make the provision redundant with section 505(a)(2)(A), which prohibits determination of any tax if contested and adjudicated before the petition date. However, the specific controls the general. So section 505(a)(2)(C) controls over the general extension of time in section 108, and the trustee must seek determination of the tax before the period for seeking de novo review has expired. *In re Village at Oakwell Farms, Ltd.*, 428 B.R. 372 (Bankr. W.D. Tex. 2010).

14.1.q. Bankruptcy court does not have jurisdiction to determine tax liability of a liquidating trust. The plan created a liquidating trust and authorized it to "request an expedited determination of taxes … under section 505(b) … for all returns filed for, or on behalf of, the [trust] for all taxable periods through the dissolution of the" trust. The IRS appeared at the confirmation hearing but did not object to this provision. The trustee filed tax returns for excise taxes related to a pension fund transaction, reporting no tax due and an income tax return for the trust reporting and paying tax. The trustee also filed with both returns a request with the IRS for a prompt determination under section 505(b). The trustee also filed a motion under sections 505(a) and 505(b) for a determination of the taxes due. Section 505(a) authorizes the bankruptcy court to determine the amount or legality of any tax. The plan provision to which the IRS did not object gives the trustee standing to seek the determination. However, section 505(a) does not apply to postconfirmation taxes, and the plan cannot confer jurisdiction. Therefore, the court does not have jurisdiction to determine the taxes under section 505(a). The court does not address whether section 505(b) applies to a liquidating trust. *In re Agway, inc.*, 412 B.R. 32 (Bankr. N.D.N.Y. 2009).

14.1.r. Postconfirmation sale that was approved preconfirmation is exempt from transfer taxes. The chapter 11 trustee obtained court approval for the sale of real property before plan confirmation. The trustee then proposed a "pot" plan that distributed the sale proceeds to administrative and priority

creditors, with the balance divided among unsecured claims. The property sales were necessary to funding the plan. Because of matters unrelated to the chapter 11 case's progress, the sales did not close until after plan confirmation. Section 1146(a) exempts a sale "under a plan confirmed under section 1129" from transfer taxes. In *Piccadilly Cafeterias, Inc.*, 128 S. Ct. 2326 (2008), the Supreme Court ruled that section 1146(a) does not exempt preplan sales from transfer taxes. In doing so, it established a bright line rule that applies the tax exemption to facilitate plan implementation if the court confirms a plan. Here, though the court approved the sale under section 363 before confirmation, the sale occurred after confirmation and was necessary to plan consummation and was therefore made "under a plan confirmed" and exempt from transfer taxes. *In re New 118th Inc.*, 398 B.R. 791 (Bankr. S.D.N.Y. 2009).

14.1.s. TEFRA requirement to determine partners' taxes at the partnership level does not preempt bankruptcy court jurisdiction under section 505(a) over a debtor partner's tax liability. Section 505(a) permits a bankruptcy court to determine the amount or legality of any tax of the debtor that has not been contested before and adjudicated by a judicial or administrative tribunal before bankruptcy. To defeat bankruptcy court jurisdiction, the tribunal must provide a full judicial-style review, even if before an administrative hearing officer, and the debtor must actually have litigated the matter. A default arising from the debtor's failure to bring an action within the deadline for doing so after a taxing agency's final determination of the tax does not preclude bankruptcy court jurisdiction. Complicating this provision for a partner debtor is the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), which requires that the partners' tax liability be determined at the partnership level and provides that any judicial review of an IRS partnership item determination be deemed to include all partners, whether or not they actually participate in the judicial proceeding. If one of the partners is in bankruptcy, however, the automatic stay prevents continuation of any such judicial proceeding. So the IRS has provided by administrative regulation and the courts have held that the debtor partner is severed from the judicial proceeding, and the debtor partner's liability based on partnership items may be determined separately in the bankruptcy court, whether under section 505 or otherwise. In this case, after an IRS Appeals Office review, the IRS issued a partnership item determination at the partnership level. Neither of the partners brought a proceeding for a judicial determination within the statutory deadline, but one of the partners filed bankruptcy some time after the deadline expired. The debtor in possession sought a determination of the partnership item in the bankruptcy court under section 505(a). Because the review process within the IRS Appeals Office more closely resembles a settlement conference than an administrative tribunal review, the partnership's participation before the Appeals Office did not preclude section 505(a) review. In addition, even though partnership items must generally be determined at the partnership level, when one of the partners is in bankruptcy, partnership items are as much a subject of section 505(a) review as the debtor's ultimate tax liability, and TEFRA does not deprive the bankruptcy court of jurisdiction over partnership items. Therefore, the bankruptcy court has jurisdiction under section 505(a) to determine the debtor's tax liability based on the disputed partnership items. *Central Valley Ag Enterps. v. U.S.*, 531 F.3d 750 (9th Cir. 2008).

14.1.t. Section 1146(a) does not exempt a preplan sale from stamp taxes. The debtor in possession agreed to sell substantially all the estate's assets as a going concern in a section 363(b) sale. As part of the negotiations for consent to the sale, the debtor reached a global settlement agreement concerning proceeds distribution with representatives of its secured and unsecured creditors. The debtor filed a plan embodying the agreement 10 days after the sale closed. The court ultimately confirmed the plan. The order approving the sale exempted the sale from stamp taxes under section 1146(a), which provides, the "making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax". The more natural reading of "under a plan confirmed under section 1129" is that the transfer must be authorized by a plan that has been confirmed under section 1129, rather than "in accordance with a plan confirmed under section 1129", without a temporal (*i.e.*, postconfirmation) requirement. The statutory context supports this reading, because the section appears in a subchapter entitled "Postconfirmation Matters". In addition, a preconfirmation transfer cannot be said to be "in accordance with" a plan that has not yet been drafted or filed, let alone confirmed. Rather, a preconfirmation transfer is made "in accordance with" or "under" section 363(b), not a plan. Finally, canons of statutory construction lead to the same reading. A statute limiting state taxation must be narrowly construed in the absence of a clear exemption, which this is not, and the Bankruptcy Code, though a remedial statute, balances many policies and therefore cannot be

liberally construed to favor the estate against state taxation. Although the reason for treating preconfirmation and postconfirmation transfers may not be readily apparent, such a distinction is not absurd and will not be overturned. Therefore, the property sale here is subject to state real property stamp taxes. *Fla. Dep't of Rev. v. Piccadilly Cafeterias, Inc.*, 554 U.S. ___, 128 S. Ct. 2326 (2008).

14.1.u. IRS may offset tax NOL carryback refund for year ending postpetition against prepetition taxes. Creditors filed an involuntary petition against parent and subsidiary debtors on December 19. Upon the close of the debtor's tax year 11 days later, the trustee filed an unconsolidated tax return for the parent alone reflecting a substantial loss for the year just ended and carried back the loss to a prior year, resulting in a substantial refund entitlement. Later, the bankruptcy court ordered substantive consolidation of the parent and subsidiary debtors and two nondebtor subsidiaries retroactive to the petition date. The IRS refused to pay the refund because it asserted a setoff right against prepetition taxes the subsidiary owed. First, although I.R.C. section 6402 creates a setoff right, it does not override section 553, which determines the right's enforceability in bankruptcy. In addition, section 106(a)(4), which requires enforcement of an award against the United States be consistent with applicable nonbankruptcy law, and section 106(c), which provides for offset of claims by and against a governmental unit, do not override section 553. They operate only to waive sovereign immunity to permit the estate to offset claims against a governmental unit, not to change the standards of section 553 on the requirements for a valid setoff in bankruptcy. Second, the refund claim did not arise postpetition. A tax refund can usually be determined only after the tax year's close. Here, however, all but 11 days of the year had passed at the petition date, and "a substantial portion of [the parent's] losses probably took place and were reasonably ascertainable before the end of the … tax year." The losses and therefore the refund were rooted in the pre-bankruptcy past. The refund right was contingent and unliquidated until the year ended, but it existed and was therefore a prepetition right. Third, substantive consolidation alone only combined the assets and liabilities of the two entities and did not merge the two entities or determine that they are alter egos. However, the separate determination that the subsidiary was the parent's alter ego establishes the mutuality required for the IRS to offset the parent's refund against the subsidiary's taxes. *U.S. v. Carey (In re Wade Cook Fin. Corp.)*, 375 B.R. 580 (9th Cir. B.A.P. 2007).

14.1.v. Preplan sale is exempt from transfer taxes. The debtor in possession, in a sale arranged before bankruptcy, sold substantially all of the estate's assets, with the court's approval. Shortly after the sale, the debtor filed a plan, which provided, among other things, for distribution of sale proceeds. Section 1146(c) (now 1146(a)) exempts an asset transfer "under a plan confirmed under section 1129" from stamp or similar taxes. "Under a plan" should be read to mean "necessary to consummation of a plan," rather than "authorized by a plan." Otherwise, certain postconfirmation sales that are necessary to consummation but not directly authorized would not be exempt, contrary to Congress' intent to carry over the effect of Bankruptcy Act section 267. Although that section similarly exempted transactions "under any plan confirmed under this chapter [X]," courts interpreted it to include transactions that serve to execute or make effective a confirmed Chapter X plan. Once the temporal connection between sale and confirmation is broken, there is no reason to limit the exemption to postconfirmation sales. Here, the sale was necessary to the consummation of the plan that was filed and confirmed after the sale, so the sale was exempt. *Florida Dept. of Rev. v. Piccadilly Cafeterias, Inc. (In re Piccadilly Cafeterias, Inc.)*, 484 F.3d 1299 (11th Cir. 2007).

14.1.w. Court may not determine whether plan distributions are wages for tax purposes. During the chapter 11 case, the debtor in possession renegotiated the debtor's union contract. In exchange, it agreed to provide a distribution of securities to employees under the plan. Shortly before confirmation, it sought a declaratory judgment under section 505(a) that the distribution would not be "wages" subject to withholding taxes. The bankruptcy court did not have authority under section 505 to determine the characterization of the plan payments for tax purposes, which is a determination of the tax effects of the plan. Section 505 applies only to claims against the debtor or the estate, not to tax claims that may arise against the reorganized debtor. Moreover, section 1146(d), which permits a bankruptcy court to determine a plan's state or local tax effects, expressly excludes federal taxes. Section 505 is an exception to the exception in the Declaratory Judgment Act, 28 U.S.C. § 2201, that prohibits a declaratory judgment about tax liability. Therefore, the Declaratory Judgment Act prohibits the determination. *In re UAL Corp.*, 336 B.R. 370 (Bankr. N.D. Ill. 2006).

14.1.x. Motor fuel tax is both an excise tax and a trust fund tax. Illinois imposes a tax on fuel which it requires the fuel distributor to "collect at the time of distribution" of the fuel. Although the tax may be an excise tax, because it is imposed on a transaction, it is imposed on the buyer, not the seller. Federal law determines whether a tax is entitled to priority, but the federal courts may look to the state courts' own interpretation of the tax regime. Here, the Illinois Supreme Court had determined that the tax was imposed on the buyer. Therefore, even though the tax is an excise tax, it is "collected or withheld from and for which the debtor is liable in whatever capacity," as provided in section 507(a)(8)(C), and it is entitled to priority regardless of age. *Illinois Dep't of Revenue v. Hayslett/Judy Oil, Inc.*, 426 F.3d 899 (7th Cir. 2005).

14.1.y. A non-profit debtor's unemployment compensation reimbursement obligation is not a priority tax. Under New Jersey law, as authorized by Federal law, a nonprofit employer may choose not to make quarterly unemployment tax contributions but instead to reimburse the state if the state makes unemployment compensation payments to the nonprofit's terminated employees. The debtor's reimbursement obligation is not a tax that is entitled to priority. A tax is an involuntary exaction imposed for general public purposes. Unemployment contribution obligations are such an exaction, because the funds benefit the government generally, whether or not the nonprofit's employees are terminated. The reimbursement obligation, however, is imposed to repay the government for the actual cost of unemployment compensation directly related to the nonprofit's terminated employees and is not for general governmental purposes. *Reconstituted Comm. of Unsecured Creditors v. New Jersey Dep't of Labor (In re United Healthcare Sys., Inc.)*, 396 F.3d 247 (3d Cir. 2005).

14.1.z. Tax Injunction Act limited bankruptcy court's authority to interpret its own order. A sale order authorized a sale free and clear of all liabilities, including taxes. When the state revenue department sought to collect a tax based on pre-sale events from the buyer, the buyer sought declaratory and injunctive relief in the bankruptcy court. Although the bankruptcy court has jurisdiction to interpret the sale order, the Tax Injunction Act, 28 U.S.C. § 1341, limits its power to do so (though not its jurisdiction). Where the Bankruptcy Code grants specific authority to the bankruptcy court to consider taxes, such as section 1146(c), section 505, or the discharge, the Tax Injunction Act does not limit the court. However, the general power to interpret orders and to authorize the sale of property under section 363 is not sufficiently specific to take priority over the Tax Injunction Act. *United Taconite, L.L.C. v. Minnesota (In re Eveleth Mines, L.L.C.)*, 318 B.R. 682 (B.A.P. 8th Cir. 2004).

