JENNER&BLOCK

Recent Developments in Bankruptcy Law, October 2017

(Covering cases reported through 571 B.R. 490 and 864 F.3d 13)

RICHARD LEVIN
Partner
+1 (212) 891-1601
rlevin@jenner.com

TABLE OF CONTENTS

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

1. AUTOMATIC STAY

1.1 Covered Activities

1.2 Effect of Stay

1.3 Remedies

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **Trustee may use FDCPA and IRC for longer reach-back periods.** More than four years before bankruptcy, the debtor made transfers that the trustee alleged were fraudulent transfers. The applicable state fraudulent transfer law provided a four-year reach-back period. One of the debtor's major creditors was the IRS, who had a substantial allowed unsecured claim. Section 544(b) permits the trustee to avoid a transfer that is avoidable under applicable law by a creditor holding an allowed unsecured claim. The Federal Debt Collection Procedures Act, in 28 U.S.C. § 3306(b)(2), gives the federal government, as creditor, a six-year reach-back period to avoid a fraudulent transfer. "Applicable nonbankruptcy law" as used in section 544(b) is broader than state law and includes applicable federal law. Congress intended section 544(b) to be expansive. Although the FDCPA provides that it "shall not be construed to supersede or modify the operation of … title 11," using it under section 544(b) does not modify the Bankruptcy Code's operation, because section 544(b) expressly contemplates using applicable law. Section 6901 of the Internal Revenue Code permits the IRS to assess and collect liability of a transferee of the taxpayer. Assessment amounts only to recording the liability and does not authorize an action against the transferee. But the IRS may rely on state fraudulent transfer law to pursue a transferee, and unless Congress provides otherwise, the statute of limitations does not run against the sovereign. Therefore, the IRS's reach-back period is unlimited. The trustee's reliance on the IRS as the triggering creditor does not involve the trustee's exercise of sovereign powers, so the trustee may use the IRS's claim under section 544(b). *Hillen v. City of Many Trees, LLC (In re CVAH, Inc.)*, 570 B.R. 816 (Bankr. D. Id. 2017).

2.2 Preferences

2.2.a **Trustee may recover an insider preference under FDCPA.** The debtor repaid a director's loan to the debtor about 13 months before bankruptcy. The IRS had substantial allowed unsecured claims against the debtor. The Federal Debt Collection Procedures Act permits a federal governmental creditor to avoid an insider preference made within two years before the avoidance action. Section 544(b) gives the trustee the rights and powers of a creditor holding an allowed unsecured claim to avoid a transfer under applicable nonbankruptcy law. Here, under the FDCPA, the IRS could have avoided the payment to the director. The trustee may do so under section 544(b). *Gordon v. Rogich (In re Alpha Protective Servs., Inc.)*, 570 B.R. 888 (Bankr. M.D. Ga. 2017).

2.3 Postpetition Transfers

2.4 Setoff

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

2.7.a **Recipient of misappropriated funds from the debtor's bank account is the initial transferee.** The debtor's principal set up a secret bank account in the debtor's name to which the principal misdirected substantial payments made to the debtor. The principal misappropriated funds in the account for his personal expenses. The recipients of payments from the account were innocent outsiders, but the checks drawn on the account used the debtor's business name, even though the recipients had provided value only to the principal or one of his affiliated companies, but not the debtor. The trustee avoided the payments as fraudulent transfers and sought recovery from the recipients. Section 550(a)(1) permits the trustee to recover from the initial transferee or the entity for whose benefit the transfer was made. Section 550(a)(2) permits recovery from a subsequent transferee, but not if the subsequent transferee received the transfer in good faith, for value, and without knowledge of the voidability of the initial transfer. An initial transferee is one who has dominion over the transferred property, that is, full legal authority to use or dispose of the property; control (that is, mere ability to direct the disposition of the property) over the property is insufficient. Here, the recipients of payments from the account, not the principal, were the initial transferees. The principal was the entity for whose benefits the transfers were made. Although the principal had control over the account, he never had legal authority to use it for his benefit, so he was not the initial transferee. Designating the recipients as the initial transferees furthers the Code's policing goals, since they are in a better position than the creditors or the misappropriating principal to know and police whether the payments are proper. In this case, the checks had the debtor's name as drawer, even though the payments were not for value to the debtor. Therefore, the trustee may recover from the recipients as initial transferees, and they do not have a good faith-value-without knowledge defense. *Henry v. Official Comm. of Unsecured Creditors (In re Walldesign, Inc.)*, 872 F.3d 954 (9th Cir. 2017).

