JENNER&BLOCK

Recent Developments in Bankruptcy Law, July 2017

(Covering cases reported through 568 B.R. 157 and 854 F.3d 1260)

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1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a **Police and regulatory power exception to the automatic stay applies to the government's False Claims Act action.** The debtor operated nursing homes. The U.S. government asserted claims under the False Claims Act for the debtor's billing and other violations. The debtor filed a chapter 11 case. The government filed a False Claims Act action against the debtor in the district court, and the parties filed a joint motion in the action to determine whether the police and regulatory power exception to the automatic stay applied to the FCA action. Section 362(b)(4) excepts from the automatic stay an action by a governmental unit to enforce its police or regulatory power. The exception applies if the action does not relate primarily to the protection of the government's pecuniary interest nor seek to adjudicate private rights. FCA actions "serve to inflict the sting of punishment on wrongdoers and, more importantly, deter fraud against the government." Although only the bankruptcy court may grant relief from the stay, a court in which an action is pending has jurisdiction to determine whether the action is subject to the stay. An FCA action liquidates the government's claim and does not give the government a pecuniary advantage against other general unsecured creditors. FCA actions effectuate public policy by deterring fraud and are not for the purpose of adjudicating private rights. Therefore, the exception applies. *U.S. v. Vanguard Healthcare, LLC*, 565 B.R. 627 (M.D. Tenn. 2017).

1.1.b **Seizure under the Mandatory Victims Restitution Act is not subject to the automatic stay.** After confirmation of the debtor's chapter 13 plan, the government seized the debtor's pension and retirement benefits under the Mandatory Victims Restitution Act (MVRA) on account of a prepetition criminal restitution award against the debtor. The automatic stay prohibits any act to collect or recover on a prepetition claim. The MVRA, enacted in 1996, permits the government, "[n]otwithstanding any other Federal law," to enforce a judgment imposing a criminal fine "against all property or rights to property of the person fined." 18 U.S.C. § 3613(a). The MVRA's later enactment and its broad "notwithstanding" clause supersedes any other federal enactment, including the automatic stay. Therefore, the seizure did not violate the automatic stay. *Partida v. U.S. (In re Partida)*, 531 B.R. 811 (9th Cir. B.A.P. 2015), *aff'd*, 2017 U.S. App. LEXIS 12166 (9th Cir. July 7, 2017).

1.2 Effect of Stay

1.3 Remedies

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **Section 548(a)(1) applies extraterritorially to transfers from a California to a German supplier under a German contract.** The California debtor issued payments from the United States to a German supplier under a development contract and a supply contract using funds provided under a Department of Energy loan program. The contracts provided for milestones to be achieved at the supplier's production facilities in Germany, German governing law and jurisdiction, and payment in euros. The debtor filed bankruptcy before receiving any products under the contracts. Under section 548(a)(1)(B), the trustee may avoid a transfer of property of the debtor in exchange for less than reasonably equivalent value made within two years before bankruptcy and while the debtor was insolvent. There is a presumption against applying a statute extraterritorially. To determine whether section 548(a) applies extraterritorially, the court must first determine whether the regulated or proscribed conduct occurred outside the United States and, if so, determine whether Congress intended the statute to apply to such extraterritorial conduct.

Here, the transfers' center of gravity was in Germany, so the regulated conduct occurred outside the United States. Section 548(a) permits avoidance of a transfer of an interest of the debtor in property. Under section 541(a)(1), property of the estate includes all interests of the debtor in property, wherever located. It would be anomalous to include property wherever located in property of the estate but not to include such property in the avoiding powers. Reading those sections together, the court concludes that Congress intended section 548(a) to apply extraterritorially, just as section 541(a)(1) does. *Emerald Cap. Advs. Corp. v. Beyerische Moteren Werke Aktiengesellschaft (In re FAH Liquidating Corp.)*, ___ B.R. ___, 2017 Bankr. LEXIS 1609 (Bankr. D. Del. June 13, 2017).

