JENNER&BLOCK

Recent Developments in Bankruptcy Law, January 2019

(Covering cases reported through 593 B.R. 68 and 910 F.3d 1300)

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

TABLE OF CONTENTS

JENNER&BLOCK

1. AUTOMATIC STAY

1.1 Covered Activities

1.2 Effect of Stay

1.2.a **Stay tolls foreclosure period for full period of the stay.** The mortgagee accelerated the debtor's mortgage note before bankruptcy. Under state law, a mortgagee has four years after acceleration to file a foreclosure action. The mortgagee here filed a foreclosure action 127 days late. The automatic stay was in effect for 127 days, including both the day the bankruptcy petition was filed and the day the stay terminated by entry of the discharge. Section 108(c) provides "if applicable nonbankruptcy law … fixes a period for commencing … an action" that is stayed by section 362, "then such period does not expire until … the end of such period, including any suspension of such period occurring on or after the commencement of the case." State law here does not have a specific tolling provision that provides for tolling (suspension) during the automatic stay but does accept the common law tolling principle as an applicable law that section 108(c) may incorporate. The common law principle prohibits counting against a person the time during which the person is prevented from exercising a legal remedy. Here, the mortgagee was prevented on the day the debtor filed the petition and on the day the stay terminated. The law does not split a day. Therefore, the deadline to file the foreclosure action was tolled for the full 127 days. *HSBC Bank USA, N.A. v. Crum*, 907 F.3d 199 (5th Cir. 2018).

1.2.b **Section 108(c) extends the time to renew a judgment lien.** Before bankruptcy, the creditor obtained a judicial lien against the debtor to enforce a judgment. By its term, the lien expired one year after it arose, unless renewed. The debtor filed bankruptcy within the one-year period. The creditor did not renew the lien. Section 108(c) extends until 30 days after notice of termination or expiration of the automatic stay any "period for commencing or continuing a civil action … on a claim against the debtor" that has not expired before the date of the filing of the petition. Section 362(a)(1) stays "the commencement or continuation" of an action "that was or could have been commenced before bankruptcy to recover a prepetition claim;" section 362(a)(2) stays "the enforcement against the debtor … of a judgment obtained before" bankruptcy; and section 362(a)(4) stays "any act to … enforce any lien against property of the estate." The attempt to enforce a judgment is a continuation of the civil action. Therefore, the renewal of the judicial lien is a continuation of the action, and section 108(c) extends the renewal deadline. A dissent argues that a judgment terminates the civil action, that the automatic stay deals separately with continuation and enforcement, and section 108(c) covers only continuation. *Daff v. Good (In re Swintek)*, 906 F.3d 1100 (9th Cir. 2018).

1.2.c **Section 108(b) does not extend the time to exercise a purchase option.** The debtor had an option to purchase real property, which expired one hour after the commencement of the case and which it was unable to exercise timely because it lacked sufficient financing. Section 108(b) extends for at least 60 days a deadline fixed under an agreement that has not expired by the commencement of the case to "file any pleading, demand, notice, or proof of claim or loss, cure a default, or perform any other similar act." "Similar" means having common characteristics or very much alike or comparable. Exercising an option and purchasing property is not similar to filing a pleading, notice, demand, or claim or curing a default. Because the agreement permitted but did not require the debtor to purchase by the deadline, the debtor's failure to do so was not a "default" that could be cured with the 60-day period. Therefore, section 108(b) does not extend the time for the debtor in possession to exercise the option. *In re 1075 S Yukon, LLC*, 590 B.R. 527 (Bankr. D. Colo. 2018).

1.3 Remedies

1.3.a **Debtor may recover fees for appealing denial of fees for stay violation.** After the creditor violated the automatic stay, the debtor moved for sanctions, including attorneys' fees. The bankruptcy court awarded fees that did not account for several days of the attorney's work. The debtors appealed to the district court, which remanded for the bankruptcy court to calculate the fees. The bankruptcy court awarded a substantial amount more but not for the attorney's appellate work, on the ground that a request for such fees was then pending in the district court. The district court denied the request, and the debtors appealed to the court of appeals. Section 362(k) requires the court to award "actual damages, including costs and attorneys' fees," to an individual injured by a willful violation of the automatic stay. Without the prospect of an attorneys' fees award, most individual debtors would lack the means to seek redress for stay violations. Moreover, the risk of a fee award acts as a deterrent to stay violations. Neither function operates effectively if the debtor may not recover fees for pursuing the damages and fees claim to final judgment. Therefore, the court must award attorneys' fees to the debtor for pursuing or defending an appeal from an order under section 362(k). *Easley v. Collections Serv. Of Nev.*, 910 F.3d 1286 (9th Cir. 2018).