14.1.aa. Nondebtor's property refinancing transaction under a plan is exempt from taxes under section 1146(c). The debtor was able to refinance its property to pay off its secured lender under its plan only if the nondebtor adjoining property owner also refinanced with the same new lender, who imposed the nondebtor refinancing as a condition to the plan. The plan contemplated the nondebtor refinancing, and the court confirmed. The nondebtor's refinancing was exempt from stamp taxes under section 1146(c), which exempts transfer "under a plan." "Under a plan" means authorized by or necessary to the consummation of the plan. The bankruptcy court had jurisdiction to determine the tax liability of the nondebtor, because the dispute involved a construction of a section of the Bankruptcy Code limiting taxes. *Florida v. T.H. Orlando Ltd. (In re T.H. Orlando Ltd.)*, 391 F.3d 1287 (11th Cir. 2004).

14.1.bb. IRS may refuse to consider chapter 11 debtor's offer in compromise. The chapter 11 debtor filed a plan providing for the adjustment of taxes owing to the IRS and, at the same time, proposed an offer in compromise to the IRS on IRS Form 656. The IRS refuses as a matter of discretionary policy to consider offers in compromise in bankruptcy cases, so the debtor brought an action against the IRS to require it to consider the offer on the merits, rather than reject it outright based on the pendency of the bankruptcy. The court refuses the requested relief on the ground that the IRS's refusal to consider the offer is not discrimination prohibited under section 525 because it is not with respect to "a license, permit, charter, franchise, or other similar grant." Section 105 does not provide a basis for relief, because a section 105 order directed against a governmental agency is in the nature of mandamus, an extraordinary remedy that is not proper when a matter is committed to the government's discretion, as consideration of an offer in compromise is. Finally, because the debtor proposed an adjustment in its plan of the taxes owing, the matter was referred to the Department of Justice, which is not governed by IRS rules and regulations on how to process offers to adjust or compromise tax liabilities. *1900 M Restaurant*

Assocs., Inc. v. United States (In re 1900 M Restaurant Assocs., Inc.), 319 B.R. 302 (Bankr. D.D.C. 2005). *Contra*, *In re Peterson*, 321 B.R. 259 (Bankr. D. Neb. 2004).

14.1.cc. Bankruptcy court may redetermine tax liability that has not been finally adjudicated before bankruptcy. Section 505(a) permits the bankruptcy court to determine the amount or legality of any tax asserted against the debtor, but prohibits the court from determining the amount or legality "if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title." In this case, the state taxing agency had adjudicated the debtor's tax liability, but its order had not yet become final, and the debtor had filed a motion for re-hearing, which was pending at the time of the commencement of the bankruptcy case. The Ninth Circuit concludes that the limitation on redetermination applies only if the state tax adjudication has become final before the commencement of the bankruptcy case. It also concludes that section 505(a)(2)(A) takes priority over the Full Faith and Credit Act, 28 U.S.C. § 1738, which requires federal courts to give preclusive (*res judicata*) effect to state court judgments to the same extent that the state court would do so. The court notes, however, that the bankruptcy court is not required to redetermine a tax and that the same factors that underlie the *res judicata* doctrine may persuade the bankruptcy court in the exercise of its discretion not to redetermine the debtor's liability. *Mantz v. California State Board of Equalization (In re Mantz)*, 343 F.3d 1207 (9th Cir. 2003).

14.1.dd. Pre-plan sales do not qualify for transfer tax exemption. Section 1146(c) exempts from documentary transfer taxes a sale "under a plan confirmed under section 1129." Here, the sale was made before confirmation of a plan under section 363 but were said to be necessary for the plan, and the plan retroactively authorized the transfers. The court rules that "under a plan" requires that the sales be authorized by the plan, not authorized under section 363, for the tax exemption to apply. *Baltimore County v. Hechinger Liquidation Trust (In re Hechinger Investment Co. of Delaware, Inc.)*, 335 F.3d 243 (3d Cir. 2003).

14.1.ee. Chapter 13 filing tolls three-year look-back for income tax dischargeability. The debtor had filed a chapter 13 within three years after an income tax return was due, entitling the tax claim to priority and non-dischargeability. The debtor later dismissed the chapter 13 case and filed a chapter 7 case more than three years after the tax return was due. The Supreme Court holds that the pendency of the chapter 13 case, which prevented the IRS from enforcing the tax claim against the debtor, tolled the three-year period of section 507(a)(8)(A). The Supreme Court characterized the three year period as a statute of limitations and applied the doctrine of equitable tolling to conclude that it would be inequitable to permit the statute to run while the IRS was prohibited from taking collection action. *Young v. United States*, 535 U.S. 43 (2002).

14.1.ff. Debtor's officers are personally liable for ERISA plan contributions. The debtor withheld ERISA plan contributions (401(k) and health insurance) from its employees pay, but did not pay over the amounts to the plan trustee, because it had insufficient funds. The debtor's funds were controlled by a working capital lender through a lock-box facility. Under ERISA, a plan fiduciary (one who exercises discretionary authority or control over management of the plan or its assets) is personally liable for any plan losses. The debtor's officers were ERISA plan fiduciaries and were therefore liable for the losses that the plan suffered as a result of their failure to pay over employee withholdings. *Dannistor v. Ullman*, 287 F.3d 395 (5th Cir. 2002).

14.1.gg. Use of NOL in consolidated tax return is not a "transfer." The debtor's corporate parent used the debtor's NOL's in preparing a consolidated tax return for pre-petition years. The debtor sought to recover from the parent the value to the parent of the use of the debtor's NOL's. The court rules that the parent's use of the NOL's was not a transfer of property of the debtor, because the Internal Revenue Code required application of the NOL's at the parent level, so the debtor did not have a property interest. Rather, the NOL's are merely hypothetical and do not constitute property. *Marvel Entertainment Group, Inc. v. MAFCO Holdings, Inc. (In re Marvel Entertainment Group, Inc.)*, 273 B.R. 58 (D. Del. 2002).

14.1.hh. Chapter 11 plan stamp tax exemption applies to pre-plan sales. Affirming the bankruptcy court, 254 B.R. 306 (Bankr. D. Del. 2001), the district court rules that sales before confirmation or even

proposal of a plan may get the benefit of the transfer tax exemption of section 1146(c), as long as the sales are an essential component of plan confirmation. *Baltimore County v. Hechinger Investment Co. (In re Hechinger Investment Co.)*, 276 B.R. 43 (D. Del. 2002).

14.1.ii. Pre-plan real property sales are exempt from transfer taxes under section 1146(c). The debtor sold real property during its chapter 11 case in order to position itself better for its liquidating plan, which it intended to file. Interpreting the language, "under a plan confirmed" in section 1146(c), the bankruptcy court rues that the language applies to a transfer that is an integral part of the plan process for a plan later confirmed, thereby excluding only transfers incidental to the debtor's business operations. *In re Hechinger Investment Co. of Delaware, Inc.*, 254 B.R. 306 (Bankr. D. Del. 2000).

14.1.jj. Fraudulent non-payment of tax does not create nondischargeable debt. The debtor failed to report taxes owing, but not in a fraudulent manner. Nevertheless, the debtor fraudulently transferred property to evade payment of the tax. Following its earlier decision in *In re Haas*, 48 F.3d 1153 (11th Cir. 1994), a panel of the Eleventh Circuit holds that fraudulent non-payment does not amount to a willful attempt "to evade or defeat such tax," as required by section 523(a)(1)(C). However the panel expresses substantial doubt about the scope of the Haas decision and suggests reconsideration of the case *en banc*. *Griffith v. United States (In re Griffith)*, 174 F.3d 1222 (11th Cir. 1999).

14.1.kk. Tax liability of the estate is not discharged under section 505(b). Section 505(b) permits the trustee to request a determination of "any unpaid liability of the estate for any tax incurred during the administration of the case." Upon resolution, the determination discharges "the trustee, the debtor, and any successor to the debtor" from liability. The court holds that the discharge does not apply to the estate, so the administrative expense claim of the IRS remains allowable. *In re Goodrich*, 215 B.R. 638 (Bankr. D. Mass. 1997).

14.1.ll. Bankruptcy court determines property tax liability. Under section 505(a), a bankruptcy court may determine the amount or legality of any tax, unless it was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before bankruptcy. A complaint filed in the state tax court that was withdrawn before litigation does not prevent the bankruptcy court from redetermining the tax, nor does the remoteness of the tax years from the date of the filing of the petition. *Custom Distribution Services, Inc. v. City of Perth Amboy Tax Assessor (In re Custom Distribution Services, Inc.)*, 216 B.R. 136 (Bankr. D.N.J. 1997)

15. CHAPTER 15—CROSS-BORDER PROCEEDINGS

15.1.a. Court authorizes turnover of documents. The court recognized the foreign proceeding as a foreign main proceeding. The foreign representatives sought turnover of documents under sections 542 and 543, through section 1521(a)(7), which permits the court, after recognition, to grant "any additional relief that may be available to a trustee, except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a)." Other courts have authorized foreign representatives to seek turnover under section 1521(a)(5), which permits the court to entrust "the administration or realization of all or part of the debtor's assets within the territorial jurisdiction of the United States to the foreign representative." However, sections 542 and 543 are not excluded from the form of additional relief that section 1521(a)(7) authorizes. Therefore, the Code does not prohibit the court from authorizing a foreign representative to seek turnover under those sections. Section 1522(a) conditions the grant of relief under section 1521 on sufficient protections of "the interests of creditors and other interested entities." Here, the court requires that the foreign representatives seek turnover only by noticed motion. The court applies the same condition on any discovery under section 1521(a)(4). *In re AJW Offshore, Ltd.*, 488 B.R. 551 (Bankr. E.D.N.Y. 2013).

15.1.b. Court may hear foreign nonmain proceeding representative's breach of fiduciary duty claim against directors. The court recognized a foreign proceeding as a foreign nonmain proceeding. The foreign representative of the foreign nonmain proceeding sued the debtor's former directors in the bankruptcy court for breach of fiduciary duty. The bankruptcy court had personal jurisdiction over the directors. Under section 1334(b), a bankruptcy court has jurisdiction over a proceeding that is related to a

case under title 11. Generally, an action is related to a title case if its outcome “could alter the debtor’s rights [or] liabilities … and impacts upon the handling and administration of the bankrupt estate.” In a chapter 15 case, the case itself substitutes for the concept of the estate. Alternatively, the court may consider the estate in the foreign proceeding. Under either view, the proceeding here is related to the chapter 15 case, because its outcome could alter the debtor’s rights and impacts administration of the chapter 15 case and the foreign proceeding estate. Section 1521(a)(5) permits a bankruptcy court to entrust to the foreign representative the administration of “the debtor’s assets within the territorial jurisdiction of the United States.” It limits the court’s in rem jurisdiction, which may substitute for personal jurisdiction over the defendant, to U.S. assets, but it does not address the liquidation of claims through litigation nor limit the court’s subject matter jurisdiction. The claim here does not implicate the court’s in rem jurisdiction, because the court has personal jurisdiction over the defendants. However, even if the claim did implicate the court’s in rem jurisdiction, the claim is located within the United States. Determining where the claim is located here does not require the court to issue a ruling on claims against a res that would bind the world. Where the court has subject matter jurisdiction over the claim and personal jurisdiction over the parties, the claim is present in the court and therefore within the territorial jurisdiction of the United States. *British Am. Ins. Co. Ltd. v. Fullerton (In re British Am. Ins. Co.)*, 488 B.R. 205 (Bankr. S.D. Fla. 2013).

15.1.c. Absent manipulation, court must determine COMI at time of chapter 15 petition. The British Virgin Islands-incorporated investment fund maintained its registered office, agency and secretary and its corporate documents in the BVI but was managed by its New York-based investment manager. It had no directors in the BVI, and its principal (over 95%) investments were in New York, in a Ponzi scheme. When the scheme unraveled, the fund immediately suspended operations and redemption, and its directors focused on winding down the business. The directors held numerous telephonic board meetings initiated by the fund’s registered agent in the BVI, and its correspondence with its shareholders originated in the BVI. The fund’s shareholders obtained the appointment of a liquidator about seven months after the fund ceased operations. One year later, the liquidator filed a chapter 15 recognition petition in New York. A bankruptcy court may recognize a foreign proceeding “as a foreign main proceeding if it is pending in the country where the debtor has the center of its main interests”. The statute uses the present tense, suggesting that the court test COMI as of the chapter 15 petition date, not as of an earlier time. Using a single point in time, rather than reviewing the history of the debtor’s operations, furthers the statutory goal of promoting certainty corresponding to the regular place where creditors can ascertain the debtor conducts its business. However, courts may review a broader time period to guard against possible bad-faith COMI manipulation between the commencement of the foreign proceeding and of the chapter 15 case. All business activities are relevant, including liquidation activities and administrative functions, depending on each case’s facts. Here, the debtor’s sole business for seven months before the foreign proceeding and for 19 months before the chapter 15 petition was liquidation, which was conducted primarily in the BVI by a BVI liquidator. Therefore, the debtor’s COMI was the BVI, and the BVI proceeding was a foreign main proceeding. *Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, ___ F.3d ___, 2013 U.S. App. LEXIS 7608 (2d Cir. Apr. 16, 2013).

