JENNER&BLOCK

Recent Developments in Bankruptcy Law, April 2017

(Covering cases reported through 564 B.R. 442 and 846 F.3d 1071)

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1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a **Supplier's lien filing against owner's real estate to collect debt from contractor violates the automatic stay.** New Jersey suppliers' lien law permits a general contractor's supplier to file a lien against the owner's real property for any amount the contractor owes the supplier, up to the total amount the owner owes the contractor. In this case, the supplier provided materials to a job, the contractor did not pay for the materials, and the contractor filed bankruptcy. The supplier filed a supplier's lien on the owner's real property in the amount of its unpaid bills. The automatic stay prohibits any act to create, perfect or enforce any lien against property of the estate. If allowed, the supplier's lien would effectively divert to the supplier the contractor's receivable from the owner. The effect is a lien against the receivable, which is property of the estate. Its creation through the supplier's lien filing violates the automatic stay. *In re Linear Elec. Co., Inc.*, ___ F.3d ___, 2017 U.S. App. LEXIS 5527 (3d Cir. Mar. 30, 2017).

1.1.b **Police or regulatory power exception applies to Medicare and Medicaid Provider Agreement.** The debtor operated a hospital and was under a Provider Agreement contract with the Centers for Medicare and Medicaid Services (CMS) as a Medicare and Medicaid provider. The debtor wrote to CMS saying it was filing a chapter 11 petition the next day, "closing as a hospital" two days after that, and terminating the Provider Agreement. The day after the debtor closed as a hospital, CMS wrote back, terminating the Provider Agreement as of the previous day because the closing removed the debtor from the CMS definition of a "hospital." The next day, the state authorized the debtor to admit patients again, and the debtor in possession notified CMS that it was not terminating the Provider Agreement. Although CMS said it would rescind the prior termination if the hospital started admitting inpatients again, the debtor in possession filed a motion to compel on the ground that the termination violated the automatic stay. Section 362(a)(3) stays the termination of an executory contract, but section 362(b)(4) exempts an action "by a governmental unit … to enforce such governmental unit's police or regulatory power." The exception applies when the governmental action is designed primarily to protect public safety and welfare and is not an attempt to recover property from the debtor. Here, the termination was to enforce the Medicare and Medicaid regulations, not to enforce CMS's contractual rights against the debtor. Enforcing regulations comes within the exception. Therefore, CMS's termination did not violate the automatic stay. *Parkview Adventist Med. Center v. U.S.*, 842 F.3d 757 (1st Cir. 2016).

1.1.c **Police or regulatory power exception applies to enforcement of civil contempt sanctions.** In a prepetition state court action, the debtor failed to respond to discovery. The state court imposed a monetary sanction, which the debtor did not pay. The creditor moved to cite the debtor for contempt. Before the hearing on the motion, the debtor filed bankruptcy. At the state court's request, the creditor filed a brief addressing the automatic stay's effect on the motion. The debtor moved in the bankruptcy court to sanction the creditor for violating the stay. Section 362(a) stays the commencement or continuation of any action or proceeding against the debtor. Section 362(b)(4) exempts from the stay "the commencement or continuation of an action or proceeding by a governmental unit … to enforce such governmental unit's police and regulatory power." Any action qualifies for the exemption if it does not seek to protect the governmental unit's pecuniary interest nor seek to adjudicate private rights. The state court is a governmental unit. The sanction order and the contempt proceeding were intended to protect the court's public policy interest in deterring certain kinds of litigation misconduct, not to protect the court's pecuniary interest nor the creditor's private rights. Therefore, the exemption applies, and the creditor's civil contempt proceeding against the debtor did not violate the stay. *Dingley v. Yellow Logistics, LLC (In re Dingley)*, ___ F.3d ___, 2017 U.S. App. LEXIS 5673 (9th Cir. Apr. 3, 2017).

1.1.d **Police or regulatory exception does not apply to Private Attorney General Act action.** The debtor's former employee filed a complaint against the debtor with the state's Labor and Workforce Development Agency for violations of the state's labor laws. The LWDA took no action, which permitted the former employee to bring an action under the state's Private Attorney General Act to enforce the state's labor law against the debtor. The debtor removed the former employee's action for labor law violations, including a PAGA claim, to the district court, which referred the entire matter, including the PAGA claim, to arbitration. The employee appealed. While the appeal was pending, the debtor filed a chapter 11 case. The automatic stay enjoins any action or proceeding against the debtor that was or could have been commenced before bankruptcy to collect a prepetition claim. But the stay does not apply to an action "by a governmental unit … to enforce such governmental unit's police or regulatory power." A PAGA action is similar to a *qui tam* action, which is not covered by the automatic stay exception. Although the employee brings a PAGA action on behalf of the state, where the state agency does not intervene in the action, the action is not "by a governmental unit," so it is not covered by the exception. *Porter v. Nabors Drilling USA, L.P.*, ___ F.3d ___, 2017 U.S. App. LEXIS 687 (9th Cir. Apr. 20, 2017).