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **Section 548(c)'s "futility exception" to the good faith defense does not apply under Texas law.** A receiver sued a Ponzi scheme investor under the Texas Uniform Fraudulent Transfer Act (TUFTA) to avoid and recover the investor's withdrawals from the scheme. Like Bankruptcy Code section 548(c), TUFTA gives a fraudulent transfer defendant a defense if the defendant received the transfer for value and in good faith. A transferee who had inquiry notice of the fraud does not take in good faith, unless the transferee actually conducts a diligent investigation and does not uncover the fraud. Section 548(c) permits the transferee a defense if the transferee shows a diligent investigation would not have uncovered the fraud, that is, if the investigation would have been futile. Under TUFTA, if the transferee had inquiry notice, then failure to investigate prevents a good faith finding no matter what the investigation might or might not have revealed. The Bankruptcy Code futility exception does not apply. *Janvey v. GMAG, L.L.C.*, ___ F.3d ___, 2019 U.S. App. LEXIS 759 (5th Cir. Jan. 9, 2019).

2.2 Preferences

2.3 Postpetition Transfers

2.4 Setoff

2.4.a **Federal interest in equality of distribution supersedes any state law right of triangular setoff.** The debtor owed a prepetition creditor $6.9 million. The creditor's affiliate owed the debtor $9.2 million. The debtor's and the creditor's prepetition agreement authorized the creditor and its affiliates to offset any amounts owed by one or more of them to the debtor or its affiliates. Section 553(a) permits setoff of mutual debts between a debtor and a creditor. Mutuality requires that the debts be between the same parties in the same capacities. Nonbankruptcy law governs property rights and obligations between the debtor and its creditors, unless a federal interest requires otherwise. The federal interest in equality of distribution among creditors supersedes any nonbankruptcy law that would enforce a contract between the debtor and a creditor that permits triangular setoff, whether directly or by treating the affiliate as a third-party beneficiary of the contract. *In re Orexigen Therapeutics, Inc.*, ___ B.R. ___, 2018 Bankr. LEXIS 3579 (Bankr. D. Del. Nov. 13, 2018).

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

2.7.a **Under section 550(a), a payroll service is a conduit, not an initial transferee.** The debtor, which conducted a fraudulent business, paid its payroll through a payroll service, which accepted funds from the debtor into an account that held only client payroll funds, not any of the service's own funds, and issued payments to employees solely at the debtor's direction, as required under the debtor-service contract. The trustee sued the service to avoid and recover payroll payments the debtor made to the service as fraudulent transfers. Section 550(a)(1) permits the trustee to recover an avoided transfer from an initial transferee but not from a mere conduit of a transfer. A conduit is one who does not have actual control over the transferred property and acted in good faith and as an innocent participant in the transfer. Here, the payroll service segregated client funds and, by contract, was required to use them only for the client's payroll. It did not have any control over the funds. As a payroll service that only issued payments at the client's express instructions and did not have any visibility into or control over the client's business, it was an innocent participant in the transfers. Therefore, it was a conduit, not an initial transferee that would be liable for recovery of the payments. *Luria v. ADP, Inc. (In re Taylor, Bean & Whitaker Mortgage Corp.)*, ___ B.R. ___, 2018 Bankr. LEXIS 3407 (Bankr. M.D. Fla. Nov. 1, 2018).

