JENNER&BLOCK

Recent Developments in Bankruptcy Law, October 2018

(Covering cases reported through 588 B.R. 660 and 897 F.3d 673)

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TABLE OF CONTENTS

1. AUTOMATIC STAY

1.1 Covered Activities

1.2 Effect of Stay

1.2.a **Section 108(c) applies to extend a judgment lien pending termination of the automatic stay.** State law grants a judgment creditor a lien on all the judgment debtor's personal property when the creditor obtains from the court and serves on the judgment debtor an order for appearance and examination (ORAP) to discover assets. The lien, which is not publicly recorded, lasts for one year. Here, the judgment debtor filed bankruptcy within the year, and the creditor took no action to enforce or extend the lien, but filed an adversary proceeding in the bankruptcy case to assert the lien more than one year after the ORAP. Section 362(a) stays the commencement or continuation of an action against the debtor, the enforcement of a judgment against the debtor, and the creation or perfection of a lien against property of the debtor or property of the estate. Section 108(c) tolls any applicable nonbankruptcy law deadline "for commencing or continuing a civil action … on a claim against the debtor" until 30 days after notice of termination or expiration of the automatic stay. Because enforcement of a judgment is a continuation of a civil action, section 108(c) applies to protect the ORAP lien until after notice of the end of the automatic stay. *Daff v. Good (In re Swintek)*, ___ F.3d ___, 2018 U.S. App. LEXIS 29646 (9th Cir. Oct. 22, 2018).

1.3 Remedies

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **Ponzi scheme presumption applies to transferees other than investors.** The individual debtor conducted a Ponzi scheme. He used some of the scheme proceeds to gamble, in the hope of winning enough to repay his investors. After bankruptcy, the trustee sued the casino to avoid the debtor's losses as actual fraudulent transfers. Under the Ponzi scheme presumption, transfers in furtherance of a Ponzi scheme are presumed to be made with actual intent to hinder, delay, or defraud creditors. The presumption is not limited to transfers to investors in the scheme but applies equally to any transfer made to further the scheme. Because the debtor gambled and made transfers to the casino in the amount of his losses in the hopes of winning enough to keep the scheme going, the presumption applies. *Pergament v. Marina Dist. Devel. Co., LLC*, ___ B.R. ___, 2018 U.S. Dist. LEXIS 177765 (E.D.N.Y. Oct. 11, 2018).

2.2 Preferences

2.2.a **Subsequent new value defense does not require that new value remain unpaid.** The supplier shipped the debtor product during the 90 days before bankruptcy. The debtor issued nonordinary course payments to the supplier after each group of shipments. Section 547(b) allows the trustee to avoid a payment on account of an antecedent debt that enables a creditor to receive more than in a chapter 7 case, but section 547(c)(4) gives the creditor a defense to the extent that after the payment, the creditor provided new value that is "not secured by an otherwise unavoidable security interest and … on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." The defense does not address whether the new value must remain unpaid, only whether the debtor made an otherwise unavoidable transfer on account of the payment. Where the debtor makes a payment that is avoidable as a preference but for section 547(c)(4)'s new value defense, the payment is avoidable and, therefore, not "otherwise unavoidable." That is, "otherwise unavoidable" applies only to avoidability under section 547(c)(4), not the entire preference section. Therefore, the debtor's later payments for the new value do not prevent application of the new value defense.

The creditor receives credit against preference liability for each new value shipment, despite payment for that shipment, as long as the shipment is made after the payment. *Kaye v. Blue Bell Creameries, Inc. (In re BFW Liquidation, LLC)*, 899 F.3d 1178 (11th Cir. 2018).

2.3 Postpetition Transfers

2.4 Setoff

2.5 Statutory Liens

2.5.a **A municipal revenue pledge is not a statutory lien.** A municipal authority issued bonds secured by a pledge of its revenues under a statute that authorized (but did not require) the authority to pledge assets to secure the bonds. The authority's resolution authorizing the issuance of the bonds provided for a pledge of the authority's revenues. The Code divides liens into three types: security interest, judicial lien, and statutory lien. A statutory lien is "a lien arising solely by force of a statute on specified circumstances or conditions … whether or not such … lien is provided by or is dependent on a statute …." The statute's empowerment of the authority to grant a lien does not cause the lien to arise on specified circumstances or conditions. A revenue pledge from the authority does not attach automatically when the authority issues bonds, but only upon the authority's pledge under the bond resolution. Because a statutory lien is mutually exclusive with a security interest, which is a lien that arises by agreement, the authority's agreement in its resolution is not a triggering event that suffices as a "condition or circumstance." *Peaje Investments LLC v. The Financial Oversight & Mgmt. Bd. For Puerto Rico*, 899 F.3d 1 (1st Cir. 2018).