1.2 Effect of Stay

1.3 Remedies

1.3.a **Court orders $1 million in actual damages and $45 million punitive damages for Kafkaesque automatic stay violation.** The individual borrowers sought a loan modification on their home mortgage. The bank refused unless the borrowers were in default for at least three months. So after numerous conversations with the bank, the borrowers reluctantly stopped paying. They received modification forms from the bank, which they completed and submitted, but the bank routinely lost them. They submitted the forms 20 times. Bank records showed the bank had no intention of agreeing to a modification. The bank then noticed a foreclosure sale. The borrowers filed chapter 13 the day before the sale. The bank conducted the foreclosure sale anyway and did not rescind the sale for months. When it did, it did not notify the borrowers. Seeing no relief in bankruptcy, the borrowers dismissed their chapter 13 case. After the bank took title to their home at the foreclosure sale, it stalked and harassed the borrowers at the house. Once the borrowers vacated to escape the harassment and the threat of eviction following the foreclosure, the bank allowed the property to deteriorate, incurring homeowner association penalties. The borrowers suffered extreme illness and emotional distress. They brought a state court action against the bank for damages for various tort and contract causes of action and for the stay violation. The state court found the bankruptcy court had exclusive jurisdiction for the stay violation, so the borrowers commenced an action there. The automatic stay prohibits foreclosure or any act to collect a prepetition debt, voids any action taken in violation of the stay, and requires the violator to rescind any such action. An individual debtor is entitled to actual damages for a stay violation, and the court may award punitive damages. The foreclosure sale, the recording of title after the sale, the failure to rescind the sale and correct title, and the harassment and stalking were all stay violations. Stay violation damages are determined based on a tort causation model, and damages are not limited to the consequences flowing from the stay violation during the time the stay is in effect. Therefore, the bank is liable for all the damages the borrowers incurred through the time of trial, slightly over $1 million. Punitive damages are also appropriate, enough to cause the bank not to treat them as a cost of doing business, but allocated in a way not to give the borrowers a windfall. Considering the societal interest in punishing bad conduct, the court awards $45 million in punitive damages, grants $5 million to the borrowers and orders payment of the remaining $40 million to state institutions and nonprofit organizations that promote consumer protection in bankruptcy. *Sundquist v. Bank of Am., N.A. (In re Sundquist)*, ___ B.R. ___, 2017 Bankr. LEXIS 809 (Bankr. E.D. Cal. Mar. 23, 2017).

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **A deposit into an unrestricted bank account is not a "transfer."** The debtor ran a Ponzi scheme. During the scheme, he deposited scheme funds that he had received into his personal bank account. The trustee sued the bank to avoid and recover the deposits as actual fraudulent transfers. Section 101(54) defines "transfer" as any "mode, direct or indirect … of disposing of or parting with" property or an interest in property. When the debtor deposited funds into his unrestricted bank account, he continued to have possession, custody, and control over the funds, and they were equally available to his creditors before bankruptcy and to his trustee after bankruptcy. He did not dispose of or part with property, so the deposits were not "transfers." *Ivey v. First Citizens Bank & Tr. Co. (In re Whitley)*, 848 F.3d 205 (4th Cir. 2017).

2.1.b **A deposit into a bank account is not a "transfer."** The debtor ran a Ponzi scheme, using two principal companies. The bank lent to one of the companies. The debtor received deposits from investors into the debtor's bank account, retained some of the funds in the account, and paid the bank's loan with other funds in the account. The trustee may avoid a transfer made with actual intent to hinder, delay, or defraud creditors. Under the Ponzi scheme presumption, any transfer the debtor makes is such a transfer. However, the debtor's deposits into the bank account were not transfers. A transfer is any mode, direct or indirect, of disposing of or parting with property or with an interest in property. A transfer occurs only when the recipient acquires dominion and control over the transferred property. The debtor's right to withdraw the deposits deprived the bank of dominion and control, so there was no transfer. However, the loan payments were transfers to the bank and were therefore avoidable. *Meoli v. The Huntington Nat'l Bank*, 848 F.3d 716 (6th Cir. 2017).