3. BANKRUPTCY RULES

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.2 Involuntary Petitions

4.2.a **Court dismisses involuntary chapter 11 petition by non-recourse noteholders against CDO.** A structured finance vehicle known as a Collateralized Debt Obligation raised funds by issuing series of non-recourse notes with contractually-specified priorities and used the funds to purchase loans issued by unrelated entities, which secured the CDO's notes and whose payments would be used to pay its notes. The indenture for the CDO's notes contained detailed provisions for liquidation of the CDO after default. After it defaulted on its Series B notes, investors purchased 100% of its Series A-1 notes and 34% of its Series A-2 notes and, after waiving their collateral to the extent of $15,775, filed an involuntary chapter 11 petition against the CDO. They then filed a motion to terminate exclusivity to file a liquidating plan. Section 303(b) permits an involuntary petition against a person by "three or more entities, each of which is … a holder of a claim against such person … [that] aggregate at least $15,775 more than the value of any lien on property of the debtor." Section 102(2) provides "'claim against the debtor' includes claim against property of the debtor." Section 1111(b)(1) provides a "claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse," with exceptions relating to sale of property or treatment under a plan. Because section 1111(b)(1) provides for conversion of non-recourse claims into recourse claims for purposes of allowance or disallowance under section 502, it does not apply to determining whether a holder of a non-recourse claim holds an unsecured claim. Because section 303(b) refers to unsecured claims "against such person" rather than against the debtor, section 102(2) does not apply by its terms and does not make the holder of a non-recourse claim eligible as a holder of a claim against the debtor. Moreover, a bankruptcy court may dismiss an involuntary chapter 11 case for cause under section 1112, even if the petitioners qualify. Here, the chapter 11 case would supplant the carefully negotiated liquidation provisions in the CDO's indenture, which the petitioning creditors accepted by purchasing their notes, would disadvantage junior creditors, and would serve no rehabilitative purpose for the static investment pool alleged debtor. Therefore, the court also dismisses the petition for cause. *In re Taberna Preferred Funding IV, Ltd.*, ___ B.R. ___, 2018 Bankr. LEXIS 3557 (Bankr. S.D.N.Y. Nov. 8, 2018).

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.1.a **Section 1114 applies to Coal Act retiree benefits in a chapter 11 section 363(b) sale.** The 1992 Coal Act requires coal mines to contribute to funds to provide retiree medical benefits. The debtor coal mine filed chapter 11 and sought approval of a sale of substantially all its assets to a buyer that was newly-formed by the debtor's secured lenders. The buyer conditioned the sale on the DIP's termination of retiree benefits under section 1114. Section 1114 permits the court to approve an agreement providing for modification, or to order modification, of retiree benefits if modification is, among other things, necessary "to permit the reorganization of the debtor." "Retiree benefits" are "payments … for the purpose of providing or reimbursing payments … for medical … benefits … under any plan, fund or program … maintained or established in whole or in part by the debtor." Based on a detailed examination of the Coal Act, its history, section 1114, and its history, the court concludes that despite the statutory requirement that coal employers fund retiree benefits, the debtor's obligations qualify as payments "under any plan, fund or program … maintained … in whole or in part by the debtor." Modification must be necessary "to permit reorganization." Chapter 11 permits a going concern sale. In this case, the sale effectively exchanged secured claims for equity, as in a classic going concern reorganization. More generally, a going concern sale, even not to existing creditors, is a form of business reorganization. As such, section 1114 permits modification of retiree benefits as part of a going concern sale undersection 363(b). *United Mine Works of Am. Combined Benefit Fund v. Toffel (In re Walter Energy, Inc.)*, ___ F.3d ___, 2018 U.S. App. LEXIS 36567 (11th Cir. Dec. 27, 2018).

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statement and Voting

5.5 Confirmation, Absolute Priority

5.5.a **A plan does not impair a class of claims when the Code, not the plan, disallows the claims.** The debtor became solvent during the case because of rising commodity prices. It proposed a plan that provided for payment in cash in full of the principal owing on its notes, excluding postpetition interest and a make-whole amount. A class of claims is impaired unless the plan does not alter its legal, equitable or contractual rights. Section 502(b)(2) disallows claims for postpetition interest. Because the Code, not the plan, disallows the postpetition interest claim, the class is not impaired. Section 1141(d) discharges the debtor upon plan confirmation, including for unpaid postpetition interest, but still the Code, not the plan, does the work. *Ultra Petroleum Corp. v. Ad Hoc Committee of Unsecured Creditors (In re Ultra Petroleum Corp.),* ___ F.3d ___, 2019 U.S. App. LEXIS 1617 (5th Cir. Jan. 17, 2019).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Court disallows make-whole claim as postpetition interest; remands to determine rate of postpetition interest in a solvent case.** The debtor's plan proposed payment of the noteholders' claims in cash in full with whatever amount of postpetition interest and contractual make-whole amount is required for the class to be unimpaired. Section 502(b)(2) disallows claims for postpetition interest *as part of* a claim. Whether a claim is for unmatured postpetition interest is based on economic realities, not formalities. A make-whole payment is the economic equivalent of interest and compensates a creditor for lost future interest. Therefore, section