3. BANKRUPTCY RULES

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a **Court dismisses debtor's petition where state court receivership order gave the receiver authority over bankruptcy filing.** The closely-held debtor owned three hotels, which it had mortgaged to a bank for a loan. After default, the bank filed a foreclosure action in state court and obtained the appointment of a receiver, whom the state court vested with the authority of the debtor's board of directors, including the authority to file a bankruptcy petition. Acting in his capacity as a shareholder and pre-receivership director, the debtor's sole shareholder filed a chapter 11 petition for the debtor. The receiver moved to dismiss. State law determines who may authorize a bankruptcy petition for a corporation, and the bankruptcy court should respect a state court's order. If the state court order exceeded its proper bounds, for example by appointing a receiver for the corporation when the only proceeding before it was for the appointment of a receiver for the corporation's real estate, the remedy lies with the state appeals court. However, state law may not prohibit the filing of a bankruptcy petition. Analyzing conflicting case law on the effect of a receivership order that grants the receiver the authority to decide whether to file bankruptcy, the court concludes that it should respect the state court order, unless the state court proceeding resulted in an improper impediment to the debtor's access to the bankruptcy court due to the receiver's bias in favor of the creditor who obtained the appointment. Since no bias was shown here, the court dismisses the petition. *Citizens & N. Bank v. Monroe Heights Dev. Corp., Inc. (In re Monroe Heights Dev. Corp., Inc.)*, ___ B.R. ___, 2017 Bankr. LEXIS 2355 (Bankr. W.D. Pa. Aug. 22, 2017).

4.2 Involuntary Petitions

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statement and Voting

5.5 Confirmation, Absolute Priority

5.5.a **In chapter 11, the court should use market rate, if available, for cram down notes.** Using the "formula" approach adopted by the plurality in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), the bankruptcy court confirmed a plan, over the lenders' rejection, that provided for issuance of new notes to the senior lenders with an interest rate based on a risk free rate plus an adjustment for risk. Under section 1129(b)(2)(A), non-consensual confirmation requires the plan to provide for deferred cash payments with a value equal to the allowed amount of the secured claim. The value of deferred cash payments is based on the interest rate provided in the new notes. To achieve par value, the interest rate should be a market rate. *Till* involved a chapter 13 case, and the plurality opinion suggested the means of determining a proper interest rate in a chapter 11 case might differ, because a market might exist for business debtors' notes, unlike for a chapter 13 debtor's note. Therefore, if there is a market rate the court can determine, it should use that rate rather than the formula rate. The court remands for consideration of a market rate. *BOKF, NA v. Momentive Performance Materials Inc. (In re MPM Silicones, L.L.C.)*, ___ F.3d ___, 2017 U.S. App. LEXIS ____ (2d Cir. Oct. 20, 2017).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Court disallows make-whole amount based on automatic acceleration.** The debtor's notes entitled the lenders to a make-whole payment if the debtor were to "redeem the Notes at its option" before a specified date. The indenture provided for automatic acceleration of the notes' maturity upon the debtor's bankruptcy filing. The debtor's plan issued replacement notes to the lenders based on an allowed claim that did not include the make-whole amount. Following its prior decision in *In re AMR Corp.*, 730 F.3d 88 (2d Cir 2013), the court rules the automatic acceleration changed the notes' maturity date. As a result, the debtor's payment of the notes under the plan was not at its option. It does not matter whether the indenture provided for the make-whole payment upon "redemption" or "prepayment"—the payment under the plan of the accelerated notes was not voluntary. And in any event, "redemption" means payment at or before maturity, not after. The court notes the different result in *In re Energy Future Holdings Corp.*, 842 F.3d 247 (3d Cir. 2016). *BOKF, NA v. Momentive Performance Materials Inc. (In re MPM Silicones, L.L.C.)*, ___ F.3d ___, 2017 U.S. App. LEXIS ____ (2d Cir. Oct. 20, 2017).