2.1.c **Contract termination might constitute a fraudulent transfer.** The defendant contracted with a publicly traded affiliate to provide management services. The contract provided a base monthly fee and additional fees for performance. It gave the affiliate the right to terminate without cause on 60 days' notice. After the defendant encountered financial trouble, the affiliate gave notice of termination, to which the defendant agreed, waiving the 60-day notice requirement and therefore the base fee payment during the 60-day period. One of defendant's creditors sued to collect and named the public affiliate as a defendant in a fraudulent transfer claim. A transfer is any mode of disposing of or parting with property or an interest in property. Property is anything that may be the subject of ownership. Although a contract that is in default, that may not be assigned, and that is terminable immediately is not property for purposes of the fraudulent transfer statutes, the contract here was not terminable immediately and gave the defendant the right to base fees during the 60-day notice period. Waiver of that period was a transfer of an interest in property, which was subject to avoidance and recovery under the fraudulent transfer laws. *Hometown 2006-1 Valley View, L.L.C. v. Prime Income Asset Mgmt., L.L.C.*, 847 F.3d 302 (5th Cir. 2017).

2.1.d **Indirect benefit to the debtor's other solely-owned corporation is not reasonably equivalent value to the debtor.** The individual debtor loaned her corporation funds to make a loan to a third party. The third party's corporation performed services for the debtor's two other corporations, for which they owed the third party's corporation an amount exceeding the loan to the third party. The debtor's lending corporation forgave the loan to the third party in exchange for the third party's corporation's release of amounts owing for services to the debtor's other corporations. The debtor was her lending corporation's sole creditor. After the individual debtor filed bankruptcy, the trustee, acting under section 541(a)(1) to collect the debtor's claim against her lending corporation, sued the third party under the Uniform Fraudulent Transfer Act to avoid the prepetition release as a fraudulent transfer by the debtor's debtor (the lending corporation). A creditor may avoid as constructively fraudulent a transfer the debtor makes without receiving reasonably equivalent value in exchange if the debtor is insolvent or renders the debtor insolvent.

Here, the debtor's lending corporation's release was a transfer of its sole asset—its claim against the third party. The individual debtor was the lending corporation's sole creditor and therefore would be the sole creditor harmed by the transfer, and the individual debtor might have benefitted by the release of her other corporation's liabilities. But that benefit inured to the other corporations, not to the individual debtor or the lending corporation, which received nothing in exchange for the release. Therefore, the third party's corporation's release of the debtor's other corporations does not constitute reasonably equivalent value to the lending corporation, and the debtor's trustee, as a creditor of the lending corporation, may avoid the release. *Motorworld, Inc. v. Benkendorf*, ___ N.J. ___, 2017 N.J. LEXIS 358 (Mar. 30, 2017).

2.2 Preferences

2.3 Postpetition Transfers

2.4 Setoff

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

3. BANKRUPTCY RULES

3.1.a **Court approves post-confirmation Rule 2004 examination.** The chapter 11 plan created two trusts. The corporate trust, for the benefit of unsecured creditors, received all the debtor's claims against third parties. The lenders' trust was for the benefit of consenting lenders, who assigned their own third-party claims to the trust. The trusts had the same trustee. After confirmation, the trustee sought a Rule 2004 examination of the debtor's accountant and certain lenders. Rule 2004 permits the court to order the examination of an entity about "the acts, conduct, or property … of the debtor … and any other matter relevant to the case." The bankruptcy court has jurisdiction over a proceeding "arising under title 11 or arising in or related to a case under title 11." A proceeding arises in a case if, by its nature, it could arise only in a bankruptcy case. Rule 2004 applies only in a bankruptcy case, so a proceeding concerning a Rule 2004 examination arises in the case. Limits on post-confirmation jurisdiction apply only to "related to" jurisdiction, not core proceedings, so jurisdiction retention language in the plan does not govern post-confirmation core jurisdiction, and the bankruptcy court has jurisdiction to grant a post-confirmation Rule 2004 motion. Rule 2004's scope is broad. It covers anything that might lead to a claim for the estate. Any claims the corporate trust might discover and pursue would be for the benefit of the estate, but the lenders' trust claims would not. Therefore, the trustee may take Rule 2004 discovery for the corporate trust, but not for the lenders' trust. The fact that the trustee is the same for both does not prevent discovery, because Rule 2004 does not prohibit use of information in collateral litigation. *In re Millennium Lab Holdings II, LLC*, 562 B.R. 614 (Bankr. D. Del. 2016).