502(b)(2) disallows a make-whole amount as well as the contractual postpetition interest on the claims. Section 1129(a)(7), which requires that a plan provide at least as much as a liquidation, allows postpetition interest "at the legal rate" *on* all allowed claims, through indirect incorporation of section 726(a)(5). Section 726(a)(5) differs from the pre-Code "solvent debtor" exception, which required payment of contractual interest as part of a claim before any surplus could be returned to the debtor, in that it applies to all claims, not just those whose contract provided for interest, applies to interest on, not as part of, the claim, and uses the legal, rather than the contractual, rate. But section 1129(a)(7), and therefore section 726(a)(5), do not apply to a class of claims that is not impaired. Therefore, the creditors are entitled to the make-whole amount if and only if the solvent debtor exception survives the Code. The court of appeals remands to determine that question. The parties agreed that the creditors are entitled to postpetition interest, based on Congress' repeal of former section 1124(3), which courts have read to deny postpetition interest to an unimpaired class, but did not agree on the rate. The court identifies two possible approaches: the legal rate under 28 U.S.C. § 1961(a), which allows interest at the legal rate on a money judgment, and equity, which might provide a right to postpetition interest at an appropriate equitable rate. The court of appeals remands to determine the appropriate rate. *Ultra Petroleum Corp. v. Ad Hoc Committee of Unsecured Creditors (In re Ultra Petroleum Corp.),* ___ F.3d ___, 2019 U.S. App. LEXIS 1617 (5th Cir. Jan. 17, 2019).

6.1.b **Court disallows default interest rate as unenforceable penalty.** The debtor's loan agreement provided a default interest rate of 5% over the nondefault rate. The debtor and the bank did not negotiate over the default rate, and the bank made no effort when it issued the loan to determine what its damages, such as administrative or funding costs or loss in the loan's value, might be if the debtor defaulted or whether the default interest rate bore any relation at all to anticipated damages resulting from a default. After bankruptcy, the debtor in possession objected to the allowance of default interest. Applicable nonbankruptcy law requires that a liquidated damages amount "must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained." An amount disproportionate to that amount is an unenforceable penalty. Because the bank here made no effort to estimate damages or loss resulting from the default, the default interest rate is an unenforceable penalty. The court disallows the claim to that extent. *In re Altadena Lincoln Crossing, LLC*, ___ B.R. ___, 2018 Bankr. LEXIS 2018 (Bankr. C.D. Cal. July 3, 2018).

6.2 Priorities

6.2.a **Section 364(c)(1) superpriority claims are not subordinate to administrative claims incurred under chapter 7 after conversion.** The court permitted a chapter 11 debtor in possession to obtain credit from a supplier on a superpriority basis under section 364(c)(1). The case converted to chapter 7. Section 364(c)(1) permits obtaining credit "with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b)." Section 726(b) provides "a claim allowed under section 503(b) of this title incurred under [chapter 7 after conversion from another chapter] has priority over a claim allowed under section 503(b) of this title incurred under any other chapter of this title," but does not refer to section 364 at all. Claims with superpriority under section 364(c)(1) are not administrative claims allowable under section 503(b); they are a special category of claims with priority over section 503(b) administrative claims. Therefore, they are not subordinate to section 503(b) administrative claims incurred under chapter 7 after conversion. *In re Happy Jack's Petroleum, Inc.*, ___ B.R. ___, 2018 Bankr. LEXIS 3424 (Bankr. D. Neb. Nov. 7, 2018).

6.2.b **Secured lender with actual knowledge of a consignment is junior to the consignor.** The debtor established a consignment program for its suppliers. About 10% of its goods were received under the program. One consignor filed a UCC-1 statement to perfect its interest in its consigned goods, but the filing had lapsed by the time of the debtor's bankruptcy. The debtor borrowed under a secured lending facility. When the lender filed its own UCC-1, it had actual knowledge of the consignor's interest, as the interest was listed in the loan agreement. After bankruptcy, the debtor in possession sold some of the consigned goods. The consignor and the secured lender each claimed the proceeds. A consignment is subject to the U.C.C.'s priority and perfection rules. A consignor must perfect, usually by filing a UCC-1, to retain priority in its goods or their proceeds. A delivery of goods to a merchant for sale is a consignment if the merchant deals in those kinds of goods and is not generally known by its creditors to be substantially engaged in selling goods of others. If a merchant is generally so known, then the delivery is not a consignment, and the deliverer need not perfect to prevail over perfected security interests. A UCC-1 gives constructive notice of a security interest in the debtor's property and protects creditors against secret liens. A creditor who has actual knowledge of a consignment takes its interest subject to the consignment interest: it would be anomalous to subject a creditor with constructive notice to a consignor's interest but not a creditor with actual knowledge, as the protection against secret liens is the same. Therefore, the court orders the sale proceeds paid to the consignor. *TSA Stores, Inc. v. Performance Apparel Corp. (In re TSAWD Holdings, Inc.)*, ___ B.R. ___, 2018 Bankr. LEXIS 3680 (Bankr. D. Del. Nov. 26, 2018).