6.1.b **Court allows make-whole amount under cash-payment nonimpairment plan.** Because commodity prices increased during the case, the debtor became hopelessly solvent. The bondholders asserted a claim for postpetition default rate interest, for a make-whole payment, and for interest on the make-whole amount, which became due on the petition date. The make-whole amount was calculated based on the present value of excess of the remaining interest payments under the bonds over the like maturity Treasury note plus 0.50%. The New York law-governed bond indenture expressly provided that the make-whole became due and payable upon any payment before regular maturity, even a payment upon acceleration after default. In this case, the chapter 11 filing was the default that accelerated the notes and triggered the make-whole obligation. The debtor's plan proposed to pay its senior bonds in cash in full in the amount necessary to render them unimpaired under section 1124(1). Under New York law, a make-whole amount is generally viewed as liquidated damages, which are enforceable to the extent they represent a reasonable measure of probable actual loss and the amount of actual loss is incapable or difficult of precise estimation. The make-whole provision satisfies this standard, because prepayment damages were not easily calculable when the indenture was executed. Upon prepayment, the lender loses future interest, offset by reinvestment of prepaid principal. However, reinvestment alternatives are uncertain. Therefore, a formula may provide a reasonable loss estimate, and this formula does. The court also concludes, through a complex hypothetical calculation, that postpetition default interest does not double count any amount payable as a make-whole. Section 1124(1) treats a class as unimpaired only if the plan does not alter any of the legal, equitable or contractual rights of the claims. Here, the claims were entitled to a make-whole payment, default-rate interest, and interest on the unpaid make-whole amount, all of which must be paid to render the class unimpaired under section 1124(1). *In re Ultra Petro. Corp.*, ___ B.R. ___, 2017 Bankr. LEXIS 3746 (Bankr, S.D. Tex. Oct. 26, 2017) (order certifying direct appeal).

6.2 Priorities

6.2.a Court orders disgorgement of professional fees to achieve pro rata distribution to administrative claimants. The chapter 7 trustee operated the debtor's business. He paid all operating expenses and made interim compensation payments to himself and his law firm, which was serving as his counsel. The trustee obtained some of the funds remaining at the end of the case through a settlement with a secured creditor of a claim under section 506(c). At the end of the case, there were insufficient funds to pay the remaining claimant, the trustee, his counsel and accountant, and the U.S. trustee fees. The trustee may recover under section 506(c) so that the estate's unencumbered assets are not used for a secured creditor's benefit. Because the recovery is to reimburse the estate's unencumbered funds, the recovery is for the benefit of the estate, not just the claimants whose expenses were the basis for the recovery. Section 726(b) entitles creditors to a pro rata distribution of unencumbered property of the estate. Section 726(b) applies equally to funds recovered under section 506(c) and to administrative claimants. Orders authorizing interim compensation are not final and may be reconsidered at any time, so interim payments are not final. To enforce section 726(b)'s pro rata distribution requirement, the court, under section 105(a), may order disgorgement of interim compensation payments to professionals. In this case, disgorgement is appropriate to ensure pro rata distribution to the remaining administrative claimants in the case. *In re NETtel Corp.*, ___ B.R. ___, 2017 Bankr. LEXIS 3363 (Bankr. D.D.C. Sept. 29, 2017).