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a **Good faith negotiation filing requirement does not waive privilege for prepetition mediation statement.** One of the eligibility grounds for a chapter 9 filing is that the debtor negotiate with creditors in good faith before filing its petition. In this case, the debtor and its principal creditors submitted to prepetition mediation. The mediator required from each party's counsel a confidential mediation statement to provide background and a description of the parties' positions. After the debtor filed its petition, one of the creditors sought discovery of the debtor's mediation statement. The ordinary work product doctrine protects an attorney's ordinary work-product prepared in anticipation of litigation—which includes raw facts—from discovery unless the opponent has a substantial need and cannot otherwise obtain the materials through other means. A mediation statement in preparation for a pre-chapter 9 mediation is prepared in anticipation of filing a chapter 9 case, which involves litigation, and because the creditor did not allege bad faith in the debtor's filing, it has not shown a substantial need for the material. Opinion work product—the attorney's mental impressions and conclusions—is not discoverable except in rare and unusual circumstances, such as where it would inculpate the attorney in illegal activity, which is not the case here. Work product is subject to discovery if there has been a waiver, such as where the party or its attorney has shown the material to a third party without expectation of confidentiality. The good faith negotiation eligibility ground itself is not such a waiver, and the disclosure to the mediator was with the full expectation of confidentiality. Finally, where the debtor is not relying on the mediation statement to show good faith negotiation, it need not disclose it to the creditor. *In re Lake Lotawana Comm. Imp. Dist.*, 563 B.R. 909 (Bankr. W.D. Mo. 2016).

4.2 Involuntary Petitions

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Adminisration

5.1.a **Supreme Court rejects distribution under structured dismissal that violates Bankruptcy Code priorities.** The debtor in possession liquidated all assets except fraudulent transfer claims against its secured lender, who had financed the debtor's LBO, and against the shareholder, who had lent additional funds and had a remaining claim secured by all the estate's $1.7 million in cash. There were allowed administrative, tax, priority WARN Act, and general unsecured claims. The bankruptcy court had denied a motion to dismiss the fraudulent transfer action, but litigation would have been difficult, complex, and risky against the well-financed defendant. There was no prospect of confirming a plan, and conversion to chapter 7 would have left the trustee without any assets to pursue claims, because the secured creditor had a lien on all cash. All parties other than the priority WARN Act claimants negotiated a settlement of all issues: the secured lender would contribute $2 million to an account earmarked to fund administrative expenses; the shareholder, also a fraudulent transfer defendant, would assign its lien on the estate's $1.7 million in cash to a trust to pay administrative and tax claims, with any balance distributed pro rata on general unsecured claims; all parties would exchange releases; and the case would be dismissed. The priority WARN Act claimants would receive nothing. Section 349 authorizes dismissal, includes provisions designed to restore the prebankruptcy status quo, and permits the bankruptcy court to order otherwise "for cause." The "cause" must be consistent with the general purpose of section 349 to restore the prebankruptcy status quo. The Bankruptcy Code imposes priorities on distributions in chapter 7 and under a chapter 11 plan, which generally may not be varied without the consent of the holders of the priority claims. Although courts have in some circumstances approved distributions that deviate from Code-mandated priorities, they do so in service of a larger bankruptcy objective that is designed to enhance overall recoveries in the case. Here, the court approved the deviation as part of a final distribution in connection with a dismissal, and the order's provisions providing for distribution that differed from the Code's priority scheme were not consistent with restoring the pre-bankruptcy status quo. The Code does not authorize such deviations. Therefore, the structured dismissal order is reversed. *Czyzewski v. Jevic Holding Corp.*, 580 U.S. ___, 137 S. Ct. 973 (2017).

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statement and Voting

5.5 Confirmation, Absolute Priority

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Section 502(b)(6) cap does not apply to landlord's claim for attorneys' fees for litigating a pre-bankruptcy breach.** The debtor stopped paying rent under his lease. The landlord sued; the debtor counterclaimed. The arbitrator awarded the landlord damages for past due and future rent and attorneys' fees, as provided under the lease. The debtor filed bankruptcy. Section 502(b)(6) caps a landlord's claim "for damages resulting from the termination of a lease of real property. The cap does not apply to damages that would be awarded to the landlord even if the debtor had not rejected or terminated the lease. The arbitrator awarded the attorneys' fees for litigation over both past due rent and future rent. The claim for damages for past due rent and the associated attorneys' fees would have occurred even if the debtor assumed the lease in his bankruptcy. Therefore, they are not capped. But the claim for future rent and for attorneys' fees for litigating future rent result from the termination and are capped. *Kupfer v. Salma (In re Kupfer)*, ___ F.3d ___, 2016 U.S. App. LEXIS 19405 (9th Cir. Dec. 29, 2016).