6.2.c **Creditor may not offset PACA trust claim against debt owing to the debtor.** The debtor and the creditor were both perishable agricultural commodity purchasers and sellers. They traded between themselves, setting up offsetting credits and debits. When the debtor filed bankruptcy, the debtor owed the creditor $205,000, and the debtor owed the creditor $263,000. The debtor had assets derived from the purchase and resale of perishable agricultural commodities. The creditor claimed the right of setoff and asserted the $58,000 balance of its claim against those assets. The Perishable Agricultural Commodities Act creates a floating trust over all a debtor/purchaser's assets in favor of sellers to the debtor of such commodities. The trust assets are not property of the estate but are held solely in trust for the sellers. As such, the creditor had a claim against the trust assets for $263,000. A creditor may offset debts and credits, but they must be mutual, that is, between the same parties in the same capacity. The creditor's claim was against the trust, not against the debtor, and so could not be offset. The creditor was required to pay its debt to the debtor's estate and share pro rata with other PACA creditors in the PACA trust on its claim against the debtor. *The PACA Trust Creditors v. Genecco Produce Inc.*, ___ F.3d ___, 2019 U.S. App. LEXIS 627 (2d Cir. Jan. 9, 2019).

7. CRIMES

8. DISCHARGE

8.1 General

8.2 Third-Party Releases

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

9.1.a **Ordinary course modification of ordinary course executory contract does not require court approval.** The debtor had contracted in the ordinary course of its business to manufacture a boat for a buyer. After bankruptcy, the debtor in possession and the buyer agreed to modify the specifications for the boat. Section 365 permits the DIP to assume or reject an executory contract. It provides the DIP a one-sided option to deal with the contract; the counterparty remains bound until the DIP elects. When the DIP and the counterparty agree to modify a contract, the DIP no longer wields section 365's coercive powers, so the protections of the counterparty are not necessary. Where the contract and the modification are in the ordinary course of the debtor's business, section 363(c) permits the DIP to modify the contract. The court enforces the modification and permits the buyer to take possession of the board in accordance with the modified contract. *In re Stiletto Mfg., Inc.*, 588 B.R. 762 (Bankr. E.D. N.C. 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 **Plan's exclusive jurisdiction provision does not trump contract's arbitration clause.** The debtor's prepetition contract provided for arbitration of all disputes arising out of or related to the contract or to any transactions contemplated under the contract. The chapter 11 plan rejected the contract, preserved all claims against the counterparty, vested the claims in a liquidating trust, granted the bankruptcy court exclusive jurisdiction over litigation of the claims "to the fullest extent permitted by law," and preserved all the counterparty's rights and defenses. The Federal Arbitration Act validates arbitration agreements and requires the federal courts to enforce them. Fed. R. Civ. Proc. 8(c)(1) (made applicable by Bankruptcy Rule 7008) provides a right to arbitrate is an affirmative defense. The plan's exclusive jurisdiction provision does not supersede the arbitration provision, because the "extent permitted by law" limitation and the preservation of the counterparty's rights and defenses protect the counterparty's right to arbitrate, which is an affirmative defense. Therefore, the court orders arbitration of the claim. *Paragon Litigation Trust v. Noble Corp PLC (In re Paragon Offshore PLC)*, 588 B.R. 735 (Bankr. D. Del. 2018).

11.1.b **Bankruptcy court may not, under 28 U.S.C. § 1631, transfer an action over which is does not have jurisdiction.** After confirmation, the liquidating trustee filed an action against a third party. The defendant moved to dismiss for want of post-confirmation jurisdiction. The bankruptcy court granted the motion. The trustee moved to transfer the case under 28 U.S.C. § 1631 to a district court in which the action could have been brought. Section 1631 requires "a court as defined in section 610 of this title [that does not have] jurisdiction … if it is in the interest of justice, [to] transfer such action … to any other such court in which the action … could have been brought." Section 610 defines "court" to include the district courts but not the bankruptcy courts. The bankruptcy court is a unit of the district court, which hears matters the district court refers to it. The reference order covers only matters over which the bankruptcy courts have jurisdiction. Because the bankruptcy court did not have jurisdiction, the action was not referred, and the bankruptcy court lacked any authority to act on the litigation. Therefore, it could not transfer the action to another court. *Troisio v. Erickson (In re IMMC Corp.)*, 909 F.3d 859 (3d Cir. 2018).