2.1.b **German fraudulent transfer law applies to transfers from a California company to a German supplier under a German contract.** A little more than two years before bankruptcy, the California debtor issued payments from the United States to a German supplier under a development contract and a supply contract using funds provided under a Department of Energy loan program. The contracts provided for milestones to be achieved at the supplier's production facilities in Germany, German governing law and jurisdiction, and payment in euros. The debtor filed bankruptcy before receiving any products under the contracts. Under section 544(b), the trustee may avoid a transfer of property of the debtor that a creditor may avoid under applicable nonbankruptcy law. California fraudulent transfer law permits avoidance of a transfer made within four years before the commencement of the action; German law provides a shorter period that would not cover the transfers. The court should apply the "most significant relationship" choice of law standard used for tort and restitution claims to determine which law to apply in a fraudulent transfer action. Here, although the transfers originated in the United States, the contracts are governed by German law, they provide exclusive jurisdiction in the German courts to resolve disputes, and the contract performance was to take place in Germany. Therefore, Germany has the most significant relationships, and German law applies. *Emerald Cap. Advs. Corp. v. Beyerische Moteren Werke Aktiengesellschaft (In re FAH Liquidating Corp.)*, ___ B.R. ___, 2017 Bankr. LEXIS 1609 (Bankr. D. Del. June 13, 2017).

2.1.c **Where debtor defrauds a single creditor, the Ponzi scheme presumption is unavailable.** The debtor factored invoices with a lender. At some point, the debtor began creating phony invoices to factor. To repay the factor the amounts advanced on the phony invoices, the debtor created new phony invoices, and so on, until the scheme collapsed. The trustee sued the factor to recover the debtor's payments as fraudulent transfers. The Ponzi scheme presumption permits the finding, without further proof, that every transfer was made with actual intent to defraud creditors. The presumption applies only in a Ponzi scheme, which is a fraudulent investment scheme in which the fraudster uses money invested by later investors to pay prior investors, creating the illusion of profitability. Here, there was only one investor, the factor, so the Ponzi scheme presumption does not apply. And a debtor's transfer to a creditor of the creditors' own collateral is not a fraudulent transfer, because the creditor already has rights in the property, and the transfer does not deplete the estate. So the transfers are not avoidable as fraudulent transfers. *Ehrlich v. Comm'l Factors of Atlanta*, 567 B.R. 684 (N.D.N.Y. 2017).

2.2 Preferences

2.2.a **Debtor's deposit to cover final bank account overdrafts is a preference.** The debtor maintained two accounts with the bank. Within the 90 days before bankruptcy, the debtor overdrew its checking account multiple times. The bank provisionally settled the overdrafts pending the midnight deadline (midnight of the next business day), and the debtor often covered the intraday overdraft before the midnight deadline. But several times, it did not, and the provisional settlement became final. The debtor then covered the final overdrafts later. A preference is a transfer of property of the debtor within 90 days before bankruptcy to or for the benefit of a creditor for or on account of an antecedent debt that enables the creditor to receive more than it would have received in a chapter 7 case if the transfer had not been made. A debt is liability on a claim. A claim is a right to payment. Under the U.C.C., a final overdraft is considered an unsecured loan or extension of credit. Therefore, the debtor's deposits to cover final overdrafts were for or on account of an antecedent debt to the bank. A transfer is "to" a creditor only if the creditor is not a mere conduit. A creditor that has dominion and control over the transferred property is not a mere conduit. Once the debtor made deposits into its account, the bank had already honored the check and paid the payee, so the bank had full dominion and control over the new funds. *Sarachek v. Luana Sav. Bank (In re AgriProcessors, Inc.)*, 859 F.3d 599 (8th Cir. 2017).

2.2.b **Unplanned overdrafts that increased in frequency during the preference period were not debts incurred in the ordinary course.** The debtor maintained two accounts with the bank. During the period beginning one year before bankruptcy and ending 90 days before bankruptcy, the debtor overdrew its checking account four times, including three times within five months before bankruptcy. Within the 90 days before bankruptcy, the debtor overdrew its checking account on nine days. The overdrafts were unplanned, and the bank discouraged them. The bank provisionally settled the overdrafts pending the midnight deadline (midnight of the next business day), and the debtor often covered the intraday overdraft before the midnight deadline. But several times, it did not, and the provisional settlement became final. The debtor then covered the final overdrafts later. A preference is a transfer of property of the debtor within 90 days before bankruptcy to or for the benefit of a creditor for or on account of an antecedent debt that enables the creditor to receive more than it would have received in a chapter 7 case if the transfer had not been made. Under section 547(c)(2), the trustee may not avoid a preference if the debt was "incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee." The "ordinary course" test under this provision is the same as under the "ordinary course" test for when a transfer is made in the ordinary course, which depends on the consistency with which the debtor and creditor transacted business. Business practices before the debtor's slide into bankruptcy are more relevant than during the months leading to bankruptcy. Because the overdrafts were unplanned and increased in frequency during the 90-day preference period, they were not in the debtor's and bank's ordinary course of business. *Sarachek v. Luana Sav. Bank (In re AgriProcessors, Inc.)*, 859 F.3d 599 (8th Cir. 2017).