6.1.b **In bankruptcy, a statute of limitations of the state of the parties' choice of law governs if longer than the forum's statute.** The debtor signed a note that was governed by Ohio law without regard to conflict of law principles. The debtor defaulted and later filed bankruptcy in California within six years. California's statute of limitations is four years; Ohio's is six years. Because bankruptcy is a federal proceeding and does not rely on diversity, federal choice of law rules apply. The Ninth Circuit looks to the Restatement for those rules. Under federal choice of law rules, ordinarily, a contractual choice of law provision does not govern the choice of a statute of limitations, which is generally considered procedural. The 1988 version of section 142 of the Restatement permits deviation from that rule in "exceptional circumstances [that] make such a result unreasonable." While a plaintiff that files in a state after its short statute of limitations expires may refile in the other state to preserve the claim, a creditor in bankruptcy may not do so. Therefore, application of the forum state's shorter statute of limitations would be unreasonable, and the longer Ohio statute of limitations applies, making the claim timely. *PNC Bank v. Sterba (In re Sterba)*, ___ F.3d ___, 2017 U.S. App. LEXIS 5892 (9th Cir. Apr. 5, 2017).

6.1.c **Lender's false estoppel certificate leads to claim disallowance and breach of contract damages.** With its loan approaching maturity, the debtor received an offer to buy the real property securing the loan. It needed an estoppel certificate from the lender, which had acquired the loan from the FDIC with a "shared loss" agreement under which the FDIC reimbursed the lender for 80% of the difference between the loan's book value and the actual recovery. Despite a state court judgment against the lender that prohibited the lender from charging interest for a period during a prior falsely-called default, the lender included the interest and other improper amounts in the estoppel certificate. The purchase offer exceeded the actual loan payoff amount but was less than the false estoppel certificate amount. As a result, the debtor was unable to sell the property, leading to the bankruptcy filing. In the bankruptcy case, the lender sought the previously disallowed interest and other amounts attributable to a default that would not have occurred if it had provided an accurate estoppel certificate. The court finds that the lender's protection from the shared loss agreement provided the lender the incentive to attempt to collect more than was owed on the loan. The bankruptcy court has authority to determine and enter a final order on the allowable amount of a claim against the estate and on the amount of any contract counterclaim that is necessarily resolved as part of the claims allowance process. Here, the court disallows the previously disallowed interest and the other amounts attributable to the false default and enters judgment against the lender on the debtor's breach of contract claim for all the costs of the bankruptcy, which the court finds would not have been incurred if the lender had provided an accurate estoppel certificate. *Kraz, LLC v. Branch Banking & Trust Co. (In re Kraz, LLC)*, ___ B.R. ___, 2017 Bankr. LEXIS 1066 (Bankr. M.D. Fla. Apr. 18, 2017).

6.2 Priorities

6.2.a **Rule of Explicitness applies in post-bankruptcy action between lenders.** Lenders entered into an Intercreditor Agreement that provided for payment of "any interest then due and payable" pro rata among the senior and subordinated debt tranches before payment of principal. It provided "interest hereunder shall be due and payable … before and after judgment, regardless of whether an Insolvency or Liquidation Proceeding exists in respect of Borrower, and, to the fullest extent permitted by law, the Lenders shall be entitled to receive post-petition interest." The chapter 7 trustee distributed collateral proceeds to the collateral agent, who held them pending nonbankruptcy litigation between holders of different tranches of debt over entitlement to payment of postpetition interest. The Rule of Explicitness permits a senior creditor to enforce a subordination provision of a junior creditor's claim to the senior creditor's postpetition interest claims only if the intent to do so is explicit in the agreement. Although the Rule began as a bankruptcy rule under the Bankruptcy Act, the New York courts have adopted it as a state law rule. The Rule applies generally to subordination of claims to postpetition interest, not just as between senior and junior creditors. Here, the ICA is explicit that it subordinates principal payment on senior tranches to postpetition interest owing on all tranches. Because the litigation is after bankruptcy, the phrase "to the fullest extent permitted by law" does not incorporate Bankruptcy Code section 502(b)(2)'s disallowance of postpetition interest. Therefore, the collateral agent must distribute the funds to pay postpetition interest on all tranches before any payments of principal on the senior tranche. *U.S. Bank N.A. v. T.D. Bank, N.A.*, ___ B.R. ___, 2017 U.S. Dist. LEXIS 14954 (S.D.N.Y. Jan. 27, 2017).

6.2.b **Section 510(b) does not subordinate a claim for the debtor's conversion of stock.** The debtors and the creditor were initially stockholders in a corporation. After the creditor became ill, he stopped participating in the corporation's activities, and the debtors fraudulently canceled his shares. He sued and won judgment against the debtors for the value of his shares at the time they were canceled. The debtors filed bankruptcy cases. Section 510(b) subordinates any claim "arising from the purchase or sale" of a "security of the debtor or of an affiliate of the debtor." The claim here did not arise from the creditor's purchase but from the debtors' conversion of the creditor's shares many years after the purchase. Therefore, section 510(b) does not apply to the creditor's claim. A dissent argues that the broad reading the courts have given section 510(b) requires a different result, because the creditor would not have had his claim but for his initial purchase of the shares. *Khan v. Barton (In re Khan)*, 846 F.3d 1058 (9th Cir. 2017).