2.6 Strong-arm Power

2.6.a **Trustee has the rights and powers of a "third person" under section 544(a).** To settle litigation over a minerals lease, the lessor agreed to ratify the lease, and the debtor agreed to pay the lessor substantial sums over a number of years. The lessor filed the ratification with the land records office, but the recordation recited only that it was in exchange for "consideration received." The debtor filed a chapter 11 case two years later and, as debtor in possession, brought an action under section 544(a)(3) to avoid the lessor's interest in the lease. The lessor claimed that the debtor's nonpayment of its obligations entitled the lessor to terminate the lease. Section 544(a)(3) grants a trustee (or a debtor in possession) the rights and powers of a bona fide purchaser of real property from the debtor. The "rights and powers" are not limited to the power to avoid a transfer but encompass all the purchaser's rights. Nonbankruptcy law determines what those rights and powers are. For purposes of applying the nonbankruptcy law, the trustee is treated as a third party, unrelated to the debtor. Under applicable nonbankruptcy law, a bona fide purchaser of the debtor's rights in this mineral lease would take free and clear of the debtor's payment obligations. Accordingly, the debtor in possession avoided the lessor's payment right. *Fallon Family, L.P. v Goodrich Petroleum Corp. (In re Goodrich Petroleum Corp.)*, 894 F.3d 192 (5th Cir. 2018).

2.7 Recovery

2.7.a **Neither one who purchases a cashier's check nor an agent for the intended recipient is an initial transferee.** The CEO of the debtor, which was engaged in a fraudulent scheme to defraud it customers, pledged to contribute funds to his alma mater's foundation. To fulfill the pledge, he embezzled funds from the debtor. At the debtor's bank, he presented a counter check on the debtor's bank account for a cashier's check payable to the university, not the foundation. When issuing a cashier's check, the bank debits the drawee account and credits its own internal account. Only the payee may negotiate the check, although the check may be returned to the bank, which will then credit the drawee account. The CEO delivered the check to the university. As required by an agreement with the foundation, the university endorsed the check to the foundation, which deposited the check in its own account. The transfer was avoidable as an actual fraudulent transfer and a constructive fraudulent transfer. Section 550(a) permits the trustee to recover an avoided fraudulent transfer from the initial transferee or from an entity for whose benefit the transfer was made. An initial transferee is one who has dominion and control over the transferred property. An agent of the intended recipient of the transferred property is not an initial transferee. Here, because the CEO could not negotiate the check for his own benefit, he did not have dominion or control over the funds represented by the check and was not the initial transferee. Under the agreement between the university and the foundation, the university was only an agent of the foundation and was not the initial transferee. Therefore, the trustee may not recover from the university. *Bodenstein v. Univ. of N. Iowa (In re Peregrine Fin. Group, Inc.)*, 589 B.R. 360 (Bankr. N.D. Ill. 2018).

3. BANKRUPTCY RULES

3.1.a **Bankruptcy Rule does not authorize transfer of an unassignable claim.** The debtor breached a contract with a land buyer. The buyer filed a claim in the debtor's chapter 11 case for breach of contract and for related torts. The buyer later sold the land and assigned the claim to the second buyer, giving the notice required by Bankruptcy Rule 3001. The contract prohibited the assignment of rights or delegation of duties under the contract without the debtor's consent, which it had not given. The reorganized debtor objected to the claim. A creditor's standing to assert a claim depends on whether the creditor suffered injury, not on whether the creditor has a right to assert the claim. The second buyer here suffered injury by buying the claim and therefore has standing to assert it, even if, on substantive grounds, it may not do so. Section 502(b)(1) disallows a claim that is unenforceable under nonbankruptcy law, which allows the trustee to object based on any defense to a claim that would be available outside bankruptcy. Bankruptcy rules are strictly procedural and do not affect any substantive rights. Bankruptcy Rule 3001 does not authorize assignment of a filed claim that may not be assigned under applicable nonbankruptcy law. Under the nonbankruptcy law applicable to the contract, a tort claim is not assignable. The tort claim is unenforceable in the hands of an assignee and is therefore disallowed. The claimant relied only on Bankruptcy Rule 3001 to support the contract claim's assignability and did not challenge the debtor's argument that the contract barred the assignment. Therefore, the claimant waived any defense to the debtor's argument, resulting in the claim's disallowance. *In re Caesars Entertainment Op. Co., Inc.*, 588 B.R. 32 (Bankr. N.D. Ill. 2018).