2.2.c **In applying the greater amount test in a preference action, a court may conduct a hypothetical preference analysis within a hypothetical chapter 7 case.** The bank's claim was secured by a security interest in the debtor's deposit account and the bank's setoff right against the account. The debtor sold its real property. On the same day, it paid its bank lender $190,000 and deposited the remaining sale proceeds of $550,000 into its account with the bank. Before the deposit, the account had $170,000. By the petition date five weeks later, the debtor had spent about $135,000 from the account. The trustee sued to recover the payment as a preference. A preference is a transfer of property of the debtor to or for the benefit of a creditor, for or on account of an antecedent debt, within 90 days before bankruptcy, that enabled the creditor to receive more than it would have received if the transfer had not been made and the creditor "received payment of such debt to the extent provided by the provisions of this title." In determining whether the bank received more, the court may conduct a hypothetical preference analysis in the chapter 7 case as if the loan payment had not been made. In this case, if the payment had not been made before bankruptcy, the debtor would have deposited the entire amount into its bank account. The bank would have had a security interest and a setoff right in the account on the petition date. Therefore, the deposit was a transfer that enabled the bank to receive more than if the loan payment had not been made, and the deposit would have been an avoidable preference to the extent of the amount of the loan. Therefore, the loan payment enabled the bank to receive more than if the payment had not been made. *Schoenmann v. Bank of the West (In re Tenderloin Health)*, 849 F.3d 1231 (9th Cir. 2017).

2.3 Postpetition Transfers

2.4 Setoff

2.5 Statutory Liens

2.6 Strong-arm Power

2.6.a **A state's non-uniform U.C.C. automatic security interest perfection rules apply only to a debtor incorporated in that state.** The debtors were incorporated in Delaware and Oklahoma. They purchased oil from producers in Texas and Kansas and sold it to end users. In non-uniform amendments to the U.C.C., Texas and Kansas law provide that an oil producer has an automatic, automatically perfected security interest in the oil in favor of the producer to secure the purchaser's payment obligation to the producer, and the security interest continues in the oil when the buyer sells it to the end user. Here, the producers brought a claim against the end users, relying on the security interest. All four states adopted the same U.C.C. choice of law provision. It provides that perfection is determined by the law of the debtor's state of incorporation. Delaware and Oklahoma did not adopt the automatic perfection rules benefiting oil producers that Texas and Kansas adopted, so perfection under Delaware and Oklahoma law requires filing a UCC-1 financing statement with the secretary of state. Relying on Texas and Kansas law, the producers did not file financing statements. Therefore, their security interests were not perfected, and the debtors properly sold the oil to the end users free and clear of the security interests. *Arrow Oil & Gas, Inc. v. J. Aron & Co. (In re Semcrude L.P.)*, ___ F.3d ___, 2017 U.S. App. LEXIS 12975 (3d Cir. July 19, 2017).

2.7 Recovery

3. BANKRUPTCY RULES

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a **Directors ousted by a receiver cannot authorize the corporation's bankruptcy petition.** At the request of a corporation's shareholders, the state court appointed a receiver, finding the directors liable for gross mismanagement. The appointment order authorized the receiver to replace the directors. The receiver did so. Later, the former directors filed a bankruptcy petition for the corporation. State law determines who may authorize a corporation's bankruptcy filing. State law here authorizes the current directors to authorize a filing. Bankruptcy policy does not permit state law to restrict a corporation's ability to seek bankruptcy relief. The state court's order does not restrict the corporation's ability to file bankruptcy; it just authorizes the appointment of a different board, which then has the authority to file. Thus, the order is not a restriction on the corporation's ability to file. The former directors lost their authority when the receiver replaced them. Accordingly, the court dismisses the petition. *Sino Clean Energy Inv. v. Seiden*, 565 B.R. 677 (D. Nev. 2017).

4.1.b **Independent director's inaction ratified debtor's board authorization to file bankruptcy.** The single asset real estate debtor's organizational documents required the consent of an independent manager as a condition to the filing of a bankruptcy petition. The debtor filed a chapter 11 case without that consent. On the secured lender's motion to dismiss, the court ruled that the consent was required but might be obtained by the independent director's ratification of the filing and offered the director the opportunity to appear and be heard in the case. The debtor and the creditor notified the independent director of the court's ruling and deposed the director about his position on the bankruptcy filing. The director took no position. State law determines the requirements for a juridical person to authorize a bankruptcy filing. Here, state law recognized the validity of the unanimous consent provision. State law also permits ratification of a corporate action after the fact, and a court may infer ratification by silence when, despite obtaining full knowledge of the facts, the director does not disavow the action. The independent director's failure to object to or disavow the filing constitutes a ratification of the board's action, providing the necessary consent to the filing. *In re Tara Retail Group, LLC*, ___ B.R. ___, 2017 Bankr. LEXIS 1330 (Bankr. N.D.W. Va. May 4, 2017).