7. CRIMES

8. DISCHARGE

8.1 General

8.2 Third-Party Releases

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.3 Exemptions

10.4 Reaffirmations and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a **Article III does not prevent a bankruptcy judge from confirming plan with a third-party release of related to claims.** As part of a global settlement, the debtor's plan provided for a substantial contribution by its shareholders and a non-consensual third-party release of all claims that creditors might have against them. As a non-Article III judge, a bankruptcy judge does not have constitutional authority to issue orders resolving claims arising under the bankruptcy court's related to jurisdiction but does have authority to issue orders resolving core proceedings, including plan confirmation proceedings. The latter category includes an order in a core proceeding that is based on bankruptcy law, even one that has a direct and substantial effect on a related proceeding, such as a confirmation order that releases claims over which the bankruptcy court has only related to jurisdiction or no jurisdiction at all. Here, the third party release arose in the context of the bankruptcy court's confirmation of the plan, and the court's determination of whether to approve the release was based solely on the applicable standards for approving a settlement and release under a plan, not on the substantive merits of the released claim. As such, the judge had the constitutional authority to confirm the plan and release the third party claims. *In re Millennium Lab Holdings II, LLC*, ___ B.R. ___, 2017 Bankr. LEXIS 3419 (Bankr. D. Del. Oct. 3, 2017).

11.1.b **Bankruptcy court may enjoin creditors from pursuing state court claims.** Creditors obtained judgments against two entities that had fraudulently transferred their assets to newly-formed entities, which continued to operate the same business. Upon attempting to enforce the judgments, the creditors learned of the transfers and filed a successful involuntary bankruptcy petition against one of the transferee companies. In the case, the creditors and the trustee pursued fraudulent transfer claims against the other transferee and numerous other individuals and entities involved in the fraudulent transfers. The bankruptcy court dismissed all claims against one individual. Later, the remaining parties settled all claims. The bankruptcy court approved the settlement only on the condition that the creditors' claims against the dismissed individual in any other court be enjoined. The bankruptcy court has power to issue an injunction against any action over which it would have subject matter jurisdiction. Its jurisdiction includes any proceeding "related to" the case. A proceeding is related to a case if the proceeding could conceivably have any effect on the estate, its assets, its liabilities, or its administration. The claims against the dismissed individual, including those not resolved by the dismissal, could affect the estate's recovery on its fraudulent transfer claims arising out of the fraudulent transfer transaction, so the bankruptcy court has authority to enjoin the claims. The All Writs Act authorizes federal courts to "issue all writs necessary or appropriate in aid of their respective jurisdictions." The Anti-Injunction Act prohibits enjoining proceedings in state court except as expressly authorized by Congress, where necessary in aid of the court's jurisdiction, or to protect or effectuate its judgment. To the extent of the dismissed claims, the injunction here protected the bankruptcy court's judgment dismissing those claims. The injunction against pursuing the other claims were necessary in aid of the court's related to subject matter jurisdiction over the other claims. Therefore, the bankruptcy court may properly enjoin the creditors from pursuing the claims. *Estate of Jackson v. Schron (In re Fundamental Long Term Care, Inc.)*, ___ F.3d ___, 2017 U.S. App. LEXIS 20468 (11th Cir. Oct. 19, 2017).

11.2 Sanctions

11.3 Appeals

11.3.a **Appeals court refuses to determine merits issues inherent in deciding whether section 363(m) mootness applies.** The trustee auctioned causes of action, including avoiding power claims, as is, where is. A creditor group outbid the potential defendant group, who claimed irregularities in the auction procedures and that only the trustee may pursue avoiding power claims. The bankruptcy court approved the sale. Without seeking a stay pending appeal, the defendant group appealed. While the appeal was pending, the purchasers brought the avoiding power action against the defendant group members, who moved to dismiss on the ground that only the trustee may pursue avoiding power claims. Section 363(m) provides that the reversal or modification of an order approving a sale of property of the estate does not affect the validity of the sale to a good faith purchaser. If the avoiding power claims are not property of the estate under section 541(a), then the stay would not apply. But determining that issue would determine the merits of the appeal. A sale objector may not evade section 363(m)'s stay requirement by challenging whether the sold property is property of the estate, because it would result in the appeals court hearing the merits of the dispute and undermine the effectiveness of section 363(m). If the appeals court determined that only the trustee may pursue avoiding power claims, it would undermine the sale, even though the "as is, where is" nature of the sale placed the risk of that issue on the purchasers. Therefore, the court of appeals dismisses the appeal as moot and leaves the issue of whether only the trustee may pursue the avoiding power claims to the trial court that is hearing that litigation. *Schepis v. Burtch (In re Pursuit Cap. Mgmt., LLC)*, ___ F.3d ___, 2017 U.S. App. LEXIS 20889 (3d Cir. Oct. 24, 2017).