3.1.b **Court disapproves class settlement without compliance with Bankruptcy Rule 7023.** The debtor completed a section 363 sale and then confirmed a plan that provided for a general unsecured creditors trust, from which unsecured claims would be satisfied. If prepetition unsecured claims exceeded a trigger amount, the 363 sale buyer would contribute an additional amount of its common stock to the trust. Several years after the sale and plan confirmation, the buyer revealed significant defects in the product the debtor, and later the buyer, manufactured, causing economic loss to about 11 million of the debtor's and buyer's customers and personal injuries to many. The plan discharged prepetition personal injuries, but the buyer had assumed liability for postpetition injuries, though not for economic losses resulting from pre- or postpetition defects. When the defect was revealed, numerous class actions were filed against the buyer, and additional claims were filed against the trust. The plaintiffs agreed to settle with the trust by giving notice to all potential claimants, waiving the claimants' right to recover from anything other than the additional common stock and, if successful, claims against the buyer, and proceeding under section 502(c) to estimate the aggregate amount of claims to determine whether the trigger amount was exceeded, and they sought approval of the settlement under Bankruptcy Rule 9019. Rule 9019 permits the bankruptcy court to approve a settlement, focusing on the best interest of the estate. Bankruptcy Rule 7023 permits class action procedures in bankruptcy cases, including for a class proof of claim, through application of Rule 7023 under Rule 9014. A Rule 9019 settlement may apply to a class of claims only if the court certifies the class under Rule 7023, which establishes strict requirements for class certification, focusing on (among other things) the protection of class members, and may not supersede the certification requirements. A class proof of claim is not deemed filed for all class members unless the court has permitted the filing of the class proof of claim by certifying the class. Although a discharge under section 1141(d)(1) binds all creditors, a settlement outside of a plan does not bind all class members unless the court has certified the class. Unless the certification requirements are met independently of a settlement, a settlement may not include class certification. Section 502(c) applies only to filed claims. Courts estimate future claims not for purposes of allowance but, based on the aggregate amount of future claims, to establish the size of a required trust or to determine plan feasibility or voting rights. Because the court had not certified the class for settlement purposes, the claims were not deemed filed, and the court could not estimate their aggregate amount. The court may approve this settlement only if the class claims meet Rule 7023's requirements. Because they don't, the court refuses to approve the settlement. *In re Motors Liq. Co.*, ___ B.R. ___, 2018 Bankr. LEXIS 2902 (Bankr. S.D.N.Y. Sept. 24, 2018).

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a **Directors ousted by a state court receiver do not have authority to file a voluntary petition.** Before bankruptcy, investors sued the debtor in state court. Finding the debtor's directors guilty of nonfeasance and gross mismanagement, the court appointed a receiver under the state corporations statute and permitted the receiver to replace the board of directors, which he did. The ousted directors filed a voluntary petition for the corporation. Section 301 permits a petition by an entity that may be a debtor under section 109. State law determines who may act for the debtor in authorizing the petition. Here, the receiver's replacement of the directors deprived them of authority to act for the corporation. Therefore, the petition was not authorized by the debtor and must be dismissed. *Sino Clean Energy, Inc. v. Seiden (In re Sino Clean Energy, Inc.)*, 901 F.3d 1139 (9th Cir. 2018).

4.1.b **Non-profit community mental health center is not a governmental unit.** The debtor is a non-profit community mental health center (CMHC), authorized by state law and designated by a state department to provide mental health services that the state previously provided. The debtor receives nearly all its funding from the state under annual bid contracts with the state, not from direct appropriations from the legislature. The state regulates the debtor, has the authority to de-designate it as eligible to be a CMHC, and reviews budgets to assure compliance with bids and contracts. The debtor has a self-perpetuating board; the state has no role in selecting directors. Only a "person" may be a debtor under chapter 11. A governmental unit is not a person. A governmental unit includes an instrumentality of a state. Whether a debtor is an instrumentality of the state depends primarily on the degree of control the state exercises over the entity. Here, the state did not create the debtor or appoint its leadership; no enabling statute guides or controls its actions; funding is under a contract with the state, not by appropriation; and the state may not terminate the entity's existence. In addition, as a private non-profit corporation, the debtor does not have governmental powers, such as eminent domain, sovereign immunity, or the taxing power. Therefore, the debtor is not an instrumentality of the state and is eligible for chapter 11. *Ky. Employees Retirement Sys. v. Seven Counties Servs, Inc.*, 901 F.3d 718 (6th Cir. 2018).

4.2 Involuntary Petitions

4.2.a **Lender may not offset a prepetition claim against a section 303(i) judgment for a bad faith filing.** The lender obtained a judgment against the debtor on its claim and then, with affiliates, filed an involuntary petition against the debtor. The debtor obtained dismissal of the involuntary and a judgment under section 303(i) against the lender and its affiliates for actual and punitive damages for a bad faith filing. Before obtaining the judgment, the debtor transferred the claim underlying the judgment to a third party. The lender sought to offset the two judgments, because the debtor was likely judgment proof. Setoff requires mutuality. In this case, mutuality was uncertain, because the debtor's judgment was against the lender's affiliates as well as the lender, and the debtor had assigned the underlying claim. Moreover, a court may deny setoff where the creditor has committed inequitable, illegal, or fraudulent acts. Section 303(i) discourages abuse of the involuntary bankruptcy process. The lender's bad faith in filing the petition provides equitable grounds to deny the setoff. *U.S. Bank, N.A. v. Rosenberg*, 581 B.R. 424 (E.D. Pa.), *aff'd* 2018 U.S. App. LEXIS 21145 (3d Cir. July 31, 2018).