15.1.d. Foreign proceeding’s secrecy is not a ground for denying recognition. A British Virgin Islands court placed the debtor into liquidation and appointed a liquidator. The liquidator filed a chapter 15 recognition petition in New York. The BVI court conducts its proceedings in secret, but public summaries of proceedings are available, and the BVI court may permit non-parties access to sealed documents. Section 1506 permits a court to refuse recognition “if the action would be manifestly contrary to the public policy of the United States”. Because the statute uses “manifestly”, courts should construe the public policy exception narrowly and apply it only in exceptional circumstances. Though the United States places great importance on the public nature of judicial proceedings, U.S. courts also permit confidential proceedings and matters to be filed under seal. Thus, unfettered access to court records is not absolute or a fundamental right. Therefore, the BVI proceeding’s confidentiality is not manifestly contrary to U.S. public policy. *Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, ___ F.3d ___, 2013 U.S. App. LEXIS 7608 (2d Cir. Apr. 16, 2013).

15.1.e. Comity prevents bankruptcy court from examining the conduct of a foreign proceeding. A Canadian creditor sued a French debtor in a French court and in a Canadian court. Before the French court

reached a decision, the debtor filed a French *sauvegarde* (reorganization) proceeding, creating, according to French law, an automatic stay with international effect. Despite the stay, the Canadian court issued judgment against the debtor. The creditor domesticated the judgment in Florida, obtained a writ of execution and caused the sheriff to seize a vessel owned by the debtor. The French foreign representative then filed a chapter 15 petition for recognition, which the Florida bankruptcy court granted. The French foreign representative sought an order entrusting the vessel to him. The creditor opposed and sought discovery of proceedings in the *sauvegarde* case to show that the French court did not treat the creditor fairly in that case. Section 1521(a)(5) permits a bankruptcy court, after recognition, to grant any appropriate relief to a foreign representative, including entrusting the administration of the debtor's property in the United States to the foreign representative, and section 1521(b) permits the court to entrust distribution of the property to the foreign representative if "the interests of creditors in the United States are sufficiently protected". Section 1522(a) permits the court to grant such relief, however, "only if the interests of creditors and other interested entities, including the debtor, are sufficiently protected". Taken together, these sections provide that a bankruptcy court may not entrust distribution unless local creditors are protected but has discretion to ensure that foreign creditors are protected. The creditor here is a foreign creditor, despite its domestication of its judgment in the United States. Therefore, the bankruptcy court may consider protection of the creditor's interests. However, in doing so, it is subject to section 1507, which requires the court to consider principles of comity. Comity permits the court to determine whether the foreign law in general sufficiently protects a particular creditor's interest, but it does not permit the court to determine whether a particular proceeding under that law protects that creditor's particular interest. Otherwise, the bankruptcy court would be acting effectively as an appellate court over the foreign court. Therefore, the bankruptcy court may not order discovery about the conduct of the *sauvegarde* case. *SNP Boat Serv. S.A. v. Hotel Le St. James*, 483 B.R. 776 (S.D. Fla. 2012).

15.1.f. 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.g. 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.h. 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.i. 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.j. 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.k. 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).

15.1.l. A Bermuda hedge fund's COMI was in Bermuda. A Bermuda-incorporated investment fund's registered office, two of its three directors, its administrator, its bank account, its custodian and its auditor were located in Bermuda. Its fund manager was located in Guernsey, its investment manager was "based in" London, its prime brokerage accounts were in London and New York, its valuation agent was located in the United States and substantially all of its funds were invested outside of Bermuda. The fund's offering documents described it as exclusively Bermudan and stressed that the fund was not to be resident in the United Kingdom for tax purposes. All subscriptions and withdrawals were through Bermuda and a Bermudan bank. The fund commenced liquidation proceedings in Bermuda, where Bermudan joint liquidators were appointed and conducted the liquidation proceedings. The joint liquidators sought recognition under chapter 15 more than two years after the opening of the Bermudan liquidation proceedings to investigate and prosecute claims against a U.S. company. The court may grant recognition to a foreign proceeding as a foreign main proceeding if it is pending in the jurisdiction "where the debtor has the center of its main interests" (COMI). To determine COMI, courts look at the location of the debtor's headquarters, of those who manage the debtor, of the debtor's primary assets and of where the majority of the affected creditors

are, at the jurisdiction whose law would apply to most disputes and at the expectations of creditors and other parties in interest, that is, where third parties might ascertain the debtor's COMI was. Here, the second, third and fourth location factors favor COMI in the United Kingdom, but the first location factor and the applicable law factor favor Bermuda. Two of the debtor's directors resided in Bermuda and the corporate books and records were maintained and audited there, pointing to Bermuda as the debtor's headquarters. Bermuda law governed the debtor's establishment and operation, and Bermuda was the only place where creditors might have ascertained as the debtor's COMI. Therefore, the fund's COMI is in Bermuda, and the court grants recognition. *In re Millennium Global Emerging Credit Master Fund Ltd.*, 474 B.R. 88 (S.D.N.Y. 2012).

15.1.m. The court may grant a foreign representative discovery in the U.S. concerning non-U.S. property. The foreign representatives in a foreign main proceeding that had been granted recognition by the bankruptcy court sought discovery from the debtor investment fund's U.S. broker of documents concerning the debtor's accounts that the broker had provided to the S.E.C. The discovery related to a proceeding that the foreign representatives had brought against the debtor's principals in the U.K., but not to property of the debtor in the U.S. or to its recovery. The documents were generated by the broker's Spanish affiliate but were in the U.S. broker's possession and control. Section 1521(a)(4) authorizes the court to issue an order for "the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities." Section 1507(a) permits the court to "provide additional assistance to a foreign representative", including making Rule 2004 applicable in the case. Under these provisions, the court may order discovery of information located in the U.S., even when it does not concern property in the U.S. The provisions provide an independent basis for assisting a foreign representative in gathering information in the U.S. Therefore, the court orders the broker to provide the information to the foreign representatives. *In re Millennium Global Emerging Credit Master Fund Ltd.*, 471 B.R. 342 (Bankr. S.D.N.Y. 2012).

15.1.n. A Mexican debtor may designate its foreign representative. Before commencing a *concurso mercantil*, a Mexican debtor appointed a Mexican individual to be its foreign representative in the proceeding. The debtor commenced the *concurso*, and the individual sought recognition of the proceeding in the U.S. Section 1515 permits a foreign representative to file a recognition petition. Section 1517 requires recognition if, among other things, the petitioner is a "foreign representative". Section 101(24) defines foreign representative as "a person or body … authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding". Thus, whether a person is a "foreign representative" within the definition is a matter of U.S., not foreign, law. The phrase "authorized in a foreign proceeding" does not require the foreign court's approval, as the phrase can be read to mean "authorized in the context of a foreign proceeding". In a *concurso*, the debtor remains in possession, as in a chapter 11 case. It is authorized to administer the reorganization of its assets and affairs. Accordingly, the debtor may appoint the foreign representative, and the foreign representative is entitled to recognition if the other recognition requirements are met. *Ad Hoc Group of Vitro Noteholders v. Vitro, S.A.B. de C.V. (In re Vitro, S.A.B. de C.V.)*, 470 B.R. 408 (N.D. Tex. 2012).

15.1.o. Court grants comity to Mexican order and stays against foreign debtor's nondebtor parent. A Mexican debtor commenced an insolvency proceeding in Mexico. The Mexican court issued an order staying action against the debtor and against its shareholder, who had guaranteed its debts. The foreign representative obtained recognition of the Mexican proceeding. The major lender then commenced an action in the U.S. against the shareholder to collect on the guarantee. The foreign representative moved in the action for a stay of the proceeding based on the Mexican court's stay order and comity. Section 1509(b)(2) permits a foreign representative who has received recognition to apply directly to a U.S. court for appropriate relief. Section 1524 permits a recognized foreign representative to "intervene in any proceeding in a State or Federal court in which the debtor is a party". Section 1524 does not limit section 1509(b)(2)'s scope: a foreign representative may apply to a U.S. court for relief even if the debtor is not a party to the proceeding in which the foreign representative seeks relief. Section 1509(e) makes the foreign representative "subject to applicable nonbankruptcy law", whether or not a bankruptcy court recognizes the foreign representative. Section 1509(e) is, like 28 U.S.C. § 959, intended to make the foreign representative comply with U.S. law while acting in the U.S., not to limit the foreign representative's rights under section 1509(b)(2) to apply for relief. Therefore, the foreign representative need not comply with Fed. R. Civ. Proc. 24 regarding intervention to apply for relief. Section 1509(b)(3) requires a U.S. court to grant

comity to the foreign representative. Section 1506 permits the court to deny relief if relief would be "manifestly contrary to the public policy of the United States". Bankruptcy courts frequently issue stays of action against a debtor's nondebtor affiliates. Accordingly, granting comity and enforcing the Mexican court's order to stay action against the debtor's parent on the guarantee is not manifestly contrary to U.S. public policy. The court therefore grants comity and stays the proceeding. *CT Inv. Mgmt Co., LLC v. Carbonell*, ___ B.R. ___, 2012 WL 92359 (S.D.N.Y. Jan. 11, 2012).

15.1.p. Comity is based on whether foreign law governing a foreign proceeding, not the particular proceeding, protects foreign creditors' interests. A French corporation commenced a French safeguard proceeding—analogous to a chapter 11 case—in France. After the commencement of the safeguard proceeding, a Canadian creditor obtained a judgment against the French company and domesticated it in Florida. It sought seizure of the French company's assets in Florida. The French foreign representative commenced a chapter 15 case in Florida to protect the assets. The Florida bankruptcy court recognized the safeguard proceeding as a foreign main proceeding. The creditor sought discovery to determine whether its interests were fairly treated in the safeguard proceeding. Under section 1521, upon recognition, the court may grant any appropriate relief, including entrusting the administration of the debtor's assets located in the United States to the foreign representative and the distribution of those assets by the foreign representative if "the interests of creditors in the United States are sufficiently protected". In determining whether those interests are sufficiently protected, a court may review only the general operation of the laws governing the foreign proceeding, not whether the specific proceeding protected those interests. Such a review would set up the U.S. court as an appellate court over the foreign court. Therefore, the creditor is not entitled to discovery on conduct of the safeguard proceeding. *SNP Boat Serv. S.A. v. Hotel Le St. James*, 483 B.R. 776 (S.D. Fla. 2012).

15.1.q. Court applies section 365(n) in a chapter 15 case to prevent termination of technology licenses. The German debtor filed an insolvency proceeding in Germany. The German Insolvency Administrator obtained recognition under chapter 15 of the German proceeding as a foreign main proceeding. In the German proceeding, the Insolvency Administrator elected nonperformance of the debtor's intellectual property cross-license agreements with international technology companies that operated in the United States. Under German insolvency law, upon electing nonperformance, the Insolvency Administrator may prevent the licensees from using the licensed technology, contrary to the protection that section 365(n) gives licensees in a U.S. bankruptcy case. The U.S. licensees developed expensive factories that incorporated the licensed technology and could suffer major losses of sunk costs (although the court was unable to estimate how much the losses would be) or exposure to royalty demands if they did not receive protection in the chapter 15 case comparable to the protection that section 365(n) provides. Section 1509(b) requires a U.S. court, after recognition of a foreign proceeding, to grant comity and cooperation to the foreign representative. Section 1521(a) requires the court to grant "any appropriate relief", subject to the debtor's and creditors' rights being "sufficiently protected", which requires the court to balance the relief and the interests of those affected, without unduly favoring one group over another. Here, the Insolvency Administrator will realize less value if section 365(n) applies, but section 365(n) would not impose any affirmative obligation on him. By contrast, the licensees could lose substantial value in existing investments, so they are not sufficiently protected without application of section 365(n). Section 1506 permits the court to refuse to take action that "would be manifestly contrary to the public policy of the United States". A court may apply section 1506 when the foreign proceeding involves procedural unfairness or application of foreign law would "severely impinge the value and import of a U.S. statutory or constitutional right, such that granting comity would severely hinder United States bankruptcy courts' ability to carry out … the most fundamental policies and purposes of these rights." Congress enacted section 365(n) to protect American technology and evidences a strong U.S. policy favoring technological innovation. Failure to apply it in chapter 15 cases would "slow the pace of innovation, to the detriment of the U.S. economy", which "would severely impinge an important statutory protection … and thereby undermine a fundamental U.S. public policy. Therefore, the court applies section 365(n) and protects the licensees. *In re Qimonda*, 462 B.R. 165 (Bankr. E.D. Va. 2011).