4.2 Involuntary Petitions

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.1.a **Non-profit debtor in possession may sell assets free and clear of Attorney General's consent rights.** The nonprofit hospital ran out of funds during its chapter 11 case and closed. It proposed to sell the closed facility, with its suspended state hospital license under section 363, to a for-profit buyer, without compliance with state law that permits the Attorney General to impose conditions on a sale of a non-profit hospital to a for-profit buyer. Section 363(d)(1) permits sale of a non-profit debtor's estate assets only "in accordance with nonbankruptcy law applicable to the transfer of property" by a non-profit. Section 363(f) permits a sale of property of the estate free and clear of an interest in that property. "Interest in property" includes obligations that arise from or are connected to the property; courts favor a broader definition of obligations that flow from the ownership of the property. Here, the Attorney General's authority to impose monetary conditions upon a sale, such as a requirement that the buyer provide a specified amount of charitable care, constitutes an interest in the hospital property that is subject to a free and clear sale under section 363(f). However, because the debtor was no longer operating a hospital, the Attorney General's consent rights did not apply, so section 363(d)(1) does not restrict the sale conditions. *In re Gardens Regional Hosp. and Med. Center, Inc.*, 567 B.R. 820 (Bankr. C.D. Cal. 2017).

5.1.b **Funder's control of litigation makes litigation finance champertous under North Carolina law.** A post-confirmation liquidating trust sought court approval of litigation financing to pursue claims. The financing terms required the trustee to make periodic funding requests and to consult regarding replacement counsel and permitted the funder to review litigation budgets, reject budget increase requests, and cut off financing at any point. Litigation proceeds would go first to pay off the funder's advances, including advances for the law firms' reduced hourly fees, and then to the law firms' reduced contingency fees, and then would be split 25%-75% between the funder and the liquidating trust, even if the funder had stopped making advances. Under North Carolina law, champerty is an agreement under which a stranger to litigation agrees to prosecute the suit at the stranger's own expense in exchange for a portion of litigation proceeds, but only where the stranger exercises control over the litigation. Here, the funder exercises control by retaining the right to refuse further funding advances, to veto budget increases, and to consult on replacement counsel. Therefore, the agreements are champertous and may not be approved. *In re Designline Corp.*, 565 B.R. 341 (Bankr. W.D.N.C. 2017)

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statement and Voting

5.5 Confirmation, Absolute Priority

5.5.a **Section 506(a) requires use in a plan of replacement value based on debtor's proposed use, even if lower than foreclosure value.** The debtor developed an affordable housing project. HUD guaranteed its $8.5 million first mortgage loan but imposed restrictions to require the project be used for affordable housing. The debtor obtained second and third mortgage loans from local and state governments, which imposed similar restrictions. The deed noted the restrictions, and they "ran with the land," but they also provided that a senior mortgagee's foreclosure sale would pass title free of the restrictions. After default, HUD paid the first mortgage lender, acquired the loan and sold the loan without the deed restrictions. The loan buyer began foreclosure proceedings, but the debtor stayed them with a chapter 11 petition. The debtor proposed a reorganization plan based on a new investment of $1.2 million from an unrelated third party. The bankruptcy court valued the property at $3.9 million with the restrictions. Evidence suggested the value without the restrictions would be about $7.5 million. Section 506(a) requires the court to value property based on the proposed use or disposition of the property. *Associates Commercial Corporation v. Rash*, 520 U.S. 953 (1997), requires use of replacement or going concern value rather than foreclosure value, which is typically lower, if the debtor retains and uses the property under the plan. Here, value is measured by the replacement value of an affordable housing project with restrictions, which the bankruptcy court found to be $3.9 million, rather than the value at a foreclosure, which the reorganization is intended to prevent. *First Southern Nat'l Bank v. Sunnyslope Housing Ltd. P'shp (In re Sunnyslope Housing Ltd. P'shp)*, ___ F.3d ___, 2017 U.S. App. LEXIS 11257 (9th Cir. June 23, 2017) (*en banc*).