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 Horizontal gifting is not necessarily unfair discrimination. The debtor's value was insufficient to satisfy claims secured by a blanket security interest on all the debtor's assets. Under the plan, secured creditors permitted payment in full of trade and operations litigation claims and a 5% recovery on unsecured note claims. The class of unsecured note claims did not accept the plan, and one noteholder appealed, claiming unfair discrimination as compared to the treatment of the trade and litigation claims. Section 1129(b)(1) permits the court to confirm a plan that has not been accepted by all classes if the plan is fair and equitable to and does not discriminate unfairly against the nonaccepting class. A plan discriminates between two classes when the claims in the classes have the same priority and receive a materially different percentage recovery. Whether the discrimination is unfair is determined only from the perspective of the nonaccepting class. Here, because the nonaccepting note claims class would not have been entitled to any recovery, its low recovery compared to the trade claims class' recovery resulted only from the senior class' "gift" to the trade claims class. Where the disparate treatment results only from such a horizontal (not a class-skipping) gift, the resulting discrimination is not unfair and also does not implicate the absolute priority rule. Separate classification is proper if there is a rational legal or factual basis for it. Here, protecting trade creditors who would continue to do business with the reorganized debtor provided such a basis. In addition, the voting interests of note holders and trade creditors differ and support separate classification. Therefore, the separate classification does not result in unfair discrimination. *Hargreaves v. Nuverra Env'tl Solutions, Inc. (In re Nuverra Env'tl Solutions, Inc.)*, ___ B.R. ___, 2018 U.S. Dist. LEXIS 141223 (D. Del. Aug. 21, 2018).

5.5.b **Section 510(a) subordination clause enforcement does not apply in a cram down plan.** The debtor's senior debt benefitted from a subordination clause in the debtor's subordinated debt instruments. The plan, which the senior debt class did not accept, provided for distribution to the senior debt class of 33.6% of its claims. Had the subordination clause been enforced literally, the senior claims would have recovered 35.9%. Section 510(a) requires the court to enforce a subordination agreement. Section 1129(b)(1) permits the court to confirm a plan that has not been accepted by one or more classes, "notwithstanding section 510(a)," if the plan is fair and equitable to, and does not discriminate unfairly against, the nonaccepting class. The "notwithstanding" clause renders section 510(a) inapplicable in a cram down. Accordingly, the court may confirm the plan even without the strict enforcement of the subordination agreement, as long as the plan is fair and equitable and does not discriminate unfairly. Under the so-called Markell test, unfair discrimination occurs against a nonaccepting class when another class with claims of the same priority receives a materially higher percentage recovery or a distribution with a materially lower risk. Here, the potential difference in distribution to the nonaccepting class was at most 2.3%, which is not material. Therefore, the court may confirm the plan. *Law Debenture Trust Co. v. Tribune Media Co. (In re Tribune Media Co.)*, 587 B.R. 606 (D. Del. 2018).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Section 562 does not apply to a termination resulting from a settlement of claims.** The debtor's counterparty had entered into a prime brokerage agreement and a securities lending contract with the debtor's English broker-dealer subsidiary, which the debtor guaranteed. When the broker-dealer filed for administration in the U.K., it held securities valued at $118 million, which it did not return to the counterparty. The broker-dealer had offsetting claims against the counterparty under the securities lender contract. During the administration case, the U.K. administrator and the counterparty settled their offsetting claims, resulting in the termination of the contracts and a payment from the counterparty to the administrator, which was based on the value of the counterparty's securities as of the date of settlement of $101 million. The counterparty filed a claim under the guarantee in the debtor's chapter 11 case for the $17 million loss. Section 562 provides that damages resulting from the trustee's rejection or a financial participant's termination of a safe harbor financial contract is measured at the earlier of the date of rejection or of termination. Section 562 must be read in conjunction with the other safe harbor provisions, which protect a counterparty's right to terminate a safe harbor contract and exempt it from the automatic stay and its contract from assumption. And section 562 relates to damages arising from termination of the contract, not to damages determined under a settlement agreement. Therefore, section 562 does not apply; the basic bankruptcy principle of section 502(b) that claims are determined as of the petition date applies. The counterparty may assert a claim for the loss in value of the securities from the petition date to the settlement date. *Maverick Long Enhanced Fund, Ltd. v. Lehman Bros. Holdings Inc. (In re Lehman Bros. Holdings Inc.)*, ___ B.R. ___, 2018 U.S. Dist. LEXIS 169413 (S.D.N.Y. Sept. 30, 2018).