11.1.c **Withdrawal of proof of claim does not defeat bankruptcy court's equitable jurisdiction.** The creditor filed a proof of claim. The trustee sued the creditor to avoid and recover a fraudulent transfer. The creditor withdrew its claim and moved for withdrawal of the reference on the ground that the bankruptcy court did not have authority to issue a final judgment on an avoiding power claim. Section 502(d) mandates disallowance of a claim of a creditor that has received and not returned an avoidable transfer and has not returned it to the estate. The bankruptcy court may determine the allowability of a claim, including a section 502(d) objection, under its equitable jurisdiction, which precludes a creditor's right to a jury trial on the avoiding power claim, because the allowability determination necessarily determines avoidability. A court's jurisdiction and authority is determined when the action is commenced. Because the creditor's claim was on file when the trustee brought the avoiding power action, the court then had authority to determine the allowability of the claim, including whether the creditor had received an avoidable transfer. The creditor's withdrawal of its claim did not change that authority or divest the bankruptcy court of its equitable authority to rule on the avoidability complaint. *Picard v. BAM L.P. (In re Bernard L. Madoff Inv. Secs. LLC)*, ___ B.R. ___, 2019 Bankr. LEXIS 127 (Bankr. S.D.N.Y. Jan. 18, 2019).

11.2 Sanctions

11.3 Appeals

11.4 Sovereign Immunity

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a **Corporate officers do not have a fiduciary duty to advise a board against the board's direction.** Based on pressure from federal and state regulators and advice from its counsel, the debtor bank holding company's board of directors determined to support its bank operating subsidiaries, whatever the effect on the holding company. The holding company received a large tax refund, which it invested in the bank. The holding company's officers did nothing to inform the board about alternative uses of the refund and whether an early bankruptcy filing might preserve the refund for the holding company and its creditors. Ultimately, the bank failed and was taken over by the regulators. The holding company filed bankruptcy. The trustee sued the officers for breach of fiduciary duty for failing to investigate alternatives for the refund and how it might help the holding company and to inform the board of the alternatives. A claim for breach of fiduciary duty requires the existence of a fiduciary relationship, a breach of the resulting duty, and harm to the beneficiary. A corporate officer is a fiduciary to the corporation. Their duties are determined under agency law, which requires an agent to provide the principal with complete information. However, the duty is not absolute. If the principal (here, the board), after due consideration, directs a course of action, the agent need not provide information to the principal that does not support that course of action nor hire experts to second-guess the principal's decision. Accordingly, the court dismisses the complaint. *Levin v. Miller*, 990 F.3d 856 (7th Cir. 2018).

12.1.b **Directors do not violate duty of loyalty by declaring a dividend to all shareholders two years before insolvency.** The Delaware LLC debtor suffered an insured accident, which destroyed the equipment that made the debtor competitive. Its directors, who also served as directors of its parent and were either members or representatives of members of the parent, determined to accept an insurance settlement and change their business model, rather than use the insurance proceeds to rebuild the equipment. Within months, they authorized distributions from the debtor to its parent, which authorized distributions to its members. Over the two years following the decision to accept the insurance settlement, the debtor lost money, opened a credit line with a new lender, and ultimately failed and filed bankruptcy. The creditors' committee sued the directors for breach of fiduciary duty. Under Delaware law, fiduciary duty includes the duties of care and of loyalty, exercised in good faith. A director breaches the duty of loyalty if the director has a conflict of interest and would stand to benefit from a decision in a way not shared by all shareholders or if the director acts in bad faith, which is conduct worse than gross negligence and involves a decision that cannot be understood as in the corporation's interest. A wholly-owned subsidiary exists to serve its parent, and its directors owe no duty to the subsidiary other than what the parent directs, unless the subsidiary is insolvent. Here, the directors did not have a conflict, because their actions, though benefitting themselves, benefitted all shareholders (members) equally. Nor did insolvency two years later affect the directors' duties when they made their decisions, because the debtor was not yet in financial trouble. The court dismisses the claims against the directors for breach of the duty of loyalty. *Official Comm. of Unsecured Creditors v. Meltzer*, 589 B.R. 6 (D. Me. 2018).

12.1.c **LLC debtor's trustee may not recover tax refunds paid after bankruptcy to LLC members.** Before bankruptcy, the debtor LLC distributed cash to its members to pay their taxes for two calendar years on the income of the LLC. As a pass-through entity, the LLC's income was attributed to the members for tax purposes. After bankruptcy, the members filed amended tax returns, seeking and obtaining a refund of the amounts paid for those two prior years. The trustee sued the members to recover the refunds either by turnover under section 542 as property of the estate or based on a conversion theory. Because the LLC distributed the cash before bankruptcy, the cash was not property of the estate. The LLC was not a tax-paying entity; all its income and expenses were attributed to its members, and it is not entitled to file a return or claim a refund. Therefore, the tax refunds do not belong to the estate, and the members' amendments to their prior returns did not effect a conversion. *The Finley Group v. Roselli (In re REDF Marketing, LLC)*, 589 B.R. 534 (Bankr. W.D.N.C. 2018).