5.5.b **Section 1111(b) does not apply after the collateral is sold.** The secured creditor held a junior non-recourse mortgage on real estate. In the debtor’s chapter 11 case, the senior secured mortgage creditor obtained stay relief and foreclosed. The foreclosure sale price exceeded the senior mortgage amount but was inadequate to pay the junior mortgage in full. The junior mortgage creditor filed a proof of claim for the balance. Section 1111(b) treats the holder of a nonrecourse claim that is secured by property of the estate under section 502 the same as if the creditor had recourse unless the creditor’s class makes the section 1111(b)(2) election or the property is sold under section 363 or under the plan. Although section 502 requires the court to determine a claim as of the petition date, section 1111(b) operates only on collateral that is property of the estate, and it cannot apply if the lien does not exist. Therefore, if the collateral is no longer property of the estate, section 1111(b) ceases to apply to provide the nonrecourse creditor an allowable unsecured recourse claim. *Mastan v. Salamon (In re Salamon)*, 854 F.3d 633 (9th Cir. 2017).

5.5.c **Court approves substantive consolidation for plan purposes over guaranteed creditor’s objection.** The debtor and its subsidiaries operated a single business as a single economic unit under a single business plan, under single control from a single shared headquarters. They shared overhead, management, accounting, and other back office functions, used a consolidated cash management system, and prepared and published consolidated financial statements and filed a consolidated tax return. They had significant intercompany obligations, which would have taken time and expense to reconcile. Any delay in exiting from chapter 11 would have worsened their business problems and made recovery more difficult. The parent debtor guaranteed the subsidiary debtor’s obligations. The debtors proposed a plan that substantively consolidated the estates only for plan distribution and claims allowance purposes, eliminating any double claims from guarantees. A court may substantively consolidate if creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit or the debtors’ affairs are so entangled that consolidation will benefit all creditors. Here, the consolidated operations, finances, and financial statements suggest creditors dealt with the entities as a single unit, and consolidation benefits creditors because it accelerates the debtors’ exit from bankruptcy. *In re Republic Airways Holdings Inc.*, 565 B.R. 710 (Bankr. S.D.N.Y. 2017).

5.5.d **Court issues plan injunction to protect city from employees’ mandatory indemnification claims for civil rights violations.** The chapter 9 debtor was subject to numerous civil rights claims under 28 U.S.C. 1983, arising from the city’s police officers’ actions. State law requires the city to indemnify the officers for their costs of defense and any liability. The debtor proposed a plan under which general unsecured creditors, including the civil rights claims, would receive 1% on their allowed claims. The plan also enjoined the claimants from pursuing their claims against the police officers, whom the city would have had to indemnify. The city could not afford to pay more without impairing its ability to perform under its fiscal recovery plan. Under Ninth Circuit case law, section 524(e) prohibits third party releases and injunctions. However, section 524(e) does not apply in a chapter 9 case. The court has jurisdiction to address the claimants’ claims against the police officers, because their claims give rise to indemnification obligations, which would affect the city and the chapter 9 case. Section 105(a) gives the court authority to issue the injunction to carry out the provisions of chapter 9 and of the plan if three conditions are met: the injunction is express, an integral part of the plan, and supported by specific factual findings regarding its necessity to the city's effective and efficient functioning, revitalization, or plan success. Here, the plan injunction was express and integral to the plan, because without it, the city effectively would have continued to be liable, albeit indirectly, to the claimants, which the city could not afford. *In re City of San Bernardino, Calif.*, 566 B.R. 46 (Bankr. C.D. Cal. 2017).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Employment discrimination claims seeking lost wages, instatement, future wages, and contract debarment are "claims."** After the debtor confirmed its plan, the Department of Labor filed three administrative complaints against the debtor for prepetition violations, asserting claims for lost wages, interest, front wages, and fringe benefits, including retroactive seniority, employee instatement, cancellation of government contracts, debarment from future government contracts, and a permanent injunction against continuing violations of Executive Orders prohibiting discrimination. A claim is a right to payment or a right to an equitable remedy for breach of performance if the breach gives rise to a right to payment. The economic loss claims the DOL seeks all constitute potentially dischargeable claims, because they all assert a right to payment. Equitable instatement is an alternative to front pay and therefore is also a claim. The demand for contract cancellation and debarment are backward looking and therefore also claims. The request for a permanent injunction is a forward looking attempt to prevent discrimination, which does not seek payment, and therefore is not a claim. *In re Pilgrim's Pride Corp.*, 564 B.R. 534 (Bankr. N.D. Tex. 2017).