6.2 Priorities

6.2.a **Court limits reach of the Federal Priority Statute.** The debtor's plan created a liquidating trust to pursue claims, including claims against former directors and officers. The trustee settled with the former CEO. The United States obtained a False Claims Act judgment against the former CEO and objected to the court's approval of the settlement on the ground that the settlement violated the federal priority statute, 31 U.S.C. § 3713, which requires that a claim of the government be paid first when a person indebted to the government is insolvent and is without enough property to pay all the person's debts, but "does not apply to a case under title 11." The exclusion applies here, so the United States may not assert the priority to defeat approval of the settlement. *Arrowsmith v. Mallory (In re Health Diag. Lab., Inc.)*, 588 B.R. 154 (Bankr. E.D. Va. 2018).

7. CRIMES

8. DISCHARGE

8.1 General

8.1.a **Covenant not to compete is enforceable against debtor after discharge.** The debtor agreed not to compete with his employer for five years. Within a year after the agreement, the employer fired the debtor. The debtor filed a chapter 7 case and received his discharge. He then got a job that competed with his former employer, who sued to enforce the covenant. A claim is a right to payment or an equitable remedy for breach of performance if the breach gives rise to a right to payment. A debt is a liability on a claim. The chapter 7 discharge releases only debts that arise before the petition date. A covenant not to compete is enforceable by an injunction. The employee may not pay money to escape the injunction or the covenant. Therefore, the covenant is not a debt and is not discharged. An executory contract is one in which performance remains to some degree on both sides. The employer had no remaining performance obligations. Therefore, the covenant is not a rejectable executory contract. Even if it were, the trustee's rejection relieves only the trustee, not the debtor, from future performance. Therefore, the court finds the covenant enforceable. *Cybertron Int'l, Inc. v. Capps (In re Capps)*, ___ B.R. ___, 2018 Bankr. LEXIS 2221 (Bankr. D. Kan. July 26, 2018).

8.2 Third-Party Releases

8.2.a **A plan release follows claims and interests and binds transferees.** The plan provided for distributions to shareholder of funds remaining after creditors were paid in full and provided a broad release of any claim in any way related to or arising out of or in connection with the bankruptcy, except for a claim arising from gross negligence or willful misconduct. After plan confirmation, the reorganized debtor sold its assets, as contemplated in the plan, distributed proceeds to creditors, and announced a distribution to shareholders. After the distribution record date but before the distribution, a buyer bought a substantial number of shares, expecting that the plan distribution would follow FINRA rules, under which the buyer would have been entitled to the distribution. The debtor's officers did not follow the FINRA rules, which the plan terms overrode, and did not disclose they were not following FINRA rules. The buyer sued the officers for negligence, breach of fiduciary duty, nondisclosure, and securities fraud. A plan may release claims that arise from the execution of the plan, as these claims did. The plan releases applied to the holders of claims and interests, and they followed the claims and interests upon sale or other transfer. Therefore, the release bound the buyer and protected the officers from the claims. *Zardinovsky v. Artic Glacier Income Fund (In re Artic Glacier Int'l Inc.)*, 901 F.3d 1162 (3d Cir. 2018).

8.2.b **Bankruptcy court may constitutionally release third-party claims.** The debtor's plan provided for releases by a nonconsenting creditor of his claim against shareholders, plan proponents, and other creditors. A court considers a third-party release under a plan in connection with confirmation, which is a core proceeding. The proceeding does not address the released claims' merits, only plan confirmation, to permit reorganization of the debtor's finances, which thus permits releases only of claims that are related to the debtor or the case. The order's effect on claims beyond the bankruptcy case does not render the jurisdiction non-core. Bankruptcy courts' authority to issue final orders in core proceedings is constitutional. Resolving claims against third parties that are integral to a reorganization is core to the bankruptcy function. Therefore, a bankruptcy court may issue a final plan confirmation order releasing third-party claims. *Lynch v. Lapidem Ltd. (In re Kirwan Offices S.á.R.L.)*, ___ B.R. ___, 2018 U.S. Dist. LEXIS 176898 (S.D.N.Y. Oct. 12, 2018).

8.2.c **Article III does not prevent a bankruptcy judge from confirming a 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 unless the issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process. Determining whether the order meets that test depends on the proceeding, not on its incidental effects on claims over which the bankruptcy court might or might not have jurisdiction. Here, the issue is the confirmation of the plan, which stems from the bankruptcy itself and is governed strictly by the Bankruptcy Code and bankruptcy case law determining when a third-party release under a plan is permissible. 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. *Opt-Out Lenders v. Millennium Lab Holdings II, LLC (In re Millennium Lab Holdings II, LLC)*, ___ B.R. ___, 2018 Bankr. LEXIS 162249 (D. Del. Sept. 21, 2018).