15.1.r. Chapter 15 court denies injunction to protect debtor's nondebtor subsidiaries. A Mexican debtor issued U.S. bonds. Its Mexican and U.S. subsidiaries guaranteed the debt. During negotiations to restructure the bonds and all the guarantees, several bondholders filed involuntary chapter 11 petitions against several U.S. subsidiaries and filed state court collection actions in the U.S. against the parent and numerous non-U.S. subsidiaries and sought to attach their U.S. assets. The parent filed an insolvency

proceeding in Mexico and soon after filed a chapter 15 petition for recognition of the Mexican proceeding as a foreign main proceeding. Pending recognition, the parent moved the chapter 15 court to stay all collection actions against it and the subsidiaries. Section 1519 permits the court, pending determination of a recognition petition, to grant interim relief, including staying execution against the debtor's assets and relief referred to in section 1521(a)(7), which, after recognition, permits "any additional relief that may be available to a trustee" (with certain exceptions). Section 1519's list of relief is not exclusive, so the court may issue a stay during the recognition gap period that is co-extensive with the automatic stay of section 362. The Mexican parent, which was subject to the chapter 15 petition, showed adequate cause for the injunction, which the court grants. Availability of comparable relief for the nondebtor subsidiaries requires they meet the four-part test for an injunction: likely success on the merits, irreparable injury, balance of equities and the public interest. Success on the merits in this context is measured by the likely outcome of the litigation sought to be stayed. Here, the evidence was divided. Irreparable harm may equate to lack of an available remedy at law. The subsidiaries could file insolvency proceedings in the U.S. or in Mexico, which would provide them the protection they seek. In addition, an injunction would harm the bondholders, because they would be remitted to the Mexican legal system to pursue their claims in the insolvency proceeding, despite the bonds' intent that disputes be resolved in U.S. courts. Finally, an injunction would not be in the public interest, because it would protect nondebtors, contrary to the important bankruptcy law principle that the Code generally protects only debtors, and would invite other foreign debtors to file insolvency proceedings in their home jurisdictions only for the parent and seek protection for their subsidiaries in the U.S. without filing insolvency proceedings in either jurisdiction. Therefore, the court denies the injunction. *Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.)*, 455 B.R. 571 (Bankr. N.D. Tex. 2011).

15.1.s. COMI is determined as of the date of opening of the foreign proceeding. A Bermuda-incorporated hedge fund commenced liquidation proceedings in Bermuda, where Bermudan joint liquidators were appointed and conducted the liquidation proceedings. The joint liquidators sought recognition under chapter 15 more than two years after the opening of the Bermudan liquidation proceedings to investigate and prosecute claims against a U.S. company. The court may grant recognition to a foreign proceeding as a foreign main proceeding if it is pending in the jurisdiction "where the debtor has the center of its main interests" (COMI). COMI has essentially the same meaning as "principal place of business". Once a liquidation proceeding is commenced, the debtor no longer has a principal place of business nor any interests. Only the liquidator does. Former section 304 looked to the debtor's principal place of business as of the opening of the foreign proceeding, among other things, to determine whether to grant comity to the foreign proceeding. The European Insolvency Regulation also looks only to the debtor's COMI as of the opening of the initial insolvency proceedings to determine whether to recognize a proceeding commenced in another nation of the EU. Using the date of opening of insolvency proceedings promotes certainty and the ability of third parties reasonably to ascertain in advance, while they are dealing with a debtor, where a debtor's COMI is located and reduces the possibility of forum shopping. Therefore, the court determines the debtor's COMI for purposes of chapter 15 recognition as of the date of the opening of the foreign proceeding. *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011).

15.1.t. A Bermuda hedge fund's COMI was in Bermuda. A Bermuda-incorporated investment fund's registered office, two of its three directors, its administrator, its bank account, its custodian and, its auditor were located in Bermuda. It fund manager was located in Guernsey, its investment manager was "based in" London, its prime brokerage accounts were in London and New York, its valuation agent was located in the United States and substantially all of its funds were invested outside of Bermuda. The fund commenced liquidation proceedings in Bermuda, where Bermudan joint liquidators were appointed and conducted the liquidation proceedings. The joint liquidators sought recognition under chapter 15 more than two years after the opening of the Bermudan liquidation proceedings to investigate and prosecute claims against a U.S. company. The court may grant recognition to a foreign proceeding as a foreign main proceeding if it is pending in the jurisdiction "where the debtor has the center of its main interests" (COMI). There is a rebuttable presumption that the debtor's COMI is where its registered office is located. Here, many of the facts point toward Bermuda as the debtor's COMI; others point in various directions. However, the debtor's employment of agents, such as the fund manager and investment manager, or the location of its investments, should be given less weight. Of greater importance is whether the COMI is

readily ascertainable by third parties. Here, the fund's offering memorandum made clear that the fund was located in Bermuda (leading investors to believe that any winding up would occur in Bermuda) and subject to a Bermuda-based board of directors, and investors sent their investments in the fund to Bermuda. Therefore, the fund's COMI is in Bermuda, and the court grants recognition. *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011).

15.1.u. A foreign representative's withdrawal of a chapter 15 petition should not prevent the court from determining COMI. The Italian trustee appointed in an involuntary bankruptcy of a U.S. debtor in Italy sought recognition of the Italian proceeding in the U.S. under chapter 15. Upon encountering opposition, the Italian trustee withdrew the chapter 15 petition. The court may nevertheless determine the debtor's COMI. Without such a determination, the foreign representative, if he encountered opposition in one jurisdiction, could withdraw the recognition petition and forum shop to find a jurisdiction that would recognize the foreign proceeding as a foreign main proceeding. A court should not facilitate such conduct. *In re Think3*, Case no. 11-11925-hcm (Bankr. W.D. Tex. Sept 12, 2011).

15.1.v. Court waives disclosure of creditor claim information in foreign representative's chapter 11 case. A foreign bank supervisory body placed a local bank into an administration proceeding and appointed an External Administrator. In the foreign proceeding, the External Administrator had obtained creditor and claim information under a confidentiality agreement with the creditors. The External Administrator obtained recognition under chapter 15 of the foreign proceeding. Sometime later, the External Administrator filed a chapter 11 case for the debtor. The External Administrator filed a statement of affairs and schedules of assets and liabilities, including a list of the names and addresses of all creditors, but did not list the amount owed to each creditor. Section 521(a)(1)(B) requires the debtor to file a schedule of assets and liabilities, unless the court orders otherwise. Courts dispense with full schedules in fully prepackaged chapter 11 cases and with certain other disclosure requirements, such as the filing of "payment advices" in consumer cases where appropriate. Chapter 15 requires that after recognition of a foreign proceeding, the court grant comity and cooperation to the foreign representative, permits the foreign representative to file a plenary case under the Bankruptcy Code and restricts the scope of the plenary case to the debtor's assets that are located in the United States. Respect for the confidentiality agreement with the creditors in the foreign proceeding and the lack of any apparent need for the claim information justifies excusing the foreign representative from filing the claim information in the schedule of liabilities. *Charles Russell, LLP v. HSBC Bank USA, N.A. (In re Awal Bank, BSC)*, 455 B.R. 73 (Bankr. S.D.N.Y. 2011).

15.1.w. Court denies foreign representative an email redirection order. The individual debtor was the subject of an insolvency proceeding in Germany. The debtor refused to cooperate with the insolvency administrator and absconded. The debtor had no assets or place of business in the U.S. His only connection with the U.S. was that he maintained two email addresses with U.S.-based internet service providers (ISPs). In Germany, it is common practice for the German court to order redirection of the debtor's mail to the insolvency administrator, which the German court did in this case. The insolvency administrator sought recognition under chapter 15 without notice to the debtor and an order directing the ISPs to disclose to the administrator all past and future emails in the debtor's account. Section 1521(a)(4) permits the court to authorize a foreign representative to undertake "the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities". This authorizes the court to recognize a foreign proceeding where the debtor has no contacts with the United States and the sole purpose of the chapter 15 case is to gather evidence. Section 1507 permits the court to grant "additional assistance" that is available under the Bankruptcy Code or "other laws of the United States". However, section 1506 restricts the relief available under both sections to relief that is not "manifestly contrary to the public policy of the United States". The restriction should be narrowly construed. For example, to enforce an order of the foreign court, the U.S. court need not determine that U.S. law would permit the same relief or that U.S. law and the foreign law are substantial the same. Rather, section 1506 applies only when fundamental U.S. policies are at stake. The Electronic Communications Privacy Act, the Stored Communications Act and the Wiretap Act all place substantial restrictions on the ability of even law enforcement officials to obtain access to emails from an ISP and criminalize certain access attempts. Moreover, a U.S. bankruptcy trustee does not have the power to access an individual debtor's emails; a trustee's investigatory and discovery authority are substantially more limited. Such

restrictions are sufficient to render enforcement of the German court's email redirection order manifestly contrary to U.S. public policy. In addition, Rule 2002(q)(1) requires notice to the debtor of a recognition petition, which was absent here. Therefore, the court denies recognition without prejudice to a later petition on notice to the debtor. *In re Toft*, 453 B.R. 186 (Bankr. S.D.N.Y. 2011).

15.1.x. Setoff avoiding power is available in chapter 15. A foreign bank supervisory body placed a local bank into an administration proceeding and appointed an External Administrator. In the foreign proceeding, the External Administrator had obtained creditor and claim information under a confidentiality agreement with the creditors. The External Administrator obtained recognition under chapter 15 of the foreign proceeding to pursue a single asset in the United States, a claim against a U.S. bank for an improper or avoidable setoff. Sometime later, the External Administrator filed a chapter 11 case for the debtor. The External Administrator filed an adversary proceeding against the bank to avoid the setoff under section 553(a). Section 1521(a)(7) permits the court to grant the foreign administrator "any additional relief … except for relief available under sections 522, 544, 545, 547, 548, 550 and 724(a)". Thus, section 1521(a)(7) does not permit a foreign representative to pursue avoiding power claims in general without filing a plenary case. But section 553's setoff avoiding power is not included in the list. As a result, a foreign administrator may seek to avoid a setoff under section 553. Moreover, the foreign administrator commenced a chapter 11 case, bolstering his ability to pursue the claim. Section 553(a) permits the trustee to avoid certain setoffs made within 90 days before the date of the filing of the petition. Section 101(42) defines "petition" to include petition for recognition under section 1508. Therefore, the foreign representative may use that date (rather than the date of recognition), even in the later chapter 11 case. Otherwise, the reachback period might run while the court determined whether to grant recognition. Moreover, section 1523(a) gives the foreign representative standing to bring avoiding power actions upon commencement of a plenary case. Such standing would be impaired if the petition date for purposes of applying the avoiding powers were the later plenary case filing date. Finally, the administration of the chapter 15 case and the chapter 11 case should be coordinated, and the filing of the chapter 11 case should be viewed in a manner that is similar to a conversion of the case from chapter 15 to chapter 11, thus preserving the date of the filing of the petition, as provided under section 348. *Charles Russell, LLP v. HSBC Bank USA, N.A. (In re Awal Bank, BSC)*, 455 B.R. 73 (Bankr. S.D.N.Y. 2011).

15.1.y. Section 108(a) applies in a chapter 15 case. The court recognized a foreign main proceeding. After obtaining recognition, the foreign representatives moved for an order granting relief under section 108, to toll any statutes of limitation that would apply against the foreign representatives, and setting the recognition order date as the date of the "order for relief" for purposes of applying section 108. They gave notice of the motion to all creditors, shareholders, directors, investment managers and service providers of the foreign debtor and to each party that had filed a notice of appearance in the case, but did not specify in any notices the claims for which or the parties against whom they sought application of section 108. Section 108(a) provides that if a statute of limitations "fixes a period within which the debtor may commence an action, and such period has not expired before the date of the filing of the petition, the trustee may commence such action … within two years after the order for relief". Section 103(a) provides that chapter 1 applies in a case under chapter 15. However, chapter 15 does not contemplate an "order for relief" nor appointment of a "trustee", although section 1502(6) provides, "'trustee' includes a trustee, debtor in possession in a case under any chapter of this title, or a debtor in a case under chapter 9 of this title". "Includes" is not limiting, and a foreign representative is indistinguishable from a trustee for purposes of applying section 108(a) to provide the entity stepping into the debtor's shoes time to evaluate potential causes of action. Section 1520 supports this reading, because it exempts from the automatic stay actions against the debtor in a foreign country, implying that section 108 applies to protect a creditor who has a claim against the debtor and is stayed from proceeding in the U.S. The recognition date, rather than the petition date, is the appropriate date for applying section 108, because it is analogous to the order for relief, marking a determination that the case should proceed. *In re Fairfield Sentry Ltd.*, 451 B.R. 52 (Bankr. S.D.N.Y. 2011).