11.4 Sovereign Immunity

11.4.a **Section 544(b) does not require a separate sovereign immunity waiver for a claim against the government.** Relying on the claim of a creditor holding an unsecured claim and state law, the trustee sued the Internal Revenue Service under section 544(b) to avoid the debtor's federal tax payments made between two and four years before bankruptcy. Sovereign immunity would have prevented the triggering creditor on whom the trustee relied from suing the IRS. Section 544(b) permits the trustee to "avoid a transfer that is voidable under applicable law by a creditor holding an unsecured claim." Section 106(a) abrogates sovereign immunity with respect to claims under section 544. The abrogation is adequate to permit the action; a secondary waiver for the underlying substantive claim is not required. Therefore, the trustee may bring the action despite the IRS's sovereign immunity defense. *Zazzali v. U.S. (In re DBSI, Inc.)*, 869 F.3d 1004 (9th Cir. 2017).

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a **Assignment of rents that is enforceable under nonbankruptcy law excludes rents from the estate.** The debtor owned rental real property. As additional collateral for its loan, it assigned rents to the lender. The lender granted the debtor a license to collect and retain rents until default, at which time the license would automatically terminate. The debtor defaulted, the lender began foreclosure proceedings, and the debtor filed bankruptcy. Under applicable nonbankruptcy law, the assignment is effective to transfer title, not just a security interest in the rents, until the debt is paid. Property of the estate includes all the debtor's interests in property. Because the debtor no longer had any interest in the rents after the default, the rents did not become property of the estate. *Town Center Flats, LLC v. ECP Comm'l II LLC (In re Town Center Flats, LLC)*, 855 F.3d 721 (6th Cir. 2017).