6.2.c **Section 510(b) does not subordinate the claims of purchasers of an SPV that owns the debtor's securities.** The debtor contracted with a placement agent to issue non-voting preferred securities. The placement agent subcontracted with a subagent. The subagent formed a special purpose vehicle and sold membership interests in the SPV to raise money for the SPV to acquire the debtor's non-voting preferred securities. The membership interest purchasers filed proofs of claim for the debtor's violations of the securities laws. Section 510(b) subordinates a claim for damages arising from the purchase or sale of a security of the debtor or of an affiliate of the debtor. The membership interest purchasers held securities of the SPV, not of the debtor. An affiliate includes an entity owning 20% or more of the debtor's voting securities or "person whose business is operated under a lease or operating agreement by a debtor." To qualify, the debtor must be a party to the lease or operating agreement. Here, even if the debtor operated the SPV, the debtor was a party to the contract with the agent but not with the subagent, so the SPV does not qualify as an affiliate. Therefore, section 510(b) does not subordinate the membership interest purchasers' claims. *In re FAH Liquidating Corp.*, 563 B.R. 160 (Bankr. D. Del. 2017).

7. CRIMES

8. DISCHARGE

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8.2 Third-Party Releases

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10. INDIVIDUAL DEBTORS

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10.2 Dischargeability

10.3 Exemptions

10.4 Reaffirmations and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a **"Related to" jurisdiction includes a proceeding that impacts in any way on the handling and administration of the estate.** The chapter 7 trustee sued the debtor's shareholder to avoid and recover a fraudulent transfer. During the litigation, the trustee's law firm hired the judge's fiancé. The shareholder moved to disqualify the judge. Ultimately, the judge recused himself. The shareholder sued the trustee's law firm in state court for conspiracy to obstruct justice and fraudulent corruption of the judicial process. The law firm removed the action to the bankruptcy court, which granted a motion to dismiss and certified the order for direct appeal to the court of appeals. A bankruptcy court has jurisdiction over proceedings arising under title 11 or arising in or related to a bankruptcy case. An action arises under title 11 if title 11 provides the rule of decision. It arises in a title 11 case if it could exist only in the bankruptcy context. Neither condition applies here, since judicial misconduct can exist in any context. A proceeding is related to a bankruptcy case not only if its outcome could conceivably have any effect on the estate's assets or liabilities, but also if it impacts in any way on the handling and administration of the estate. Because the action alleged that the law firm's conduct affected the handling of the bankruptcy case, the bankruptcy court had related to jurisdiction. *Wortley v. Bakst*, 844 F.3d 1313 (11th Cir. 2017).

11.1.b **Bankruptcy court does not have "related to" jurisdiction over a fraudulent transfer defendant's cross-claims.** The Ponzi scheme trustee sued an account holder to avoid and recover fraudulent transfers and to recover fees the account holder's custodian received as a subsequent transferee. The account holder cross-claimed against the custodian for fraud, negligence, and breach of contract, among other claims. The holder argued its defense of the trustee's avoiding power claims—lack of knowledge of the fraud—and its claims against its custodian were based on the same facts. A bankruptcy court has related to jurisdiction over a proceeding whose outcome might have a conceivable effect on the estate. Here, the account holder's claim against the custodian would have no effect on the estate. Even common facts in the avoiding power claim and the cross-claim are insufficient to establish an effect on the estate where the outcome of the cross-claim will not affect the estate's assets or claims. Therefore, the court dismisses the cross-claim. *Picard v. HSBC Bank PLC (In re Bernard L. Madoff Inv. Secs. LLC)*, 561 B.R. 334 (Bankr. S.D.N.Y. 2016).

11.2 Sanctions

11.3 Appeals

11.3.a **Court of appeals does not have direct appeal jurisdiction over a report and recommendation in a related proceeding.** The trustee sued to avoid transfers. During the litigation, the trustee's law firm hired the bankruptcy judge's fiancé. After the court issued judgment for the trustee, the defendants sued the trustee's lawyer and the judge's fiancé in state court for conspiracy to obstruct due operation of law and for fraudulent corruption of the judicial process. The lawyer and fiancé removed the action to the bankruptcy court, which granted their motion to dismiss and certified the order for direct appeal to the court of appeals. A court of appeals, upon appropriate certification, may have direct appellate jurisdiction over a final judgment, order, or decree of the bankruptcy court. A core proceeding is one that arises under title 11, that is, based on a claim or right established by the Bankruptcy Code, or that arises in a case under title 11, that is, one that could not exist outside of bankruptcy. The proceeding against the lawyer and fiancé here are not core proceedings, because they assert state law tort claims and address an issue—judicial corruption—that can arise in any court or proceeding. A proceeding is related to a title 11 case if its outcome could have any conceivable effect on the bankruptcy estate. The proceeding here could have such an effect, because its outcome could result in setting aside the avoidance judgment against the defendants. A bankruptcy court does not have authority to issue a final judgment in a related proceeding without the parties' consent, which was not given here. Its determination may be treated as a report and recommendation to the district court. As such, it is not a judgment, order, or decree over which the court of appeals has appellate jurisdiction. The court dismisses the appeal. *Wortley v. Bakst*, 844 F.3d 1313 (11th Cir. 2017).