15.1.z. An Australian liquidation is recognized as a foreign main proceeding, despite the pendency of a parallel receivership proceeding. An Australian corporation entered into voluntary administration proceedings in Australia. The corporation's bank lenders were secured by substantially all of the corporation's assets. The commencement of the administration proceedings defaulted the

corporation's loan agreement with its banks, who then commenced a receivership proceeding for the corporation. Later, the corporation's creditors resolved to wind up the corporation and appointed the administrators as liquidators, who commenced winding up proceedings. The administrators filed a chapter 15 recognition petition in the U.S. and continued the proceeding after they were appointed as liquidators. Based on *In re Betcorp Limited*, 400 B.R. 266 (Bankr. D. Nev. 2009), the petitions meet the seven requirements for recognition of the Australian liquidation proceeding as a foreign main proceeding. The pendency of the receivership proceeding does not change the result. Although the banks control the receiver, who took possession of substantially all the assets for the banks' sole benefit, the liquidation proceeding remains a collective proceeding, and Australian law provides for concurrent existence of the two proceedings as separate and distinct, each confined to its proper sphere. Therefore, the court grants recognition. *In re ABC Learning Centres*, 2010 Bankr. LEXIS 4091 (Bankr. D. Del. Nov. 16, 2010), *reconsideration granted in part, denied in part*, 445 B.R. 318 (Bankr. D. Del. Jan. 21, 2011)

15.1.aa. Court denies turnover to a foreign representative of property subject to a U.S. attachment that is not patently wrongful or avoidable under foreign law. A non-U.S. creditor obtained a judicial attachment against the debtor's cash in a New York bank account. The sheriff levied on the bank. The debtor commenced insolvency proceedings in Bahrain, which the court recognized as a foreign main proceeding. The Bahraini administrator sought release of the attached fund to be administered in Bahrain. The New York attachment created a judicial lien. Bahraini law permits avoidance of an attachment in certain circumstances, which were not patent here. Chapter 15 encourages judicial deference to foreign insolvency proceedings. Section 1521(a)(5) permits the court to entrust the administration and, if "the court is satisfied that interests of creditors in the United States are sufficiently protected", the distribution of assets, to the foreign representative. Creditors in the United States, not just U.S. creditors, are entitled to such protection. In addition, a secured creditor is entitled under section 361 to adequate protection. Turnover may be necessary to permit administration and distribution, but it is a discretionary remedy. The court should not order turnover where turnover would result in release of an attachment lien, unless the attachment occurred after the commencement of the foreign proceeding or was plainly wrongful under the foreign law. Because the attachment is not patently voidable under Bahraini law, the court denies turnover and orders the parties to seek a ruling from the Bahraini court on the voidability of the lien. *In re Int'l Banking Corp. B.S.C.*, 439 B.R. 614 (Bankr. S.D.N.Y. 2010).

15.1.bb. Chapter 15's automatic stay does not have extraterritorial reach. The debtor was a foreign bank in a rehabilitation proceeding in its center of main interest. A Swiss bank with no U.S. contacts brought an arbitration proceeding against the debtor in Switzerland to collect on a loan. The debtor's foreign representative obtained recognition of the foreign proceeding under chapter 15. The foreign representative sought to hold the Swiss bank in contempt for violating the automatic stay by pursuing the arbitration. Section 1520(a)(1) provides that upon recognition of a foreign main proceeding, "sections 361 and 362 apply with respect to the debtor and the property of the debtor that is within the territorial jurisdiction of the United States". Section 1508 requires the court, in interpreting chapter 15, to consider its international origin. Chapter 15 is intended to facilitate international cooperation in and coordination of cross-border insolvency proceedings. A chapter 15 case is ancillary to a foreign proceeding and has a narrower purpose and reach than a plenary case, and there is no estate. Literally, section 1520(a)(1) could be read to apply the automatic stay to the debtor worldwide, because the phrase "that is within the territorial jurisdiction" applies only to the debtor's property, not to the debtor. However, because of chapter 15's international and ancillary purpose, the territorial jurisdiction limitation is central to its interpretation and application. Therefore, the court should interpret section 1520(a)(1) to apply to an action against the debtor only where the action would affect property within the territorial jurisdiction of the United States. To hold otherwise would establish a United States bankruptcy court in an ancillary proceeding as the gate-keeper of all litigation worldwide for a foreign debtor, despite the primacy of the foreign proceeding court in liquidating or rehabilitating the debtor. Based on this interpretation, the Swiss bank's action did not violate the automatic stay in the chapter 15 case. *In re JSC BTA Bank*, 435 B.R. 334 (Bankr. S.D.N.Y. 2010).

15.1.cc. 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.dd. 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.ee. 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).

15.1.ff. An insurance company's insolvency proceeding that gives priority to customer claims is a collective proceeding and qualifies as a foreign proceeding. Insolvency administrators were appointed in several Caribbean jurisdictions, including the Bahamas and Saint Vincent and the Grenadines (SVG), for a Bahamian-registered insurance company and its subsidiaries in those other jurisdictions. Both the Bahamian and SVG insurance laws require an insolvent insurance company's administrator to place policy holders' interests ahead of the interests of general creditors. In these cases, it did not appear that general creditors would receive any recovery, and the administrators therefore focused almost exclusively on policy holders' claims and rights. Both administrators sought recognition under chapter 15 of their

respective proceedings. Chapter 15 permits recognition of a foreign proceeding, which is a "collective judicial or administrative proceeding in a foreign country" under a foreign insolvency law to reorganize or liquidate the debtor. A collective proceeding is distinguished from a receivership, for example, in which the proceeding is for the sole benefit of a single or limited group of creditors. In these cases, although the administrators focused on policy holders rather than all creditors, the applicable law recognizes that the proceeding may be for the benefit of general unsecured creditors as well, if there is adequate value to reach their claims. Therefore, the proceedings qualify as foreign proceedings. *In re British Am. Ins. Co. Ltd.*, 425 B.R. 884 (Bankr. S.D. Fla. 2010).

15.1.gg. Court refuses recognition as a foreign main proceeding of a foreign proceeding pending in the debtor's jurisdiction of registration, where the debtor conducted no business. A Bahamian insurance company entered into a services agreement with its Trinidad-based subsidiary to provide all administrative, marketing, information technology, investment, actuarial and legal services for the parent. It conducted business throughout the Caribbean, including in Saint Vincent and the Grenadines (SVG), through subsidiaries in each local jurisdiction. It did not have any activities in the Bahamas: it did not issue insurance policies there, did no claims processing or adjustment and had no employees or bank account in the Bahamas. Its only pre-insolvency contact there was that it was chartered and had a registered agent in the Bahamas. Insolvency administrators were appointed in several Caribbean jurisdictions, including the Bahamas and SVG. The local courts each charged the administrators with developing a plan to sell, continue the business of or wind up the various local entities. The Bahamian administrator supplanted the parent's board of directors, whose members had resigned, and took over supervision, from the Bahamas, of the business and the insolvency proceedings. He hired professionals, investigated the debtor, pursued assets and developed a plan, among other things, from the Bahamas, but he continued to use the Trinidadian company's services to conduct all insurance business. The SVG administrator undertook similar activities in SVG, but limited only to the SVG subsidiary. A court must recognize a foreign proceeding as a foreign main proceeding if it is pending in the jurisdiction that is the debtor's center of main interests (COMI). Courts consider, among other things, the location of the debtor's headquarters, of those who actually manage operations, of the debtor's principal assets and creditors and of the law that would apply to most disputes, as well as third parties' expectations. The debtor's headquarters and therefore its COMI is more than the location of its board of directors. It is where the breadth of management tasks occur. In this case, all management tasks occur in Trinidad under the services agreement. COMI should be determined as of the date of the chapter 15 petition, not as of the date of the commencement of the foreign proceeding, to promote commercial certainty. Even though determined as of that later date, the activities of a foreign representative alone do not provide a basis for finding a debtor's COMI, and the court must look through to the actual business operations. Based on all the foregoing, the debtor's COMI is not in the Bahamas, and the court refuses recognition of the Bahamian proceeding as a foreign main proceeding. A court may recognize a foreign proceeding as a foreign nonmain proceeding only if the debtor has an establishment, that is, a place of business, in the jurisdiction where the foreign proceeding is pending. The debtor here did not conduct business in the Bahamas, and the administrator's activities do not amount to the conduct of business in the Bahamas sufficient for an establishment. The court therefore also refuses to recognize the Bahamian proceeding as a foreign nonmain proceeding. The court grants recognition, however, to the SVG proceeding as a foreign nonmain proceeding because the debtor conducted business in SVG before the insolvency proceedings. *In re British Am. Ins. Co. Ltd.*, 425 B.R. 884 (Bankr. S.D. Fla. 2010).

15.1.hh. Court denies recognition to the Israeli receiver of a debtor who moved his domicile to the U.S. The debtor conducted business in Israel until 1996, when his business failed. His creditors filed an involuntary bankruptcy petition against him there in 1997, and a liquidating receiver was appointed. The debtor left Israel shortly before the petition was filed and settled in the United States. He married a U.S. citizen, had five children in the U.S., worked and owned real property in the U.S., had assets only in the U.S., was a legal permanent resident of the U.S. and never returned to Israel. However, the debtor's principal assets were in Israel (until his relocation to the U.S.), all his creditors were in Israel and Israeli law governed their relations. In 2006, the Israeli receiver commenced a chapter 15 case in the U.S. and sought recognition of the Israeli bankruptcy proceeding as a foreign main proceeding or a foreign nonmain proceeding. A foreign main proceeding is a foreign proceeding pending in the country where the debtor has his center of main interests (COMI). For an individual, COMI is presumed to be the place of the

debtor's habitual residence, which roughly equates with domicile, but evidence may be introduced to rebut the presumption. COMI is determined as of the chapter 15 recognition petition date, not as of the date of the foreign proceeding petition. The statute reads in the present tense, and determining COMI as of the chapter 15 petition date provides certainty to those dealing with the debtor in the interval between the foreign proceeding and the chapter 15 petition. The debtor's domicile here as of the chapter 15 petition date was in the U.S. The Israeli receiver offered evidence about the location of the debtor's assets and creditors, but that was not sufficient to prove that the debtor's COMI was Israel. A foreign nonmain proceeding is a foreign proceeding pending where the debtor has an "establishment", which is "any place of operations where the debtor carries out nontransitory economic activity", again, as of the chapter 15 petition date, such as, for an individual, a place of business or employment or a secondary residence. The foreign proceeding itself is not a nontransitory economic activity. A bankruptcy proceeding by its nature is transitory. Further, the affairs of the estate are not the debtor's economic activity, because the receiver, at least for an individual debtor, is not the debtor's agent for the purpose of administering the bankruptcy. Otherwise, every foreign proceeding would be at least a foreign nonmain proceeding. Therefore, the court denies recognition. *Lavie v. Ran (In re Ran)*, 607 F.3d 1017 (5th Cir. 2010).

15.1.ii. Foreign liquidators' stay request in U.S. action requires prior recognition under chapter 15. A British Virgin Islands-incorporated money market fund filed an interpleader action in New York to bring about a final distribution of its assets. While the action was pending, a BVI court appointed joint provisional liquidators for the fund. The liquidators requested a stay of the New York action on the ground that upon their appointment, they supplanted the fund's board of directors and could act for the fund. Section 1517 requires that foreign representative obtain recognition under chapter 15 before applying to a court in the U.S. for relief. Chapter 15 recognition is a determination that the liquidators' appointment is valid and that they are authorized to act for the fund. Permitting the liquidators to seek a stay would constitute tacit recognition of their standing and authority, which may be done only through formal recognition under chapter 15. Therefore, the court denies the stay request. *Reserve Int'l Liquidity Fund, Ltd. v. Caxton Int'l Ltd.*, 2010 U.S. Dist LEXIS 42216 (S.D.N.Y. Apr. 29, 2010).

15.1.jj. Section 365 does not apply automatically in a chapter 15 case. The German debtor filed an insolvency proceeding in Germany. The German Insolvency Administrator obtained recognition under chapter 15 of the German proceeding as a foreign main proceeding. In the German proceeding, the Insolvency Administrator rejected intellectual property cross-license agreements with international technology companies that operated in the United States. German insolvency law does not protect intellectual property licensees as section 365(n) does in a U.S. bankruptcy case. The technology companies in the U.S. sought application of section 365(n) in the chapter 15 case so as to protect their intellectual property licenses in the U.S. Section 1520 specifies which Bankruptcy Code sections apply upon recognition of a foreign main proceeding. It does not list section 365, but it does list section 363. Section 363(*l*) permits sales of property of the estate, despite an *ipso facto* clause, but "subject to section 365". This cross-reference to section 365 in a single subsection of section 363 does not suffice to make section 365 generally or section 365(n) specifically apply automatically in a chapter 15 case. Section 1509(b)(3) requires the bankruptcy court to grant comity to a foreign representative. Therefore, the court need not balance interests as in a typical comity analysis, and prior precedents denying comity in cross-border bankruptcy cases no longer apply. But section 1506 permits the court to refuse to take action that would be "manifestly contrary to the public policy of the United States". Mere conflict between U.S. and foreign insolvency law does not require a finding that granting comity would be manifestly contrary to U.S. public policy. However, the court should not defer to a foreign proceeding where procedural fairness is doubtful nor take action in a chapter 15 case that would frustrate the ability to administer the case or severely impinge a U.S. constitutional or statutory right. On remand, the bankruptcy court should determine whether non-application of section 365(n) would violate U.S. public policy. *Micron Tech, Inc. v. Qimonda AG (In re Qimonda AG Bankr. Litig.)*, 433 B.R. 547 (E.D. Va. 2010).