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

9.1.a **Chapter 7's automatic rejection of an executory contract after 60 days prevents assumption and assignment.** The debtor did not schedule a license agreement. The chapter 7 trustee sold all the debtor's assets, including all executory contracts, more than 60 days after the case's conversion to chapter 7. The licensor later sued the buyer for infringing the licensor's intellectual property rights by using them without a license. Section 365(d) provides that an executory contract is automatically rejected 60 days after the order for relief in a chapter 7 case, unless the court extends the 60-day period. Because the sale occurred more than 60 days after the chapter 7 order for relief, the license agreement was automatically rejected and no longer property of the estate. The trustee had no authority to sell it. The debtor's failure to schedule the license does not affect the 60-day period, because the trustee is responsible to investigate the debtor's financial affairs, whether or not scheduled. Therefore, the buyer acquired no rights in the license. *RPD Holdings, L.L.C. v. Tech Pharmacy Servs. (In re Provider Meds, L.L.C.)*, ___ F.3d ___, 2018 U.S. App. LEXIS 30600 (5th Cir. Oct. 29, 2018).

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 **Neither the bankruptcy court's exclusive jurisdiction over property nor section 904 preclude stay relief.** An operating municipal debtor's bondholders sought stay relief to move for a receiver in state court. Section 904 prohibits the court "by any stay, order, or decree, in the case or otherwise," from interfering with the debtor's political or governmental powers or any property or revenues. Its purpose is to limit only the federal court's powers, as a means of respecting state sovereignty. The prohibition is limited to the bankruptcy court itself. It does not preclude the court from granting stay relief to permit another court with jurisdiction under local law to interfere. Any other reading would effectively nullify section 362(d), which authorizes stay relief. Similarly, the bankruptcy court's exclusive jurisdiction over property of the debtor and of the estate under 28 U.S.C. § 1334(e) permits the bankruptcy court to control which court addresses and manages activities necessary for reorganizing the debtor and protecting the property rights of secured creditors. It does not preclude stay relief. *Ad Hoc Group of PREPA Bondholders v. The Financial Oversight & Mgmt. Bd. For Puerto Rico (In re The Financial Oversight & Mgmt. Bd. For Puerto Rico)*, 899 F.3d 13 (1st Cir. 2018).

11.2 Sanctions

11.3 Appeals

11.3.a **Sixth Circuit establishes test for when an order is final for purposes of appeal.** The creditor had sued the debtor for breach of contract in state court. One week before trial, the debtor filed a chapter 11 case. The creditor moved for stay relief to proceed with the state court action. The bankruptcy court denied the motion. The creditor filed a proof of claim, to which the DIP objected. The court disallowed the claim. The creditor then appealed from order denying stay relief and from the order disallowing the claim. Under 28 U.S.C. 158(a), the district courts "have jurisdiction to hear appeals from final judgments, orders, and decrees of bankruptcy judges entered in cases and proceedings," unlike in ordinary civil actions, where the courts have appellate jurisdiction only over "final decisions." Under Bankruptcy Rule 8002(a), an appellant must file its notice of appeal within 14 days after entry of the order. A judgment, order, or decree in a bankruptcy case or proceeding is appealable if it is entered in a proceeding and is final. A proceeding is a dispute narrower than and distinct from the bankruptcy case as a whole. It is a discrete dispute within the overall bankruptcy case that resolves a litigated matter. A stay relief motion meets this definition, because it determines the creditor's right under the legal standards for stay relief. An order is final if it terminates the proceeding, alters the status quo and fixes the rights and obligations of the parties. An order that denies relief without prejudice or with leave to amend is not final, because it does not alter the status quo or fix rights and obligations—the parties may still raise the issue in a future proceeding. An order denying stay relief without more is final, because it requires the creditor to pursue its claim in the bankruptcy court rather than in another forum or be barred from doing so, whether by a claims bar date or the conclusion of the bankruptcy case and the entry of the discharge. Because the creditor waited until after resolution of its proof of claim, its appeal from the stay relief denial was untimely and must be dismissed. *Ritzen Group, Inc. v. Jackson Masonry, LLC (In re Jackson Masonry, LLC)*, ___ F.3d ___, 2018 U.S. App. LEXIS 29009 (6th Cir. Oct. 16, 2018).

11.3.b **Equitable mootness doctrine applies in chapter 9 cases.** The county confirmed a chapter 9 plan that provided for issuance of refinancing bonds, supported by sewer revenues, required county commissioners to increase sewer rates annually for 40 years, and provided continuing bankruptcy court jurisdiction to enforce that provision. Ratepayers appealed, seeking reversal of the rate-increase and bankruptcy court jurisdiction provisions, but did not seek a stay pending appeal or seek to expedite the appeal. The equitable mootness doctrine permits an appellate court, based on equitable or prudential considerations, to dismiss an appeal where granting relief would be extremely burdensome, especially on non-parties. Considerations include whether permitting the appeal will impinge on actions taken in good faith reliance on the judgment and whether appellate relief will interfere with actions taken without knowledge that claims are still pending final resolution, but courts are sensitive to the right to appeal, especially if the appellant promptly sought a stay or was unjustifiably denied a stay. The reasons supporting the doctrine in chapter 11 cases apply equally in a chapter 9 case. The presence of sovereignty or other constitutional issues does not detract from the principle; and a court might properly be more solicitous of a municipal debtor in permitting a plan to proceed than of a commercial debtor, because of the public interests. Because the county implemented the plan and issued new securities on the public markets and the appellants did not even seek a stay, the court finds the appeal equitably moot and dismisses it. *Bennett v. Jefferson County, Ala.*, 899 F.3d 1240 (11th Cir. 2018).