11.4 Sovereign Immunity

11.4.a **Section 106 does not abrogate an Indian tribe's sovereign immunity or waive it upon filing a proof of claim, because the tribe is not a governmental unit.** The debtor provided cash processing services for an Indian casino under a services agreement. Shortly before bankruptcy, the debtor failed to reimburse the casino for cash the casino expended; the casino filed a proof of claim. The trustee sued the casino to avoid and recover as preferences payments the debtor had made to the casino under the services agreement. Section 106(a) abrogates sovereign immunity "as to a governmental unit" for certain purposes under the Code, including preference avoidance and recovery. "Governmental unit" means the United States, the states, their various agencies and instrumentalities, a foreign state, or "other foreign or domestic government." Congress may abrogate an Indian tribe's sovereign immunity only by clear and unequivocal language. The general reference to "other foreign or domestic government" does not suffice. A tribal entity enjoys the tribe's sovereign immunity based on its relationship to the tribe, principally based on whether it operates as an arm of the tribe. Here, the casino is owned by the tribe, carries out the tribe's interests, and transmits all proceeds to the tribe and therefore is an arm of the tribe that enjoys sovereign immunity from the trustee's action. Section 106(b) provides, "A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity" with respect to claims against the governmental unit that arose out of the same transaction or occurrence. Because a tribe is not a governmental unit, section 106(b) does not apply. So there is neither abrogation nor waiver of the tribe's sovereign immunity. *Casino Caribbean, LLC v. Money Centers of Am., Inc. (In re Money Centers of Am., Inc.)*, 565 B.R. 87 (Bankr. D., Del. 2017).

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.2 Turnover

12.3 Sales

12.3.a **Lack of notice vitiates sale free and clear of recorded right of first refusal.** The debtor had previously granted a right of first refusal if the debtor sold its real property. The grantee recorded the right in the land records office. The debtor did not list the grantee on its creditors list filed with its chapter 11 petition, so the grantee did not receive written notice of the filing. The chapter 11 plan provided for a sale at auction of the real property free and clear of all claims and interests. The grantee did not receive written notice of the sale, and whether the grantee's attorney received oral notice shortly before the hearing on the sale was disputed. After the buyer sold the real property to a third party, the grantee sued the buyer for violating its right of first refusal. Rule 60(b)(4) permits a challenge to a sale order "in the rare instance where a judgment is premised either on a certain type of jurisdiction error or on a violation of due process that deprives a party of notice of the opportunity to be heard." The lack of notice to the grantee meets this requirement. Section 363(m) and general bankruptcy policy protect a good faith purchaser at a bankruptcy sale. The recording of the right of first refusal gave constructive notice to the world of the right, preventing the purchaser from being a good faith purchaser for this purpose. Therefore, the court determines that the sale order was not effective to convey the real property free and clear of the right of first refusal. *In re Olsen*, 563 B.R. 899 (Bankr. E.D. Wis. 2017).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.1.a **Barton applies to a foreign proceeding.** The plan confirmation order vested assets, including causes of action, in a plan administrator, whom the plan charged with collecting and distributing them. The plan administrator established a Delaware LLC, of which the administrator was the managing member, and assigned to the LLC claims under insurance policies. The policies were issued by Bermuda insurers and had Bermuda arbitration clauses. The administrator and the LLC commenced an action in the bankruptcy court to collect on the policies. While asserting in the bankruptcy court that the claims were subject to arbitration in Bermuda, the insurers commenced an action against the administrator and the LLC in Bermuda seeking to enjoin them from pursuing the bankruptcy court action and requiring arbitration in Bermuda. *Barton v. Barbour*, 104 U.S. 126 (1881), held that a state court lacks jurisdiction over an action against a federal court receiver brought without leave of the court that appointed the receiver. Any such action interfered with the administration of the receivership and therefore with the jurisdiction of the receivership court. The courts have extended the doctrine to encompass bankruptcy trustees, those assisting them in carrying out their duties (such as counsel), those who are the trustee's "functional equivalent," and those whose statutory duties are similar to a trustee's, all with the purpose of centralizing bankruptcy litigation in the bankruptcy court and keeping a watchful eye on bankruptcy professionals. Accordingly, the doctrine also applies to a plan administrator appointed under a plan confirmation order, and it applies whether the action is brought in a domestic or foreign court. In *Barton*, the Supreme Court, acting as the court of last resort over federal courts' decisions and certain state court decisions implicating federal rights, had power to determine the extent of the interfering state court's jurisdiction. It does not have similar power over a foreign court. Perhaps recognizing this inherent weakness in the doctrine's international reach, the bankruptcy court enjoins the insurers from pursuing the Bermuda action and requires they dismiss it. *MF Global Holdings Ltd. v. Allied World Assur. Co Ltd. (In re MF Global Holdings Ltd.)*, 562 B.R. 866 (Bankr. S.D.N.Y. 2017).