15.1.kk. The bankruptcy court has jurisdiction to hear a foreign law avoiding power action by a recognized foreign representative. The bankruptcy court recognized the winding up of a Nevis insurance company as a foreign main proceeding. The foreign representatives filed an adversary proceeding to recover under Nevis law property that the debtor had transferred before the Nevis winding up proceeding. Section 1521 permits the bankruptcy court, after recognition, to "grant any appropriate relief, … except

for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a)". Section 1523 grants the foreign representative, upon recognition, standing to initiate actions under those sections in a case concerning the debtor under another chapter. Section 1521 does not, however, exclude actions under the avoiding powers of the law of the foreign proceeding. Application of foreign avoiding power law avoids choice of law issues and prevents a foreign representative from exploiting the seams between U.S. and foreign law that permitting pursuit of U.S. avoiding power actions without commencing a full U.S. bankruptcy case would permit. Finally, in enacting chapter 15, Congress did not intend to restrict a U.S. court's power to apply foreign law, which could protect a debtor who attempts to hide assets from the foreign representative in the U.S. Therefore, the foreign representative may pursue Nevis avoiding power actions in a chapter 15 case. *Fogerty v. Petroquest Res. Inc. (In re Condor Ins. Ltd.)*, 601 F.3d 319 (5th Cir. 2010).

15.1.ll. Court denies motion to dismiss involuntary chapter 7 case against chapter 15 debtor. A Canadian company and its U.S. subsidiary filed a CCCA proceeding in Canada. The Canadian monitor, who was appointed in both CCCA proceedings, sought recognition under chapter 15 of the U.S. subsidiary's proceeding. The bankruptcy court originally found, based on an uncontested record, that the U.S. subsidiaries place of incorporation and principal assets, employees and operations were in the U.S. but that its headquarters were in Canada. It therefore granted recognition of the CCCA proceeding as a foreign main proceeding, subject to a reservation to determine the allowability against the U.S. debtor of a large intercompany claim by its Canadian parent. However, it later questioned its finding that the headquarters were in Canada. Three U.S. creditors filed an involuntary chapter 7 petition against the U.S. subsidiary. The Canadian monitor moved to dismiss under section 305, which permits dismissal in a chapter 15 case if "the purposes of chapter 15 would be best served by such dismissal". Section 1501 lists chapter 15's purposes to include cooperation and comity, legal certainty for trade and investment, fair and efficient administration that protects all creditors and maximization of estate value. Cooperation and comity do not support dismissal here, because the U.S. subsidiary bore all the hallmarks of a U.S. corporation and its noninsider creditors were all U.S. entities. That finding also suggests that permitting a U.S. bankruptcy case to proceed promotes legal certainty for trade and investment. Dismissal would undercut fair and efficient administration, because the principal dispute in the CCCA proceeding is over the allowability of the insider claim against the U.S. subsidiary, and neither the Canadian debtors nor their monitor could provide independent representation of the subsidiary against the parent. Finally, a chapter 7 trustee's costs would not harm estate value maximization, because the costs would not likely exceed those of the monitor's if the case were dismissed and the monitor administered the chapter 15 case. Therefore, the court denies the motion to dismiss. *RHTC Liq'g Co. v. U. Pac. RR Co (In re RHTC Liq'g Co.)*, 424 B.R. 714 (Bankr. W.D. Pa. 2010).

15.1.mm. U.S. bankruptcy court may recognize and enforce third-party releases issued in a foreign proceeding. The entire Canadian asset-backed commercial paper market had collapsed in August 2007. A joint CCCA proceeding of all Canadian asset-backed commercial paper issuer conduits restructured the issuers' obligations to the holders of the commercial paper. The CCCA plan released all participants in the market, including the issuers, the asset providers, the liquidity providers, those who sold the commercial paper and all individuals who acted on behalf of any of them. The Canadian court determined that it had jurisdiction under the CCCA to issue the broad releases and that they were proper in this case. The foreign representative of the issuers sought recognition under chapter 15 of the CCCA proceeding and enforcement of the third-party release. Chapter 15 requires recognition of a foreign main proceeding if the recognition criteria are met. Section 1507 permits the court to provide additional assistance to a foreign representative based on the just treatment of all claims holders, protection against prejudicial treatment of U.S. holders, prevention of preferences and fraudulent property dispositions, proceeds distribution substantially in accordance with title 11 rules and comity. Such additional assistance is discretionary. Section 1506 limits action if it would be "manifestly contrary to the public policy of the United States". Courts must construe this limitation narrowly to give effect to chapter 15's overarching purpose to facilitate cooperation in cross-border bankruptcies. Differences in outcome between the foreign proceeding and a comparable U.S. proceeding are therefore permissible. Canadian judgments are generally entitled to comity in the U.S. courts, and the CCCA order here was issued after notice to all creditors and the Canadian court's determination of its jurisdiction and the propriety of the order under the circumstances. Thus, while a U.S. court would not likely sanction a broad third-party release, the court

should recognize and enforce the order here. *In re Metcalfe & Mansfield Alt. Invs.*, 421 B.R. 685 (Bankr. S.D.N.Y. 2010).

15.1.nn. Court denies recognition to a foreign receivership in which the receiver's appointment violated the automatic stay. The debtor was located in New York, although nearly all of its assets were in Israel. The debtor had granted a security interest in its receivables, inventory and machinery and equipment in Israel to an Israeli bank to secure its obligations to the bank. The bank seized its collateral in Israel and commenced an Israeli receivership proceeding. Before the Israeli court appointed a receiver, the debtor filed a chapter 11 case in New York, and the New York court determined that the automatic stay applied to all property of the debtor, "wherever located". The Israeli court then appointed a receiver after it duly considered and determined that the automatic stay did not apply. The Israeli receiver sought recognition under chapter 15 of the receivership as a foreign main proceeding. Section 101(23) defines "foreign main proceeding" as "a collective judicial or administrative proceeding … in which the assets and affairs of the debtor are subject to control or supervision by a foreign court". A secured creditor's receivership proceeding instituted to collect a secured claim is not a collective proceeding. It does not require the receiver to consider the rights and interests of all creditors, only of the secured creditor. In addition, it does not give the foreign court control over the debtor's affairs, only over its assets. Finally, the appointment of the receiver violated the automatic stay in the New York chapter 11 case, because it was the continuation of a judicial proceeding to collect a prepetition debt. Even though the Israeli court determined that the stay did not apply, the U.S. bankruptcy court has exclusive jurisdiction to consider its application. Under section 1506, a court may refuse to recognize a foreign proceeding if recognition would be manifestly contrary to the public policy of the United States. Recognition of a foreign proceeding in which the foreign representative was appointed in violation of the automatic stay would be contrary to U.S. public policy, because it would reward and legitimize a stay violation, limit a bankruptcy court's jurisdiction over the debtor's property and condone future violations. Therefore, the court denies recognition. *In re Gold & Honey, Ltd.*, 410 B.R. 357 (Bankr. E.D.N.Y. 2009).

15.1.oo. The bankruptcy court does not have jurisdiction to hear a foreign law avoiding power action by a recognized foreign representative. The bankruptcy court recognized the winding up of a Nevis insurance company as a foreign main proceeding. The foreign representatives filed an adversary proceeding to recover under Nevis law property that the debtor had transferred before the Nevis winding up proceeding. Section 1521 permits the bankruptcy court, after recognition, to "grant any appropriate relief, … except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a)". Section 1523 grants the foreign representative, upon recognition, standing in a case concerning the debtor under another chapter to initiate actions under those sections. Taken together, along with their legislative history, these sections evidence Congressional intent that a foreign representative be able to bring avoiding power actions only in a full case under another Bankruptcy Code chapter, where the court can determine appropriate forum and choice of law questions. Therefore, the bankruptcy court does not have jurisdiction to hear the foreign representatives' complaint. *Fogerty v. Condor Guar., Inc. (In re Condor Ins. Ltd.)*, 411 B.R. 314 (S.D. Miss. 2009).

15.1.pp. An individual debtor's foreign proceeding alone does not amount to an "establishment" that entitles the foreign representative to recognition. The debtor had lived and owned and operated a business in Israel. The business failed. Shortly after the failure, creditors initiated an involuntary bankruptcy petition against the debtor. Two years later, the Israeli court declared him bankrupt. Around the time of the petition, the debtor relocated to Texas, where he has lived with his wife and children for over 10 years. All of his financial activities (bank accounts, employment, etc.) are in Texas. He is applying for U.S. citizenship and has no intention to return to Israel, where he and his family are subject to threats. Nearly 10 years after he moved to Texas and seven years after being declared bankrupt, his Israeli bankruptcy trustee sought recognition of his Israeli bankruptcy as a foreign proceeding under chapter 15. Chapter 15 permits recognition of a foreign proceeding as a foreign main proceeding if it is in the debtor's center of main interests or as a foreign nonmain proceeding if it is not and if the debtor maintains an establishment there. Section 1508 requires a U.S. court interpreting these provisions to consider the statute's international origins and purpose and need to promote uniformity. Therefore, the court may consider foreign sources of law, such as the Guide to Enactment of the UNICITRAL Model Law on Cross-Border Insolvency, the European Union Convention on Insolvency Proceedings and the Report on the Convention on Insolvency Proceedings. The court must apply the statutory "center of main interest" and

"establishment" as of the chapter 15 petition date, because the definitions speak in the present tense, rather than referring to the time when the foreign proceeding was commenced. In an individual case, center of main interest means place of habitual or permanent residence of domicile. When the Israeli bankruptcy trustee sought recognition, the debtor's domicile was in Texas. Therefore, the Israeli proceeding was not a foreign main proceeding. An "establishment" is a debtor's nontransitory place of the operations. Here, the debtor's only current contact with Israel is his bankruptcy case. The foreign proceeding itself cannot constitute an establishment. The debtor is not carrying out the activity or operation, and a bankruptcy action is a transitory action by its nature. Finally, such a result would mean that all foreign proceedings that are not foreign main proceedings are foreign nonmain proceedings, which is a result the statute, by requiring an "establishment", does not contemplate. Therefore, the court denies recognition. *Lavie v. Ran*, 406 B.R. 277 (S.D. Tex. 2009).

15.1.qq. An Australian voluntary winding up is recognized as a foreign main proceeding. An Australian corporation's shareholders voted for a members' voluntary winding up of the corporation under the Australian Corporation Act and, as required by the Act, appointed liquidators. The liquidators later petitioned the bankruptcy court for recognition of the winding up as a foreign main proceeding. Section 101(23) defines "foreign proceeding" as "a collective judicial or administrative proceeding in a foreign country … under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation." A "proceeding" involves acts and formalities set down in law. It does not require a judicial process. The Australian Corporation Act permits winding up by members through a liquidator, but the winding up process may become subject to judicial supervision, and the liquidator's actions are subject to judicial review. Once the process is begun, the directors are ousted, and the shareholders cannot stop the process. Therefore, the winding up process is a "proceeding". It is a "judicial or administrative" proceeding, because the process has an administrative character. A collective proceeding is one that differs, for example, from a receivership remedy that a single creditor initiates. A company need not be insolvent for the proceeding to be under a law relating to insolvency. Here, a voluntary winding up can apply to an insolvent corporation, although the proceeding then converts to a judicially supervised administration, and, in adopting its own version of the Model Law on Cross-Border Insolvency, the Australian Parliament determined that a voluntary winding up is a proceeding under a law relating to insolvency. The winding up process is subject to judicial supervision, because the liquidator or a creditor may request a court to determine any question arising in the process, and any person aggrieved by a liquidator's actions may appeal to a court. Finally, the purpose of the winding up process is liquidation. Therefore, an Australian voluntary winding up process qualifies as a "foreign proceeding". A foreign proceeding is a foreign main proceeding if it is pending where the debtor's center of main interest (COMI), similar to the principal place of business, is located. The COMI determination is made as of the date of the petition for recognition, not as of the foreign proceeding commencement date. Based on these rulings, the court determines that the Australian winding up proceeding is a foreign main proceeding. *In re Betcorp Limited*, 400 B.R. 266 (Bankr. D. Nev. 2009).