12.1.d **Court recognizes limits on a shareholder's and vice president's duties of care and loyalty.** The debtor's principal investor and majority shareholder served as a director and vice president but was not involved at all in the operation or management of the business and had no particular duties as vice president. However, in the beginning, she authorized someone to start and operate the business. She did not actively supervise or manage him or the business operations. The business failed as a result of his mismanagement, self-dealing, and dishonesty. A majority shareholder does not owe fiduciary duties to a corporation, only to minority shareholders in dealings at the shareholder level. A vice president is a fiduciary who owes a duty of care, good faith, and loyalty to the corporation, but without specific duties delegated to the vice president in the operation and management of the corporation, a vice president does not breach those duties by inaction. A director owes a duty of care, good faith, and loyalty to the corporation. A failure to supervise and to take reasonable steps to inform oneself may constitute a breach of the duty of care. Therefore, the court dismisses the trustee's claims against the investor as shareholder and vice president, but not as director. *Geltzer v. Bedke (In re Mundo Latino Market Inc.)*, 590 B.R. 610 (Bankr. S.D.N.Y. 2018).

12.1.e **Court measures directors' breach of duty of loyalty to insolvent corporation by benefit to creditors, not shareholders or corporation.** The directors approved an LBO that rendered the debtor insolvent. The transaction benefitted the directors as shareholders to the same extent as other shareholders, but creditors ultimately suffered. The trustee sued them for breach of fiduciary duty. A director owes a duty of due care and loyalty, which includes a duty of good faith, to the corporation and its shareholders. However, when the corporation becomes insolvent, the creditors become the residual beneficiaries of the duty. "Because the duty of loyalty compels directors to maintain 'an undivided and unselfish loyalty to the corporation[,]' Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (emphasis supplied), a director of an insolvent corporation is interested in a transaction if he or she receives a personal benefit not shared by all of the insolvent corporation's creditors." Therefore, the complaint adequately alleges that the directors breached their duty of loyalty. *In re Tribune Co. Fraudulent Conveyance Litigation*, ___ B.R. ___ (S.D.N.Y. Jan. 23, 2019).

12.2 Turnover

12.3 Sales

12.3.a **Court overrules objection to a credit-bid claim absent a showing that the reduced price would have resulted in a different sale.** Before bankruptcy, the debtor engaged an investment banker to sell its business as a going concern. Ultimately, the debtor's private equity owner teamed with another financial firm to form a partnership to bid on the purchase. The bid included a credit bid of the PE firm's prepetition second lien debt and of the debtor in possession financing provided by the partnership. No other bidders appeared. After the sale, the Creditors Committee, which had reserved rights to challenge the second lien claim's allowance and priority, the DIP financing, and certain terms of the sale, sought to subordinate or disallow the DIP financing claim.

In its complaint, the Committee did not allege that any other bidder would have bid at all, let alone for an amount that would have been the highest bid after disallowing or subordinating the DIP claim portion of the credit bid. Because disallowance or subordination would not have made a difference in the sale, the Committee does not state a claim on which relief can be granted, and the court dismisses the complaint. *Official Comm. Of Unsecured Creditors v. Victory Park Cap. Advs., LLC (In re Katy Indus., Inc.)*, 590 B.R. 628 (Bankr. D. Del. 2018).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.2 Attorneys