12.2 Turnover

12.3 Sales

12.3.a **Court reconsiders and denies merger termination fee approval after merger termination.** The debtor proposed a plan involving a merger. Before confirmation, the debtor in possession sought and obtained court approval of the merger agreement, which contained a provision for a termination fee that was payable if the debtor or debtor in possession terminated the agreement and pursued an alternative transaction, but not if the buyer terminated the agreement. The agreement did not have a closing deadline. At the hearing on the merger agreement approval, there was some confusion about the circumstances in which the termination fee would become payable, and neither the DIP, the buyer, or any other party in interest explained clearly to the court that because of the absence of a closing deadline, a regulatory disapproval would almost certainly require the debtor to terminate the agreement to be able to confirm a plan and exit bankruptcy. The court confirmed the plan. The buyer sought regulatory approval of the sale, which the regulator denied. Because interest was continuing to accrue on secured claims and the buyer refused to terminate the agreement, the debtor negotiated and signed an alternative transaction for a lower value and terminated the merger agreement. On a motion to reconsider the approval of the termination fee one year after the prior approval, the court determined that it misapprehended the facts, because of the confusing and incomplete record at the approval hearing. Under Bankruptcy Rule 9023, a court may reconsider an order if it "has overlooked or misapprehended some factual matter that might reasonably have altered the result" and reconsideration is necessary to prevent manifest injustice or to correct a clear error of law. Under Bankruptcy Rule 9024, a court may grant relief from an order based on, among other reasons, mistake or "any other reason justifying relief from the operation of the judgment." In this case, because the fee was effectively payable even if the buyer failed to get regulatory approval, it did not meet the legal standards required for approval of providing an actual benefit to the estate. If the court had properly understood the facts, it would not have approved the fee. The court grants reconsideration of the approval order as a manifest error of law and denies approval of the fee. *In re Energy Future Holdings Corp.*, ___ B.R. ___ (Bankr. D. Del. Oct. 3, 2017).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.1.a **Chapter 7 trustee is entitled to *Harlow* qualified immunity.** After the tenant had neglected the landlord debtor's property, resulting in water damage from frozen pipes, the debtor's chapter 7 trustee took possession of the debtor's real estate, changing the lock and locking out the tenant. The trustee promptly sought a court order approving the action. The tenant sued the trustee, seeking damages and a TRO against the trustee, which the court denied at the same time it granted the trustee's approval order. In *Harlow v. Fitzgerald*, 457 U.S. 800 (1982), the Supreme Court held that a governmental official performing discretionary duties is protected from civil liability for actions taken in an official capacity that does not violate a clear statutory or constitutional right that a reasonable person would have known. A chapter 7 trustee is created by federal statute, appointed and supervised by the U.S. trustee, and entrusted with statutory duties. A trustee is entitled to *Harlow* qualified immunity. Although state law prohibits tenant eviction without due process, the trustee's action was authorized under federal law, which required her to collect and reduce to money property of the estate. Therefore, the trustee had qualified immunity from the tenant's claim. Tracing the history of trustees in bankruptcy, a concurring opinion argues that the trustee should be protected by quasi-judicial immunity, not *Harlow* qualified immunity. *Phoenician Mediterranean Villa, LLC v. Swope (In re J&S Props.), LLC*, 871 F.3d 138 (3d Cir. 2017).

13.2 Attorneys

13.2.a ***Baker Botts* does not prohibit fee allowance for supplementing a fee application.** The chapter 7 trustee's counsel filed a fee application. The U.S. Trustee objected, requesting that the fee application be supplemented with a more detailed description of the work counsel performed. Counsel prepared the supplement and sought fees for the time spent doing so. The U.S. trustee objected to the fees incurred for preparing the supplement. *Baker Botts LLP v. ASARCO*, 135 S. Ct. 2158 (2015), held that a court may not allow fees under section 330 for litigating an objection to a fee application, because the time spent does not provide any service to the estate. Here, the extra time counsel spent to prepare the supplement provided the same service to the estate that the time spent on preparing an initial fee application provided—it described the services rendered so that the court could determine the fees' reasonableness. Even though the extra fees were incurred after an objection, the time was not spent on litigating the objection but only on providing the additional information. Therefore, *Baker Botts* does not prohibit allowing fees for the time spent. *In re Stanton*, 569 B.R. 840 (Bankr. N.D. Fla. 2017).

13.2.b **Court approves engagement agreement with fee defense fees provision.** The debtor in possession's law firm sought approval of its employment at the expense of the estate. Its engagement letter provided for the debtor in possession to pay fees that counsel incurred in successfully defending any objection to its fee application. The American Rule requires that each party to litigation pay its own attorneys' fees, unless a statute or contract provides otherwise. *Baker Botts LLP v. ASARCO LLC*, 135 S. Ct. 2158 (2015), held that the American Rule prohibited the bankruptcy court from approving fees under section 330(a) for the debtor's counsel's successful defense of an objection to its fee application, because section 330(a) limits fee allowance to a reasonable fee for services to the estate. Fee litigation defense does not provide a service to the estate. However, section 330(a) is subject to section 328(a), which permits the court to approve employment on any reasonable terms and conditions. *ASARCO* did not hold that a fee litigation defense provision was per se unreasonable. In fact, such a provision may be reasonable, even though it does not provide a service to the estate, just as other engagement provisions for counsel's benefit are reasonable, such as the client's agreement to pay promptly, to replenish a retainer, to pay returned check fees or interest on late payments, to permit counsel to withdraw if fees are not paid, and granting a lien on recoveries. The court approves the provision in the engagement letter, subject to two conditions. First, fee recovery applies only when the fee defense litigation is successful. Second, the debtor in possession must also agree to a similar provision in committee counsel's engagement, to level the playing field. *In re Hungry Horse, LLC*, ___ B.R. ___, 2017 Bankr. LEXIS 3183 (Bankr. D.N.M. Sept. 20, 2017).