15.1.rr. Courts orders turnover to foreign representative of funds attached in admiralty in the U.S. Non-U.S. creditors obtained admiralty attachments against the debtor's bank accounts in New York both before and after the debtor commenced a bankruptcy case in Denmark. Danish bankruptcy law voids attachments against the debtor's property. The Danish foreign representative sought and obtained recognition of the Danish bankruptcy case in the U.S. and turnover of the funds subject to the attachments. Upon the court's recognition of a foreign main proceeding, section 1520 automatically applies the automatic stay to the debtor and its property but does not require turnover. Section 1521(a)(5) authorizes the court to entrust "the administration or realization of all or part of the debtor's assets within the territorial jurisdiction of the United States to the foreign representative", and section 1521(b) authorizes the court to "entrust the distribution of all or part of the debtor's assets located in the United States to the foreign representative … provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected". Section 1507 permits the court, "consistent with the principles of comity", to grant additional assistance to the foreign representative. The legislative history says that chapter 15's provisions should be interpreted consistent with prior law under section 304, which required the court to consider comity in fashioning relief. To afford comity to the Danish court's proceedings, the court grants the foreign representative's request that the attached funds be entrusted to her for administration in the Danish proceeding. However, the funds turned over remain subject to the

attachments, the validity of which the Danish court would determine. *In re Atlas Shipping A/S*, 404 B.R. 726 (Bankr. S.D.N.Y. 2009).

15.1.ss. Applying section 362 as provisional relief does not require an adversary proceeding; the court may apply any Code sections in a chapter 15 case. The debtors were subject to administration in the U.K. The U.K. administrators sought recognition under chapter 15 of the U.K. proceeding as a foreign main proceeding. While the recognition application was pending, a U.S. creditor obtained a U.S. judgment and a writ of attachment against the debtors. Section 1519(a) permits the court to grant relief if urgently needed to protect creditors, including "staying execution against the debtor's assets", "entrusting administration or realization of [the debtor's U.S. assets] to the foreign representative", suspending the debtor's right to transfer assets and providing for witness examination. Section 1519(e) provides, "The standard, procedures, and limitations applicable to an injunction shall apply to relief under this section". Those procedures require an adversary proceeding. The U.K. administrators sought application of section 362's automatic stay as provisional relief under section 1519. Section 1519(a) permits forms of relief that are not similar to an injunction and for which applying the standards and procedures for an injunction would not work, such as witness examination, so section 1519(e)'s procedural requirements should apply only where the provisional relief is injunctive relief. The automatic stay differs from an injunction. It is in rem, not directed at any particular person, is provisional (replaced by the discharge injunction at the end of the case) and arises automatically upon filing a U.S. bankruptcy case. Therefore, applying the automatic stay as provisional relief under section 1519(a) is not injunctive relief and does not require an adversary proceeding. Moreover, the combination of section 1519(a), authorizing provisional relief, with section 1521, authorizing additional relief upon recognition, and section 105(a), authorizing a court to issue any order necessary or appropriate to carry out the provisions of the Bankruptcy Code, permits the court to apply any Code section in a chapter 15 case, despite sections 103, because it is often clearer and more complete to apply a Code section with all its case law interpretation and meaning rather than to refashion the section in the terms of the provisional relief order itself. *In re Pro-Fit Intl. Ltd.*, 391 B.R. 850 (Bankr. C.D. Cal. 2008).

15.1.tt. Argentine restructuring is binding on U.S. creditors. An Argentine debtor restructured its U.S.-issued debt under a privately negotiated restructuring plan under Argentine law, known as an *Acuerdo Preventivo Extrajudicial* (APE), which is similar to a U.S. prepackaged chapter 11 case. The standards for approval are looser than for confirmation of a U.S. chapter 11 plan. For example, there is no minimum distribution requirement similar to the best interest of creditors test, the grounds on which creditors may object are limited and the principal focus of the Argentine court is that the proposal not be abusive, fraudulent or discriminatory. A dissenting U.S. noteholder, who first purchased notes after the debtor's initial default and continued to purchase notes even after the Argentine court approval of the APE, and who had notice of but did not appear in the Argentine court, instructed the indenture trustee not to exchange its notes on the ground that the Trust Indenture Act (TIA) prohibits principal or interest reduction without consent of 100% of all affected noteholders. The debtor sought section 304 protection to bind the dissenting noteholder to the APE. A touchstone of section 304 relief is the "just treatment of creditors". The availability of only limited grounds for objection to the APE under Argentine law does not preclude just treatment. A "comprehensive procedure for the orderly and equitable distribution of [the debtor's] assets among all of its creditors" suffices. U.S. public policy does not prevent approval of a foreign proceeding whose distribution scheme does not precisely match that of chapter 11. The APE proceeding is not contrary to fundamental U.S. public policy and is therefore entitled to comity by the U.S. courts. The TIA prohibition on reducing principal or interest without noteholder consent is subject to the bankruptcy power. Because this proceeding was brought under the Bankruptcy Code, the TIA prohibition must give way, even though this proceeding was not a full U.S. bankruptcy case. Because the APE procedure provided extensive notice and opportunity to be heard and the noteholder chose not to participate, it could not complain of unjust treatment. *Argo Fund Ltd. v. Board of Dir. of Telecom Argentina, S.A. (In re Board of Dir. of Telecom Argentina, S.A.)*, 528 F.3d 162 (2d Cir. 2008).

15.1.uu. Court recognizes postconfirmation Oversight Board as foreign representative. A Spanish debtor successfully completed a *convenio* (repayment plan) under the Spanish Insolvency Act (since repealed). The Spanish court retained jurisdiction during the repayment period to settle any disputes arising under the plan and to convert the proceeding into a liquidation if the debtor does not complete

payments. In this case, the *convenio* provided for the appointment of an Oversight Committee, comprised primarily of creditor representatives, to supervise and control compliance with the plan. The Oversight Committee obtained the Spanish court's designation as a foreign representative and authorization to initiate a proceeding in the U.S. under chapter 15 to pursue a U.S. asset. Chapter 15 permits a U.S. bankruptcy court to recognize a foreign representative in a foreign proceeding as a foreign main proceeding if the proceeding is "pending" where the debtor has its center of main interests. The Spanish proceeding qualifies as a foreign proceeding, because it provides a procedure for the adjustment of the debtor's debts. The Spanish court's approval of the *convenio* did not terminate the foreign proceeding. Section 1515 requires that a foreign representative seeking recognition must file evidence of the existence of the foreign proceeding and of its appointment as the foreign representative. The Spanish court order sufficed for those purposes. Even viewed in the context of U.S. bankruptcy procedure and without the support of the Spanish court's order, the Spanish proceeding was a foreign postconfirmation proceeding, and the Oversight Committee qualifies as a foreign representative, similar to a postconfirmation liquidating trustee, who should be entitled to recognition in foreign countries. Finally, "pending" refers only to location, not to time. Therefore, the court grants recognition. *In re Oversight and Control Comm's of Avanzit, S.A.*, 385 B.R. 525 (Bankr. S.D.N.Y. 2008).

15.1.vv. Court recognizes Swiss proceeding only as a foreign nonmain proceeding. The debtor, a Swiss corporation, operated on-line foreign exchange trading for retail customers around the world. It maintained an office in Switzerland with 2 or 3 employees and a technology consultant but very few, if any, significant documents relating to the business. Its Boston office had 18 employees, operated the computer platform, handled all customer agreements and accepted customer deposits. The Swiss Federal Banking Commission (SFBC), which claimed regulatory jurisdiction over the debtor and acts as a bankruptcy court for the liquidation of banks and securities brokers, issued a decree initiating bankruptcy proceedings against the debtor, but the debtor appealed, and the proceedings were apparently stayed. U.S. creditors commenced an involuntary chapter 7 case, and the Swiss liquidators commenced a chapter 15 case, in Boston. A "foreign proceeding" is a "proceeding … in which the assets and affairs of the debtor are subject to control or supervision by a foreign court". A "foreign court" is "a judicial or other authority competent to control or supervise a foreign proceeding". Therefore, the SFBC is a foreign court, the Swiss proceeding is a foreign proceeding, and the Swiss liquidators are foreign representatives qualified to seek chapter 15 recognition. A foreign proceeding is a foreign main proceeding if it is pending in the state of the debtor's "center of main interests" (COMI). Section 1516(c) creates a presumption that the registered office is the COMI, but if there is contrary evidence, the foreign representative has the burden of proof on the COMI location. The evidence here did not support a finding that the COMI was in Switzerland, but because the debtor had an office in Switzerland, the court recognizes the Swiss proceeding as a foreign nonmain proceeding. Finally, section 305(a)(2) permits a foreign representative to seek dismissal of a concurrent chapter 7 case if the court has recognized the foreign proceeding and dismissal would best serve the purposes of chapter 15. Here, the trustee has begun collecting assets, the vast majority of creditors are in the U.S., and the Swiss proceeding is stayed pending appeal. Therefore, the court grants relief under chapter 7 and denies dismissal of the chapter 7 case. *In re Tradex Swiss AG*, 384 B.R. 34 (Bankr. D. Mass. 2008).

15.1.ww. Court refuses to recognize Cayman proceeding for a Cayman entity. A U.S. investment bank operated a hedge fund that was incorporated in the Cayman Islands. The fund petitioned the Cayman court for liquidation under Cayman law. The Cayman Joint Official Liquidators sought U.S. recognition as a foreign main proceeding. The petition for recognition disclosed that the fund has no assets, employees, officers, or managers in Cayman, that all operations were conducted in the U.S., and that all books and records were located in the U.S. Chapter 15 permits recognition of a foreign proceeding as a foreign main proceeding if the proceeding is in the jurisdiction of the debtor's center of main interests (COMI), which is similar to "principal place of business". Chapter 15 presumes that the location of a debtor's registered office is its COMI's location, but contrary evidence may rebut the presumption. The absence of objections does not require the court to accept the presumption, especially where the petition itself contains evidence to the contrary. Registration alone is insufficient to establish a COMI. Therefore, the court refuses to recognize the Cayman proceeding as a foreign main proceeding. The court also refuses to recognize the proceeding as a foreign nonmain proceeding. The court may recognize a foreign proceeding only as a main or nonmain proceeding, but to recognize it as either, the debtor must have an

"establishment" in the jurisdiction (roughly the same as a non-transitory place of business) where the foreign proceeding is pending, as opposed to having only assets in the jurisdiction. Here, Cayman law prohibits "exempted companies" such as the fund from engaging in business in the Cayman Islands. Since chapter 15's recognition regime does not carry over the flexibility that former section 304 afforded courts in permitting a case ancillary to a foreign proceeding, neither comity nor practical consideration override chapter 15's limitations on recognition. *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R. 325 (S.D.N.Y. 2008).

15.1.xx. Section 1516's presumption that the COMI is at the registered office does not prevent a court from requiring additional evidence. Section 1517 requires recognition of a foreign proceeding as a foreign main proceeding if, among other things, the foreign proceeding is pending in the jurisdiction in which the debtor's center of main interests (COMI) is located. Section 1516 provides, "In the absence of evidence to the contrary, the debtor's registered office … is presumed to be the center of the debtor's main interest." Here, the debtor was registered in the Cayman Islands as an exempted company. Under Cayman law, an exempted company "shall not trade in the Islands". The debtor's books and records and its attorneys and auditors were located in the Islands. Based on these facts alone and the section 1516 presumption, and declining the court's invitation to submit additional evidence on the debtor's COMI, the Joint Official Liquidators in a Cayman proceeding sought recognition of the Cayman proceeding as a foreign main proceeding on a motion for summary judgment. No one objected. Neither section 1516's presumption nor the failure of any party in interest to object prevents a court from demanding more evidence before recognizing the foreign proceeding. A court is not a rubber stamp of a recognition petition, so it must be satisfied that the necessary elements have been satisfied. Where, as here, there are enough facts in the record and in express provisions of foreign law to cast doubt on the location of the debtor's COMI, the court may require more evidence before granting recognition. The court therefore denies the summary judgment motion and sets the matter for an evidentiary hearing. *In re Basis Yield Alpha Fund (Master)*, 381 B.R. 37 (Bankr. S.D.N.Y. 2008).

15.1.yy. A foreign representative does not need recognition to file a lis pendens. The debtor was a U.K. citizen and subject to an English bankruptcy case. He owned property in the U.S., where he was residing under a temporary visa. The English bankruptcy trustee sought to recover the U.S. property for the benefit of the English estate. Pending a ruling on litigation to recover the property, he filed a lis pendens with the state court, which maintains local real property records. Subject to an exception for collection of claims that a foreign debtor may own, a foreign representative must seek recognition before requesting "comity or cooperation" in any court in the United States. A lis pendens only provides notice that the interests in the real property are subject to dispute and therefore does not seek comity or cooperation from a court. Therefore, the foreign representative need not obtain recognition before filing the lis pendens. *In re Loy*, 380 B.R. 154 (Bankr. E.D. Va. 2007).