6.2 Priorities

6.2.a **For purposes of section 503(b)(9), the debtor "receives" goods only when it takes physical possession.** The creditor shipped goods FOB (free on board) from China more than 20 days before the date of the filing of the petition. When goods are shipped FOB, the buyer assumes the risk of loss upon shipment. The debtor took physical possession of the goods when they arrived in the United States, within 20 days before the date of the filing of the petition. Section 503(b)(9) gives a creditor an administrative priority claim if the debtor receives the creditor's goods within 20 days before the date of the filing of the petition. The Code does not define "receive." But the context in which Congress adopted the legislation shows that Congress intended "receive" to have the same meaning as it does under the U.C.C. U.C.C. section 2-103(1)(c) defines "receipt" as "taking physical possession." Dictionary definitions of "receive" also define it as meaning to take physical possession. The court previously construed "receive" in section 546(c), which addresses reclamation rights, to mean take physical possession. Sections 503(b)(9) and 546(c) relate to the same subject matter and should be construed together. Therefore, the creditor is entitled to administrative priority under section 503 (b)(9). *In re World Imports, Ltd.*, ___ F.3d ___. 2017 U.S. App. LEXIS 12254 (3d Cir. July 10, 2017).

6.2.b **For purposes of section 503(b)(9), the debtor does not "receive" drop-shipped goods.** The supplier shipped goods directly to the debtor's customers, which the customers received within 20 days before the petition date. Section 503(b)(9) gives a creditor an administrative priority claim if the debtor receives the creditor's goods within 20 days before the date of the filing of the petition. The Code does not define "receive." But the context in which Congress adopted the legislation shows that Congress intended "receive" to have the same meaning as it does under section 546(c), which governs reclamation claims under U.C.C. 2-702 and 2-705. There, "receipt" requires physical possession, either directly or through the buyer's agent. The court also relies on the Third Circuit's opinion, issued three days earlier, in *In re World Imports, Ltd.*, ___ F.3d ___.

2017 U.S. App. LEXIS 12254 (3d Cir. July 10, 2017), which construed "receive" to require physical possession. Because neither the debtor nor its agent received the goods, section 503(b)(9) does not apply. *In re SPC Liquidation, LLC*, ___ B.R. ___, 2017 Bankr. LEXIS 1932 (Bankr. D. Del. July 13, 2017).

6.2.c **Employees' restricted stock unit claims are subordinated under section 510(b).** As part of their compensation, the debtor's employees received restricted stock units (RSUs) that vested after five years if the employees met certain employment-related conditions. The employer held the RSUs in trust until they vested. The employees were credited with additional RSUs in lieu of dividends that the debtor paid on its stock, and the employees were entitled to direct the trustee how to vote the shares. After bankruptcy, the employees filed proofs of claims for their RSUs. Section 510(b) subordinates to the level of equity securities a claim arising from the purchase or sale of an equity security of the debtor or for damages arising from the purchase or sale. An equity security includes stock and any other claim or interest commonly known as a security. The RSUs permitted participation in firm profits and therefore were equity securities. The claimants purchased the RSUs by exchanging their labor for the RSUs as compensation. Therefore, any claims arising from the purchase or for damages are subordinated. *In re Lehman Bros. Holdings Inc.*, 855 F.3d 459 (2d Cir. 2017).

7. CRIMES

8. DISCHARGE

8.1 General

8.2 Third-Party Releases

8.3 Environmental and Mass Tort Liabilities

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10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.3 Exemptions

10.4 Reaffirmations and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a **Bankruptcy court does not have jurisdiction over a dispute arising from a section 363 sale agreement.** The debtor in possession sold its assets in a section 363 sale. The sale agreement required the buyer to offer employment to the debtor in possession's employees and to pay severance pay to any it did not employ. The order approving the sale retained jurisdiction in the court to interpret and enforce the agreement and determine any disputes arising under or relating to the agreement. The buyer terminated two employees upon the closing. The employees sued the buyer in the bankruptcy court for severance pay. Section 1334(b) grants district courts jurisdiction over proceedings arising under title 11 or arising in or related to a title 11 case. A proceeding arises under title 11 when title 11 creates the cause of action. A proceeding is related to a title 11 case when the outcome could have any conceivable effect on the case. A proceeding arises in a title 11 case when, by its nature and independent of the particular factual circumstances, it would have no existence outside of bankruptcy. That an issue actually arose in a title 11 case, such as the severance pay dispute here, does not provide jurisdiction if the issue, by its nature, could equally have arisen outside of a bankruptcy case. Such a dispute is common under asset purchase agreements outside of bankruptcy, so the dispute here does not arise in the title 11 case. A court order may not "retain" jurisdiction that it does not have, so the order's retention of jurisdiction provision to resolve disputes under the contract does not expand the court's jurisdiction or permit the court to hear the action. Therefore, the court dismisses the action for lack of jurisdiction. *Gupta v. Quincy Med. Ctr.*, 858 F.3d 657 (1st Cir. 2017).