13.2.c **Section 502(b)(4) reasonableness standard for disallowing a prepetition attorney's fee does not differ from state law.** The debtor's attorney successfully prosecuted a contingent fee matter, earning a fee of $2.5 million. The debtor disputed the fee. The attorney sought arbitration. The arbitrator awarded the fee, finding it reasonable under applicable state law. The attorney confirmed the award in a state court judgment. Before paying, the debtor filed a chapter 11 case. Section 502(b)(4) provides for disallowance of a claim for services of an attorney of the debtor to the extent the claim exceeds the reasonable value of the services. The proper analysis of a section 502(b)(4) objection to claim requires the court to determine whether the attorney's fee contract was breached, the state law damages assessment, the reasonableness of the damages under section 502(b)(4), and reduction by the extent, if any, the damages are excessive. Reasonableness under section 502(b)(4) does not contemplate a different analysis than under state law. Where a state court finds a fee reasonable, the bankruptcy court should not impose a different reasonableness standard to review the fee. Because the arbitrator found the fee reasonable and the state court confirmed the award, the fee should be allowed. *Spiller McProud v. Siller (In re CWS Enterps., Inc.)*, 870 F.3d 1106 (9th Cir. 2017).

13.3 Committees

13.3.a **Creditors' committee has right to intervene in adversary proceedings.** The creditors' committee moved to intervene in an adversary proceeding. Fed. R. Civ. Proc. 24, incorporated into adversary proceedings by Bankruptcy Rule 7024, permits intervention when a federal statute gives a right to intervene. Section 1109(b) provides "a party interest, including … a creditors' committee … may raise and may appear and be heard on any issue in a case" under chapter 11. A "case" is commenced by a petition. A "proceeding" is any particular dispute or matter arising within a case. An issue may arise only in a proceeding of some kind, so that all proceedings in a chapter 11 case, including adversary proceedings, take place within the larger case. The phrase "any issue in a case" is sweeping language that should be read broadly to include issues arising in a proceeding in a case. Therefore, section 1109(b) gives a right to intervene in an adversary proceeding. The right is not unlimited. It does not give the party in interest the right to settle the adversary proceeding or to appeal, and the court may impose reasonable restrictions on the scope of intervention, including limitations on the relief sought, on discovery, and on participation in the trial. In addition, because of the intervenor's potentially narrower role, in an appropriate case, the court may excuse the requirement under Rule 24(c) that the intervenor accompany the motion to intervene with a pleading. *Assured Guaranty Corp. v. Fin. Oversight and Mgmt. Board*, 872 F.3d 57 (1st Cir. 2017).

13.4 Other Professionals

13.4.a **Court disallows investment banker's attorneys' fees incurred in litigating a success fee.** The court approved the debtor's employment of an investment banker, with compensation to be determined under section 328(a). The engagement agreement provided for payment of the banker's attorneys' fees to collect its compensation if not paid "when due." The banker raised capital, but the debtor disputed the right to a success fee. After confirmation, the court awarded the success fee, and the appellate courts affirmed the award, after which the bankruptcy court allowed the claim. The banker sought allowance of the attorneys' fees incurred in litigating the award. The confirmed plan provided that administrative expense claims must be filed within four months after the effective date and were due when allowed. Because the success fee was not due until allowed, the agreement's attorneys' fee provision did not apply to the pre-award attorneys' fees. Moreover, by waiting until after the award to seek attorneys' fees, the banker's claim was late. *ASARCO, LLC v. Baker Botts LLP*, 135 S. Ct. 2158 (2015), held that attorneys' fees incurred in collecting compensation from the estate are not allowable under section 330(a). Although the banker's success fee was governed by section 328(a), the agreement did not extend the section 328(a) standard to the attorneys' fees provision. So under *ASARCO*, the court applied section 330(a) and disallowed the fees. Finally, section 330 permits allowance of attorneys' fees only for counsel employed under section 327 at the expense of the estate. The banker's counsel was not so employed and so is not entitled to an award of fees. *Roth Cap. P'ners, LLC v. Valence Tech., Inc.*, ___ B.R. ___, 2017 U.S. Dist. LEXIS 167539 (W.D. Tex. Oct. 10, 2017).