11.4 Sovereign Immunity

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a **Insurance policy proceeds are property of the estate when insufficient to pay insured claims.** The debtor operated a bus, which crashed, killing nine passengers and injuring numerous others. It had minimal assets but a $5 million insurance policy. Some claimants reached quick settlements with the insurer, which would have exhausted policy limits; others filed an involuntary petition against the debtor to prevent the settlements. Property of the estate includes all of the debtor's interests in property. Thus, the policy itself is property of the estate. However, when policy proceeds are not payable to the debtor, they generally are not property of the estate, unless policy limits are insufficient to cover all claims under the policy. In those "limited circumstances," the proceeds are property of the estate so that the bankruptcy court can oversee their distribution. *Martinez v. OGA Charters, L.L.C. (In re OGA Charters, L.L.C.)*, 901 F.3d 599 (5th Cir. 2018).

12.2 Turnover

12.3 Sales

12.3.a **Court reconsiders and denies merger termination fee approval after merger termination.** The debtor in possession proposed a plan involving a merger. Before confirmation, it 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, including an internal reorganization plan, 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, nor 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, granted reconsideration, and disallowed the fee upon the failure of regulatory approval. On appeal, even though the order was interlocutory, the court accepts the bankruptcy court's application of the heightened standard to alter or amend a judgment under Bankruptcy Rule 9023, under which 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. 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. The appeals court affirms the grant of reconsideration of the approval order as a manifest error of law and denies approval of the fee. *In re Energy Future Holdings Corp.*, ___ F.3d ___, 2018 U.S. App. LEXIS 25945 (3d Cir. Sept. 13, 2018), *reh'g denied*, (Oct. 24, 2018).

12.3.b **Purchaser's knowledge of adverse claims precludes good faith finding.** Before bankruptcy, the debtor sued his business partners. After bankruptcy, a company in which he claimed a 25% interest sued the same defendants. During the bankruptcy, the trustee settled with the defendants by agreeing to a distribution to them and to the transfer of the causes of action in the two law suits to the defendants. The debtor objected on the ground, among others, that the second lawsuit was not property of the estate. The court approved the sale, and the debtor appealed. Section 363(m) prohibits the reversal or modification on appeal of an order approving a sale to a good faith purchaser from affecting the validity of the sale. Good faith requires a purchase for value, in good faith (that is, without collusion or fraud), and without notice of adverse claims. Mere notice of only objections to the sale or of an appeal is not sufficient to defeat good faith. However, where the purchaser has been involved in litigation over the objection and has detailed, long-standing knowledge of the adverse claims, the purchaser has sufficient knowledge to defeat a good faith finding. *In re Cooper*, ___ B.R. ___, 2018 U.S. Dist. LEXIS 163240 (S.D.N.Y. Sept. 24, 2018).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.2 Attorneys

13.2.a **Court denies disgorgement of attorneys' fees in administratively insolvent case.** Based on an agreement between the chapter 11 trustee and debtor in possession's counsel, the court awarded final compensation in an amount substantially less than the total fees requested, allowing counsel to keep fees paid before the trustee was appointed. When it became apparent that the estate was administratively insolvent, the trustee moved to distribute funds on hand and dismiss the case. In connection with the motion, the trustee and the United States, which was owed substantial unpaid withholding taxes, moved for an order requiring counsel to disgorge about half the fees already paid. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), prohibits a structured dismissal that does not respect priorities. But it does not address disgorgement or pro rata distributions within a creditor class and therefore does not require disgorgement. Section 330(a)(5) expressly provides for disgorgement where interim compensation already paid exceeds final compensation ultimately allowed. Otherwise, the bankruptcy court has discretion whether to order disgorgement, taking into account all relevant circumstances. Here, the bankruptcy court properly exercised its discretion not to order disgorgement, based on the value of services rendered. *U.S. v. Seiller Waterman LLC (In re St. Catherine Corp. of Ind., LLC)*, ___ B.R. ___, 2018 U.S. Dist. LEXIS 165112 (S.D. Ind. Sept. 26, 2018).