13.3 Committees

13.4 Other Professionals

13.4.a **GOB sale advisor is not a professional person.** Immediately before bankruptcy, the debtor contracted with a firm that specializes in conducting or advising on going-out-of-business sales for retail merchants. The agreement required the firm to advise on pricing, timing, staffing coordination, accounting, and communication relating to the DIP's planned retail GOB sales, but the DIP retained full authority over these matters. The agreement also permitted the firm to sell furniture, fixtures, and equipment and receive a 15% commission. The prices for the retail sales and the FF&E sales were fixed, not subject to bidding or negotiation, with the DIP fixing the retail prices, and the firm fixing the FF&E prices. Section 327(a) authorizes the employment of "appraisers, auctioneers, or other professional persons" subject to certain requirements and conditions. An auctioneer is one who conducts sales by bidding and sale to the highest bidders. A court determines whether a firm is an "other professional person" based on six factors: control or management of assets that are significant to the reorganization, involvement in negotiating a plan, direct relationship to the debtor's routine business operations, discretion to exercise professional judgment in part of administering the estate, extent of involvement in administration, and degree of specialized knowledge or skill employed. Here, the firm did not accepts bids for assets and so was not an auctioneer. The firm did not control assets significant to the reorganization, was not involved in plan negotiations, had no discretion to administer the estate, and was not involved in administering the estate. Although the firm had specialized knowledge and skill, that factor is largely meaningless, since substantially all who work for any business requires specialized knowledge and skill. The work was not related to the debtor's routine operations, but that factor alone does not predominate in these circumstances. Therefore, the firm is not a section 327(a) "professional person." *In re Brookstone Holdings Corp.*, 592 B.R. 27 (Bankr. D. Del. 2018).

13.5 United States Trustee

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **Court recognizes Curacao insurance rehabilitation proceeding.** Curacao law permits a Curacao court, on short notice and after hearing from the insurance regulator and the insurance company, in "the interest of the joint creditors," to issue an order authorizing the regulator to seize and control an insolvent insurance company with a view to continuing its operations and rehabilitating it. Here, the regulator sought the order on July 3, the court gave notice of a hearing on July 4 at 10:00 AM, on July 4 at 10:30 AM, adjourned the hearing to July 4 at 2:15 PM, heard from the regulator and the company, and issued the decree. The court later appointed a foreign representative, who sought recognition under chapter 15 of the Curacao rehabilitation proceeding as a foreign main proceeding. In the chapter 15 case, the foreign representative and the objector disputed whether creditors are entitled to participate in the Curacao proceeding. To grant recognition, the court must find, among other things, that the foreign proceeding is a collective proceeding in which the debtor's assets and affairs are subject to the control or supervision of a foreign court. A proceeding is collective if it considers the rights of and obligations to all creditors, rather than a single creditor or a single group of similarly-situated creditors. Because the proceeding expressly provides that it be conducted in the interest of joint creditors, the proceeding is collective in nature, whether or not the creditors may participate. Section 1502(3) defines "foreign court" as "a judicial or other authority competent to control or supervise a foreign proceeding." An administrative agency is an "other authority" as provided in the definition. The Curacao regulator has authority to control and supervise the debtor in the rehabilitation proceeding. Therefore, the proceeding meets the requirement of supervision or control by a foreign court. Under section 1506, a court may not recognize a foreign proceeding if doing so would be manifestly contrary to the public policy of the United States. Courts must construe the limitation narrowly. Lack of due process would meet the standard. The Curacao court heard the insurance company, though on shortened notice, and many U.S. state insurance regulations permit seizure and rehabilitation *ex parte*. Therefore, the limited notice to the insurance company of the Curacao proceeding was not manifestly contrary to U.S. public policy. *In re ENNIA Caribe Holding N.V.*, ___ B.R. ___, 2018 Bankr. LEXIS 3986 (Bankr. S.D.N.Y. Dec. 20, 2018).

15.1.b **Financial contract safe harbor prohibits a foreign representative from avoiding a transfer under foreign avoiding powers.** In a chapter 15 case, the foreign representative brought an action to recover transfers the debtor made before its foreign liquidation to non-U.S. persons to redeem the debtor's own securities. The actions were based on the foreign jurisdiction's avoiding power statutes that were similar to the Code's preference and fraudulent transfer provisions. Section 546(e) prohibits a trustee from avoiding a prepetition transfer by, to, or for the benefit of a financial institution or financial participant in connection with a securities contract, unless the transfer is avoidable under section 548(a)(1)(A) (actual fraudulent transfer). The section 546(e) safe harbor is designed to prevent the ripple effects in the financial markets of unwinding certain financial transactions. Section 561(d) extends the safe harbor "to limit avoidance powers to the same extent as in a proceeding under chapter 7 or 11." Because a foreign representative may not exercise the Code's avoiding powers, section 561(d) must apply to a foreign representative's attempt to use foreign avoiding powers in a chapter 15 case. Therefore, section 561(d) limits a foreign representative's ability to recover property covered by the section 546(e) safe harbor, and the foreign representative may not avoid a transfer in connection with a securities contract to a financial institution or financial participant. *Fairfield Sentry Ltd. v. Theodoor GGC Amsterdam (In re Fairfield Sentry Ltd.)*, ___ B.R. ___, 2018 Bankr. LEXIS 3827 (Bankr. S.D.N.Y. Dec. 6, 2018).