13.5 United States Trustee

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **Court denies recognition of Canadian proceeding of U.S. subsidiaries who are not debtors in the proceedings and do not have an establishment in Canada.** The Canadian parent company filed a scheme of arrangement proceeding in Canada to restructure its bond debt. In the proceeding, it sought and obtained an order enjoining creditor collection action against its U.S. subsidiaries, which had guaranteed the debt. The U.S. subsidiaries were ineligible to file their own proceedings in Canada, because they were not Canadian companies. They had no operations, employees, or place of business in Canada. The parent sought recognition of the Canadian proceeding under chapter 15 as a foreign main proceeding and enforcement of the Canadian court's order approving the scheme. The U.S. subsidiaries sought recognition of the Canadian proceeding as a foreign nonmain proceeding. The court may recognize a proceeding for a foreign debtor as a nonmain foreign proceeding if the debtor is a debtor in the proceeding and has an establishment in the country where the proceeding is pending. The U.S. subsidiaries were not debtors in the Canadian proceeding, despite the Canadian court's order enjoining creditor action against them. An establishment requires a nontransitory place of carrying on business. The U.S. subsidiaries did not have an establishment in Canada. Therefore, the court denies recognition for the U.S. subsidiaries, but in recognizing the Canadian court's order, enforces the injunction in the United States in favor of the U.S. subsidiaries. *In re Mood Media Corp.*, 569 B.R. 556 (Bankr. S.D.N.Y. 2017).

15.1.b **Court accepts foreign bankruptcy tourism as basis for COMI and recognition.** The holding company debtor's and its three subsidiaries' business was owning and operating deep water drilling rigs. They were incorporated in the Marshall Islands as non-resident corporations and operated their business from Cyprus. They issued New York-law governed debt. When they encountered financial distress and within a year before commencing a Cayman scheme of arrangement proceeding and then a chapter 15 case, the parent re-incorporated in the Cayman Islands as an exempted company, which requires that the company's objects be carried out mainly outside Cayman. When it did so, it moved its main corporate office to Cayman, conducted its management and operations, established bank accounts, maintained its books and records, and held its board meetings in Cayman, and gave public notice of its relocation to Cayman, all with the express purpose of effecting a Cayman scheme, because the Marshall Islands has no restructuring law. The parent and the subsidiaries deposited a substantial amount in their New York lawyer's trust account. The joint provisional liquidators from the Cayman scheme proceeding sought recognition in a chapter 15 case. The court may grant recognition to a foreign proceeding if it is a foreign main proceeding or a foreign nonmain proceeding and if the debtor has property or a place of business in the United States. The deposit in the trust account and the New York law-governed debt instruments suffice as property in the United States. A foreign proceeding is a foreign main proceeding if it is at the debtor's center of main interest. The court determines the COMI as of the chapter 15 petition date based on where third parties can determine where the debtor conducts regular business, unless the COMI was manipulated in bad faith. The facts here support COMI in the Cayman Islands for the parent and the subsidiaries. Courts determine bad faith manipulation based on insider exploitation, untoward manipulation, and thwarting third party expectations, among other factors. No such factors are present here. Rather, the debtors moved their operations because the Marshall Islands' debt process would have resulted in a value-destroying liquidation rather than reorganization. Therefore, the court grants recognition to the Cayman scheme proceedings. *In re Ocean Rig UDW Inc.*, 570 B.R. 687 (Bankr. S.D.N.Y. 2017).