11.2 Sanctions

11.3 Appeals

11.3.a **A bankruptcy purchaser is not a person aggrieved by a creditor's violation of the automatic stay.** The debtor in possession sold its assets free and clear of all claims and interests. However, it had not given notice to a creditor in a pending state court action. After the sale, the state court entered judgment against the debtor and, on the creditor's motion, amended the judgment to include the purchaser as a judgment debtor. The purchaser moved the bankruptcy court for an order enforcing the automatic stay against the creditor to require the creditor to dismiss the action and for damages for stay violation. The bankruptcy court denied the relief, and the purchaser appealed. The automatic stay is a fundamental debtor protection. However, it does not protect a non-debtor, such as the purchaser. Only a person aggrieved by the bankruptcy court's order has standing to appeal. A person aggrieved is one whose pecuniary interests are directly and adversely affected by the order. Because the purchaser is not entitled to the automatic stay's protection, the purchaser is not a person aggrieved and does not have standing to appeal. *Encanto Restaurants, Inc. v. Aquino (In re Cousins Int'l Food Corp.)*, 565 B.R. 450 (1st Cir. B.A.P. 2017).

11.3.b **Appeal challenging whether a sale is free and clear of interests is not moot.** The trustee moved to sell real property free and clear of all interests. Two lessees of portions of the real property objected, relying on their right under section 365(h) to retain possession. The court approved the sale, expressly subject to a post-closing determination of the section 365(h) claims. The court later denied the claims, confirming the sale as free and clear of the leaseholds. The lessees appealed. Section 363(m) provides than an appeal from an order approving a sale to a good faith purchaser may not affect the validity of the sale. Here, the lessees did not challenge the sale's validity, only whether the sale was free and clear of their leasehold interests. Therefore, the appeal would not affect the sale's validity and is not mooted by the closing of the sale. *Pinnacle Restaurant at Big Sky, LLC v. CH SP Acquisitions, LLC (In re Spanish Peaks Holdings II, LLC)*, ___ F.3d ___, 2017 U.S. App. LEXIS 12526 (9th Cir. July 13, 2017).

11.4 Sovereign Immunity

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.2 Turnover

12.3 Sales

12.3.a **A trustee may sell real property free and clear of a lessee's rights under section 365(h).** The destination resort debtor leased some of its real property to affiliates for long terms at nominal rents. The affiliates no longer operated facilities on the leased property. The secured lender's mortgage was senior to the leases, and foreclosure would have eliminated the leases.

The trustee proposed to sell the real property free and clear of all interests under section 363(f), subject to a post-closing determination of whether section 365(h), which protects a tenant's possessory right after the trustee's rejection, prevented a sale free and clear of the leases. Section 363(f) and section 365(h) appear to conflict, but they each operate in their own separate spheres—in the contexts of sale of property and rejection of real property leases—which may overlap in some circumstances, as they do here. The court must attempt to harmonize the two provisions. Section 363(e) requires the court to provide adequate protection of an interest in property; its command covers leasehold interests. Section 363(f)(1) authorizes a sale free and clear of an interest in the property if "applicable nonbankruptcy law permits sale of such property free and clear of such interest." Here, foreclosure law would permit such a sale. Therefore, the trustee may sell free and clear of these leases, but subject to the lessees' rights to adequate protection. *Pinnacle Restaurant at Big Sky, LLC v. CH SP Acquisitions, LLC (In re Spanish Peaks Holdings II, LLC)*, ___ F.3d ___, 2017 U.S. App. LEXIS 12526 (9th Cir. July 13, 2017).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.1.a **Insured-versus-insured exception applies to a chapter 11 liquidating trustee.** The debtor's chapter 11 plan assigned claims against directors to a liquidating trustee, seeking to recover from the debtor's directors and officers insurance policy. However, the policy excluded coverage for "any claim made against an Insured Person … by, on behalf of, or in the name or right of the company or any Insured Person." After the trustee filed the lawsuit, the insurance carrier sought a declaration that the exclusion applied. Here, the debtor in possession, which for these purposes was the same entity as the Company, assigned the claims to the liquidating trustee, which therefore stands in the Company's shoes. Accordingly, the exclusion applies to the liquidating trustee the same as it would apply to the debtor. The court suggests the result might differ if there had been a chapter 11 trustee, which the dissent seizes upon as a reason for a different result. *Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373 (6th Cir. 2017).