13.2 Attorneys

13.2.a **Res judicata effect of sale order does not bar claim against law firm for breach of fiduciary duty to former clients who were unsuccessful bidders.** Before bankruptcy, the debtor's principals retained a law firm to advise them how to retain control over their closely-held corporation in the face of impending defaults to lenders. After advising them on strategies, including the benefits of a bankruptcy sale, and without obtaining a conflict waiver from the principals, the law firm switched to representing the debtor, filed the debtor's bankruptcy case, and arranged for a former partner to represent the principals. The law firm did not disclose the prior engagement in its employment application. During the case, the law firm helped to engineer a sale of the debtor's assets to a competing bidder with which it also had a relationship. Because of delays in the sale process and in collateral proceedings, the principals lost their financing for the purchase and did not bid at or object to the sale. After the bankruptcy court approved the sale and the sale closed, the bankruptcy court confirmed a liquidation plan. The principals later sued the law firm and two partners for breach of fiduciary duty, tortious interference with economic advantage, and common law fraud. Res judicata bars a claim that was or could have been brought in a prior action if a prior final judgment on the merits between the same parties involved the same causes of action. Translating res judicata principles to bankruptcy judgments is "awkward" because of the different procedural posture of bankruptcy proceedings, among other reasons. Courts are careful not to allow later actions to undo the effect of a bankruptcy court order. Here, although the principals could have raised their claims of law firm misconduct in the sale proceeding, they could not have sued the law firm in that proceeding. The claim against the law firm does not involve the estate or the purchaser and so does not threaten the finality of or impair the rights or interests established by the bankruptcy court's sale and plan confirmation hearing. Therefore, res judicata does not bar the principals' post-bankruptcy claim against the law firm. *Brown Media Corp. v. K&L Gates, LLP*, ___ F.3d ___, 2017 U.S. App. LEXIS 6481 (2d Cir. Apr. 14, 2017).

13.3 Committees

13.4 Other Professionals

13.5 United States Trustee

14. TAXES

14.1.a **State law specifying interest rate only in bankruptcy is not a "nonbankruptcy law."** The debtor's chapter 13 plan provided for payment of delinquent taxes, plus interest at 12%. A state statute imposed a 12% interest rate and a 6% penalty rate on overdue taxes. The statute provided, "For purposes of any claim in a bankruptcy proceeding …, the assessment of penalties … constitutes the assessment of interest." Under section 511, the present value calculation of plan tax payments must use "the rate determined under applicable nonbankruptcy law." States may promulgate bankruptcy laws, as long they are not inconsistent with federal law. Therefore, "nonbankruptcy law" in section 511 means federal or state law that applies generally, not only in bankruptcy. The state law here treating the penalty as interest applies only in bankruptcy cases and is therefore a bankruptcy law. Therefore, under section 511, it is not a "rate determined under applicable nonbankruptcy law." *Metro. Gov't of Nashville v. Hildebrand (In re Corrin)*, 849 F.3d 653 (6th Cir. 2017).

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **Chapter 15 does not prevent giving preclusive effect to a foreign judgment in a U.S. case.** The defendant had brought a winding up petition in the Cayman Islands against a company in which he was a 50% owner. The plaintiff (the other 50% owner) opposed the winding up petition on various grounds relating to the defendant's conduct and sued the defendant in Connecticut for damages resulting from that conduct. Section 1501 permits a court to grant recognition of a foreign proceeding under chapter 15 where a foreign representative seeks assistance in the United States in connection with a foreign proceeding, assistance is sought in a foreign country in connection with a title 11 case, a foreign proceeding and a title 11 case concerning the same debtor are pending concurrently, or creditors or other parties in interest in a foreign country have an interest in requesting the commencement of, or participating, in a title 11 case or proceeding. None of those conditions apply in this case. Therefore, chapter 15's recognition procedures and requirements do not apply to the Cayman judgment, and they do not prevent the Connecticut court from giving it issue preclusive effect. *Trikona Advisers Ltd. v Chugh*, 846 F.3d 22 (2d Cir. 2017).