13.3 Committees

13.3.a **Committee dissolves upon conversion to chapter 7.** The bankruptcy court denied approval of a structured dismissal motion. The creditors' committee did not appeal. The court converted the case to chapter 7. The committee opposed conversion and then appealed. Section 1103 provides for the appointment of a creditors' committee, but section 1103 applies only in chapter 11. Once the case is converted to chapter 7, the Code provides no authority for the continuance of the committee. The Code also does not provide for a successor to the committee after conversion or for the committee to transfer its rights, if any, to another party. Therefore, even treating the committee as a post-conversion ad hoc committee would not save the appeal. *Official Committee of Unsecured Creditors v. Constellation Enterps. LLC (In re Constellation Enterps. LLC)*, 587 B.R. 275 (D. Del. 2018).

13.4 Other Professionals

13.5 United States Trustee

13.5.a **U.S. trustee fee does not apply to re-advance of funds swept under a roll-over postpetition credit facility.** The debtor in possession agreed with its prepetition revolving lender on a postpetition facility. Under the facility, the DIP deposited its collections of both pre- and postpetition accounts receivable into its account with the lender, who swept the funds to reduce the prepetition loan amount, and re-advanced the same amount (less interest and other charges) under the postpetition facility. The DIP and the lender viewed the arrangement as a cash management device for the DIP and a means of rolling over the lender's prepetition claim into a postpetition claim that is entitled to administrative expense priority. The arrangement did not reduce the lender's claim; it just changed its priority. Section 1930 of title 28 requires a trustee or DIP to pay quarterly fees to the United States trustee equal to a percentage of "disbursements." The statute does not define "disbursements." Most ordinary usage definitions define it as paying out money. However, because the total indebtedness amount did not change, the deposit and sweep, followed by a re-advance in the same amount, should not be considered a disbursement that is subject to the U.S. trustee fee. *In re Cranberry Growers Coop.*, ___ B.R. ___, 2018 Bankr. LEXIS 2878 (Bankr. W.D. Wisc. Sept. 21, 2018).

14. TAXES

14.1.a **Section 505 permits a tax refund claim initiated by the debtor before bankruptcy.** The debtor challenged the state taxing authority's assessment of its real property for ad valorem tax purposes and, before bankruptcy, filed an action in state court for a refund of taxes previously paid based on the challenged valuation. After bankruptcy, the debtor in possession sought the refund in an action in the bankruptcy court. Section 505(a) permits the court to "determine the amount of legality of any tax … whether or not previously assessed, whether or not paid …." However, section 505(a)(2)(B)(i) prohibits the court from determining "(B) any right of the estate to a tax refund, before … 120 days after the trustee properly requests such refund ….” In a chapter 11 case, the debtor is a debtor in possession, which has all the rights and powers of a trustee, and is not a separate entity. Therefore, in a chapter 11 case in which the debtor remains in possession, the debtor’s prepetition request for a refund satisfies the requirement that the trustee have properly requested the refund. However, the court ultimately dismisses the action on sovereign immunity grounds. *In re La Paloma Generating Co.*, 588 B.R. 695 (Bankr. D. Del. 2018).

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **New York court grants recognition to Croatian plan approval that discharges English law governed debt, whether or not recognizable in England.** The Croatian debtor holding company and numerous subsidiaries had issued debt governed by English law and debt governed by New York law. Upon insolvency, they opened insolvency proceedings in the jurisdiction of their center of main interests. They negotiated and presented a “settlement agreement,” which is similar to a chapter 11 plan, to their creditors. The settlement agreement provided for classification of creditors, equal distribution among creditors of the same class, discharge of claims, and third-party releases. Non-insider creditors voted heavily in favor of the settlement agreement, and the court approved it. The foreign representative of the holding company and eight subsidiaries, with both English and New York law governed debt, sought recognition under chapter 15 in New York of the foreign proceedings and of the foreign court’s order approving the settlement agreement. The New York court had previously granted recognition of the foreign proceedings as foreign main proceedings. Section 1507 permits recognition of the settlement agreement as “additional assistance” if consistent with principles of comity and with the fairness considerations of section 1507(b). The settlement agreement and its approval met all such considerations. English law generally refuses to enforce a foreign discharge of debt governed by English law (the *Gibbs* rule). Here, granting comity to the Croatian court’s approval of the settlement agreement might constitute a refusal to extend comity to the laws of England, which might refuse to recognize not only the Croatian discharge but also the U.S. court’s recognition and enforcement of that discharge within the United States. However, the court must apply only U.S. law in determining whether to grant comity to the Croatian order and not be deterred from doing so based on other countries’ laws. Because the factors required to support a grant of comity and recognition to the Croatian ruling are present, and because an order granting recognition would have effect only within the territorial jurisdiction of the United States, the court recognizes and enforces the settlement agreement within the territorial jurisdiction, even though the English courts might not enforce the order as to English law governed debt. *In re Agrokor d.d.*, ___ B.R. ___, 2018 Bankr. LEXIS 3267 (Bankr. S.D.N.Y. Oct. 24, 2018).