13.2 Attorneys

13.2.a **Attorney directed by state court to prepare show cause order against debtor's counsel is not entitled to absolute quasi-judicial immunity for acts to collect the debt.** The debtor obtained a personal injury settlement, which his attorney placed in his client trust account. The attorney withdrew his own fees but held the balance for distribution to lien claimants to the funds. One of the lien claimants filed an interpleader action in state court but did not name the debtor or his attorney in the action. The debtor soon filed a chapter 7 case. The state court judge initially determined that a state law precedent required the debtor's attorney to deposit the funds in the state court and at a second hearing asked which attorney would prepare an order to show cause to bring the debtor's attorney before the state court to explain why the funds had not been deposited into the state court, rather than with the bankruptcy trustee. The interpleader plaintiff's attorney volunteered, and the state court ordered him to do so. The plaintiff's attorney prepared a draft and sent it to the debtor's attorney. In a later telephone call, the plaintiff's attorney told the debtor's attorney he would attempt to have the debtor's attorney held in contempt of the state court if the funds were not deposited with the state court. After another state court hearing, at which the debtor's attorney did not appear, the plaintiff's attorney sent the debtor's attorney a letter with a draft order to show cause. The debtor's attorney then brought an action to hold the plaintiff's attorney in contempt for violating the automatic stay by advocating that the funds belonged in the state court, urging that he be held in contempt for not doing so, and threatening with being held in contempt. Absolute judicial immunity insulates a court, and absolute quasi-judicial immunity its officers, from liability for judicial actions. It applies where an exercise of judicial or quasi-judicial discretion is required. Based on this functional approach, the plaintiff's attorney is not entitled to absolute quasi-judicial immunity, because each of the actions alleged in the complaint were independent of merely drafting the order to show cause and were private advocacy attempts to collect, not discretionary adjudicatory acts. Therefore, the attorney is subject to sanctions for violating the stay. *Burton v. Infinity Cap. Mgmt.*, ___ F.3d ___, 2017 U.S. App. LEXIS 12309 (9th Cir. July 10, 2017).

13.2.b **Court allows creditor's substantial contribution claim in a chapter 7 case.** The creditor and his counsel provided substantial assistance to the trustee in the trustee's action to recover property for the estate. Counsel applied for allowance of an administrative expense claim for a substantial contribution to the case. Under section 503(b), the court shall allow "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." Because the introductory language is nonexclusive, the limitation in paragraph (3)(D) to a chapter 9 and 11 case does not prohibit allowance of a substantial contribution claim in a case under another chapter. Therefore, the court allows the claim. *In re Maqsoudi*, 565 B.R. 40 (Bankr. C.D. Cal. 2017).

13.2.c **Absence of a creditors committee does not relax the standard for "substantial contribution" reimbursement under section 503(b)(4).** A creditor sought reimbursement of its attorney's fees for raising objections to the debtor's plan that a creditors committee might have raised if a committee had been serving in the case. Section 503(b)(4) permits the court to award a creditor reimbursement of its fees for making a substantial contribution in the case. The standard for awarding fees under section 503(b)(4) does not vary based on whether a creditors committee is serving in the case. Because the creditor did not meet that standard, the court denies the request for reimbursement. *In re KIOR, Inc.*, 567 B.R. 451 (D. Del. 2017).

13.3 Committees

13.4 Other Professionals

13.5 United States Trustee

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **Foreign representative may bring state avoiding power action if doing so does not require reliance on Code avoiding power rights.** The Brazilian banking supervisor appointed a trustee for the liquidation of a bank. The trustee obtained recognition under chapter 15 as a foreign representative and brought an action against entities owned by the individuals who controlled the bank, alleging that the individuals looted the bank and transferred the proceeds to the defendants. The trustee's action included claims under New York's Uniform Fraudulent Conveyance Act. Section 1521(a)(7) permits a bankruptcy court to grant a foreign representative additional relief, except for relief available under the Code's avoiding powers. Ordinarily, a bankruptcy trustee brings an action under state fraudulent transfer law, which typically permits only a creditor to sue to avoid a fraudulent transfer, by asserting a creditor's rights that section 544(b) give the trustee. However, if the trustee has standing in its own right to bring the action, such as if the trustee has the rights of creditors under the authorizing foreign law, the trustee need not rely on section 544(b) to bring the action. In this case, the court finds Brazilian law gives the trustee the rights of the bank's creditors, and on that basis, the trustee has standing to bring a New York fraudulent conveyance action. *Laspro Consultores LTDA v. Alinia Corp. (In re Massa Falida do Banco Cruzeiro do SUL S.A.)*, 567 B.R. 212 (Bankr. S.D. Fla. 2017).