15.1.zz. Foreign representative does not need recognition to administer U.S. assets without judicial assistance. The Japanese debtors owned 100% of the stock of several Hawai'ian corporations. After his appointment, the debtors' Japanese bankruptcy trustee took action as the sole shareholder of the corporations, appointing new directors and, with the Japanese bankruptcy court's approval, authorizing the sale of the corporations' assets. Chapter 15 does not require the Japanese trustee, as a foreign representative, to obtain recognition before proceeding to administer the Japanese debtors' U.S. assets without judicial assistance. Under section 1509, recognition grants a foreign representative the capacity to sue and be sued in United States courts and to apply to the bankruptcy court for appropriate relief and provides a procedure for the foreign representative to seek comity or cooperation from United States courts. Section 1509 deals only with a foreign representative's acts that require assistance from a United States court. By implication, therefore, a foreign representative's acts that do not require such assistance do not require recognition, and the Japanese trustee was authorized to act with respect to the debtors' Hawai'ian corporations without first obtaining recognition. *Iida v. Kitahara (In re Iida)*, 377 B.R. 243 (9th Cir. B.A.P. 2007).

15.1.aaa. Court recognizes Cayman proceeding for a Cayman entity as a foreign nonmain proceeding. A U.S. debtor in possession sued a Cayman Islands fund for preference recovery. The parties settled, the fund agreeing to pay the estate substantial funds. Fund investors objected to the settlement

as being too favorable to the estate. The bankruptcy court approved the settlement. The investors appealed. Under the settlement terms, the settlement was ineffective while an appeal was pending. The district court expedited the appeal. The investors then took over control of the fund and filed a Cayman insolvency proceeding for the fund. The fund later filed a voluntary Cayman liquidation proceeding. The fund's only contact with Cayman was its registered office and activities related to maintaining registration and compliance with Cayman regulation. All of its business activities occurred in the U.S., and substantially all of its assets were located in the U.S. The Cayman foreign representative sought recognition of the proceeding in the U.S. under chapter 15 as a foreign main proceeding, which is a proceeding in the state where the entity's center of main interest (COMI) is located. Chapter 15 contains a presumption that an entity's registered office is its COMI, but the presumption may be rebutted by contrary evidence. The court may rely on the presumption where a party in interest does not object. Here, however, the objectors rebutted the statutory presumption. In addition, the foreign representative's motive in seeking recognition of the Cayman proceeding was primarily to gain strategic advantage by invoking application of the automatic stay to delay the appeal of the settlement approval order and thereby obtain negotiating leverage against the U.S. debtor in possession. The taint of improper forum shopping and strategic conduct persuades the court to recognize the Cayman proceeding as a foreign nonmain proceeding and thereby deny the foreign representative the benefit of the automatic stay. *Krys v. Official Comm. of Unsecured Creditors (In re SPhinX, Ltd.)*, 371 B.R. 10 (S.D.N.Y. 2007).

15.1.bbb. Court refuses to recognize Cayman proceeding for a Cayman entity. A U.S. investment bank operated a hedge fund that was incorporated in the Cayman Islands. The fund petitioned the Cayman court for liquidation under Cayman law. The Cayman Joint Provisional Liquidators' chapter 15 petition for recognition as a foreign main proceeding disclosed that the fund has no assets, employees, officers, or managers in Cayman, that all operations were conducted in the U.S., and that all books and records were located in the U.S. Chapter 15 permits recognition of a foreign proceeding as a foreign main proceeding if the proceeding is in the jurisdiction of the debtor's center of main interests (COMI), which is similar to "principal place of business". Chapter 15 presumes that the location of a debtor's registered office is its COMI's location, but contrary evidence may rebut the presumption. The absence of objections does not require the court to accept the presumption, especially where the petition itself contains evidence to the contrary. Registration alone is not sufficient to establish a COMI. Therefore, the court refuses to recognize the Cayman proceeding as a foreign main proceeding. The court also refuses to recognize the proceeding as a foreign nonmain proceeding. The court may recognize a foreign proceeding only as a main or nonmain proceeding, but to recognize it as either, the debtor must have an "establishment" in the jurisdiction (roughly the same as a non-transitory place of business), as opposed to having only assets in the jurisdiction, where the foreign proceeding is pending. Here, Cayman law prohibits "exempted companies" such as the fund from engaging in business in the Cayman Islands. Since chapter 15's recognition regime does not carry over the flexibility that former section 304 afforded courts in permitting a case ancillary to a foreign proceeding, practical consideration do not override chapter 15's limitations on recognition. *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122 (Bankr. S.D.N.Y. 2007).

15.1.ccc. Ancillary case does not give a bankruptcy court jurisdiction over claims. The English debtor filed a case under section 304 to obtain an enforcement order for its U.K. Scheme of Arrangement. The court issued an injunction against commencing or continuing any proceeding in the U.S. related to any claim that the Scheme addressed. The debtor's former employee brought an adversary proceeding in the bankruptcy court on a claim he asserted against the debtor. Only a foreign representative may invoke section 304. Section 304 does not create an estate that requires administration, so the bankruptcy court lacks the full jurisdiction it normally has in a title 11 case. Its jurisdiction extends only to matters related to the purposes of section 304, which is to protect administration of the foreign proceeding against U.S. creditors' actions. Section 304 does not by its terms permit U.S. creditors to bring actions against the debtor or pursue claims. What's more, the former employee's claim is not related to the section 304 case, because it could not "conceivably have any effect on the estate being administered in bankruptcy." Therefore, the bankruptcy court does not have jurisdiction to hear the former employee's claim against the debtor. The bankruptcy court may, however, determine whether it should modify the section 304 injunction to permit the former employee to pursue his claim in another forum. *Osanitsch v. Marcone PLC (In re Marconi PLC)*, 363 B.R. 361 (S.D.N.Y. 2007).

15.1.ddd. "Center of main interests" equates generally with "principal place of business." The St. Vincent and Grenadines (SVG) registered insurance company debtor operated out of its SVG office to sell and underwrite insurance policies for U.S. customers, who were the company's sole creditors. Premium checks were sent to a U.S. post office but were forwarded to SVG for processing. The liquidators in an SVG insolvency proceeding sought recognition of the proceeding in the U.S. as a foreign main proceeding. A foreign proceeding is a foreign main proceeding if it is in the country where the debtor's "center of main interests" (COMI) is located. Under section 1516(3), COMI is presumed to be at the location of the debtor's registered office, in the absence of evidence to the contrary. The burden of proof on the location of COMI rests with the foreign representative, but section 1516(3) places the burden of going forward with contrary evidence on any objector. The phrase "COMI" derives from the European Union Convention on Insolvency Proceedings and, consistent with section 1508's direction that chapter 15 be construed to promote international uniformity in its application, should be construed in conformity with the Convention, as well as with other countries' interpretation and application of the phrase. The Convention defines COMI as "the place where the debtor conducts the administration of his interests on a regular basis." This definition equates generally with "principal place of business," as that phrase is understood in U.S. jurisprudence. Here, that was SVG. Therefore, the court recognized the SVG proceeding as a foreign main proceeding. *In re Tri-Continental Ins. Exch. Ltd.*, 349 B.R. 627 (Bankr. E.D. Cal. 2006).

15.1.eee. Court recognizes Cayman proceeding for a Cayman entity as a foreign nonmain proceeding. A U.S. debtor in possession sued a Cayman Islands fund for preference recovery. The parties settled, the fund agreeing to pay the estate substantial funds. Fund investors objected to the settlement as being too favorable to the estate. The bankruptcy court approved the settlement, and the investors appealed. Under the settlement terms, the settlement was ineffective while an appeal was pending. The district court expedited the appeal. The investors then took over control of the fund and filed a Cayman insolvency proceeding for the fund. The Cayman foreign representative sought recognition of the proceeding in the U.S. under chapter 15 as a foreign main proceeding, which is a proceeding in the State where the entity's center of main interest (COMI) is located. There is little distinction between recognition as a foreign main or nonmain proceeding, except the application of section 362's automatic stay for a foreign main proceeding. Chapter 15 contains a presumption that an entity's registered office is its COMI, but the presumption may be rebutted by contrary evidence. The determination should take into account the international source of chapter 15 as well as uniformity in its application in adopting States. In addition, the absence of any foreign proceeding other than the one for which recognition is sought does not require that the foreign proceeding be recognized as the foreign main proceeding. Here, the fund's only contact with Cayman was its registered office and activities related to maintaining registration and compliance with Cayman regulation. All of its business activities occurred in the U.S. What is more, the foreign representative appeared to have sought recognition as a foreign main proceeding primarily to gain strategic advantage by invoking application of the automatic stay to delay the appeal of the settlement approval order and thereby obtain negotiating leverage against the U.S. debtor in possession. For example, the foreign representative would not agree to relief from the stay and to permit the appeal to proceed if the Cayman proceeding was recognized as a foreign main proceeding. The court concludes that chapter 15 does not require a main vs. nonmain decision immediately upon recognition and considers deferring the determination. However, the taint of improper forum shopping and strategic conduct persuades the court to recognize the Cayman proceeding as a foreign nonmain proceeding and thereby deny the foreign representative the benefit of the automatic stay. *In re SPhinX, Ltd.*, 351 B.R. 103 (Bankr. S.D.N.Y. 2006). For a strong dissenting view about the opinion's analysis, *see* Daniel M. Glosband, *SPhinX Chapter 15 Opinion Misses the Mark*, 25 ABI Journal No. 10 (Dec. 2007), which argues that the determination of whether a foreign proceeding is main or nonmain is supposed to be objective, not flexible, and that the court should not have recognized the foreign proceeding at all, because the debtor did not have an "establishment"—that is, a "place of operations where the debtor carries out a nontransitory economic activity," §1502—in the Caymans.

15.1.fff. Chapter 15 permanent injunction does not require an adversary proceeding. The bankruptcy court granted a foreign representative recognition under chapter 15. The representative filed a motion for a permanent injunction against a creditor who was seeking to garnish the debtor's assets in the U.S. Section 1521(a) authorizes such an injunction; section 1521(e) applies "the standards, procedures, and limitations applicable to injunctions" to such injunctions. Bankruptcy Rule 7001(7) requires an

adversary proceeding to obtain a permanent injunction. Rule 1018 specifies which Rules apply in chapter 15 cases. It does not include Rule 7007(7). An injunction was permitted under former section 304 without an adversary proceeding, and there is no indication that the enactment of chapter 15 was intended to change that procedure. Therefore, the court grants the injunction on the representative's motion. *In re Lee*, 348 B.R. 799 (Bankr. W.D. Wash. 2006).

15.1.ggg. Court refuses additional restrictions on release to administration of foreign representative of seized U.S. funds. The U.S. DOJ had seized funds in the U.S. that a foreign representative claimed were property of the foreign debtor and that a U.S. creditor claimed were subject to its lien. After recognition of the foreign proceeding as a foreign main proceeding, the U.S. DOJ agreed to release the funds to the foreign representative for administration in the foreign proceeding, but subject to the continuing jurisdiction of the U.S. court. Section 1522 authorizes the court to impose additional restrictions so that the interests of U.S. creditors are "sufficiently protected." The U.S. creditor sought under section 1522 to prohibit the foreign representative's use of the funds for expenses of administration. Because the foreign representative sought to be entrusted only with "the administration or realization of" the debtor's U.S. assets under section 1521(a)(5), not with "the distribution of all or part of the debtor's assets located in the United States" under section 1521(b), the court refused to impose additional restrictions. Under section 1521(a)(2), section 363(c)(2)'s restrictions on the use of cash collateral apply. In addition, the foreign representative did not seek entrustment for distribution. Finally, additional restrictions could involve the U.S. court in reviewing the rulings of the court administering the foreign main proceeding. Thus, additional restrictions are unnecessary. *In re Tri-Continental Ins. Exch. Ltd.*, 349 B.R. 627 (Bankr. E.D. Cal. 2006).

15.1.hhh. Court recognizes and enforces foreign proceeding procedure that denies a jury trial to personal injury claimants. A Canadian bankruptcy court approved a claims resolution procedure for multiple tort claims. The procedure contemplated a hearing before a claims officer rather than a jury. The monitor in a Canadian case obtained recognition under section 1519 of the Canadian proceeding as a foreign main proceeding and sought U.S. enforcement of the claims resolution procedure, so as to require U.S. creditors to prosecute their claims only under the Canadian claims resolution procedure. Section 1506 permits the bankruptcy court to deny enforcement if the procedure is "manifestly contrary to the public policy of the United States." Chapter 15's legislative history says the U.N.'s official Guide to the Enactment of the Model Law on Cross-Border Insolvency should be consulted for guidance in construing chapter 15. The Guide directs that courts construe section 1506 narrowly and apply it only "under extraordinary circumstances concerning matters of fundamental importance for the enacting State." The absence of a right to a jury trial for personal injury claims does not meet that standard, as long as the remaining procedural protections in the claims resolution process comport generally with due process, as they do here. *RSM Richter Inc. v. Aguilar (In re Ephedra Prods. Liab. Litig.)*, 349 B.R. 333 (S.D.N.Y. 2006).