JENNER&BLOCK

Recent Developments in Bankruptcy Law, April 2021

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1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a The debtor violated numerous state court orders in actions to recover amounts he misappropriated. The state court held him in contempt and imposed monetary sanctions and ordered him to stop managing property he did not own and to turnover proceeds from the illegal management. The debtor filed his bankruptcy petition the day before a state court hearing on sentencing the debtor to jail for contempt. Section 362(a) stays any prepetition action or proceeding against the debtor, but section 362(b)(4) excepts from the stay any action by a governmental unit to enforce its police or regulatory power." The exception applies when the government's action is to effectuate a public policy to protect public safety and welfare or is to further its own interest but not if the government proceeds for a pecuniary purpose to recover property from the estate. The state court is a governmental unit, and its order to stop managing the property was in the interest of public safety. Its order to turn over money that the debtor collected in violation of the state court's order does not reflect a pecuniary purpose, even though money is involved, because it seeks redress of the violation of a court order and therefore comes within the police power exception. *Kupperstein v. Schall (In re Kupperstein)*, ___ F.3d ___, 2021 U.S. App. LEXIS 11944 (1st Cir. Apr. 22, 2021).

1.1.b **Automatic stay does not apply to state enforcement of COVID-19 protection measures.** The state enacted measures to limit restaurant operations during the COVID-19 pandemic. The debtor disregarded those measures, claiming they were unconstitutional. The county sued in state court to shut down the debtor's operation. The debtor filed chapter 11, invoking the automatic stay. 28 U.S. C. § 959(b) requires a debtor in possession to manage and operate its property "according to the valid laws of the State." Therefore, the safety measures apply to the debtor in possession. Section 362(b)(4) excepts from the automatic stay an action by a governmental entity to enforce its police or regulatory powers. In determining whether an action falls within this exception, the court may not determine the merits of a debtor's challenge to the legality of the state law. Nothing in section 362(b)(4) authorizes the court to examine the legality of the governmental unit's action, which is left to the state court, lest the bankruptcy courts are to scrutinize every governmental regulatory action for legality. Therefore, the county's enforcement action may proceed. *Cty of Allegheny v. Cracked Egg, LLC (In re Cracked Egg, LLC)*, 624 B.R. 84 (Bankruptcy W.D. Pa. 2021).

1.2 Effect of Stay

1.2.a **Government may seek stay annulment to validate postpetition setoff in violation of the stay.** The debtors owed HUD on a guaranteed, defaulted housing loan. HUD notified the Treasury, which then offset the debt against the debtors' tax overpayment, which the debtors attempted to exempt, after the petition date. Section 6402(d) requires the Treasury Secretary to offset tax overpayments against any amounts the taxpayer owes to the government. Section 553(a) preserves the setoff right in bankruptcy. The debtors' exemption claim does not supersede the setoff right. However, the postpetition setoff violated the automatic stay, which HUD might remedy by seeking annulment of the stay. *Wood v. U.S. Dept. of Housing & Urban Devel. (In re Wood)*, ___ F.3d ___, 2021 U.S. App. LEXIS 10029 (4th Cir. Apr. 7, 2021).

1.3 Remedies

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.2 Preferences

2.3 Postpetition Transfers

2.4 Setoff

2.4.a **Creditor may not offset claim against breach of fiduciary duty claim against the creditor.** The debtor's director loaned the debtor money. When he learned that the debtor had failed to disclose substantial other debts, he called the loan and sued to collect. The debtor brought a breach of fiduciary duty action against him. The jury found in favor of both claims. The debtor later filed bankruptcy. The director sought to offset the two judgments. Section 553(a) preserves the right to offset mutual debts and claims, subject to equitable considerations. A claim arising from a breach of fiduciary duty is not a mutual claim against a contract debt, because the liability on the claim arises from the defendant's acts in a fiduciary capacity. Moreover, allowing such a creditor to offset of judgment for breach of fiduciary duty would allow the creditor to benefit from his own wrongdoing. Therefore, the court denies setoff. *In re E. Coast Custom Coaches, Inc.)*, 624 B.R. 390 (Bankr. E.D. Va. 2020).

2.4.b **Mutuality requirement defeats contractual triangular setoff.** The debtor sold goods to the counterparty and contracted with the counterparty's affiliate to perform marketing services for the debtor. The sale contract provided that amounts owing to the counterparty could be offset against any amounts the counterparty or any of its affiliates owed to the debtor. When the debtor filed bankruptcy, it owed the affiliate $7 million, and the counterparty owed the debtor $9 million. The counterparty sought permission to offset the debts so it would pay only $2 million to the estate. Section 553(a) provides the Code "does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor … against of claim of such creditor against the debtor," subject to three enumerated exceptions, which do not include an exception for non-mutual debts. The mutuality requirement is embedded in the statutory authorization and does not require a separate exception to make it effective. Mutuality requires that the creditor and debtor owe each other directly, not through a third party. A contractual right to a triangular setoff enforceable under state law does not create mutuality; more generally, parties may not contract around the mutuality limitation. Here, the debts were not owing between the same parties, so the setoff was denied. However, the court notes some alternatives the counterparty could have used to preserve a setoff right, including joint and several liability among the parties or the granting of a security interest in the accounts receivable. *In re Orexigen Therapeutics, Inc.*, 990 F. 3d 748 (3d Cir. 2021).

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

3. BANKRUPTCY RULES

3.1.a **Certified mail is not adequate for service of process.** The plaintiff served the complaint and summons on the defendant by certified mail but did not receive a receipt of delivery from the defendant. Bankruptcy Rule 7004 permits service by first class mail. Certified mail imposes additional requirements on the Postal Service and on the recipient. Because certified mail differs from ordinary first class mail, service was ineffective. *Ratliff v. Dept. of Educ. (In re Ratliff)*, ___ B.R. ___, 2021 Bankr. LEXIS 599 (Bankr. S.D.W. Va. Mar. 15, 2021).

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a **Owner of defunct business is not eligible for subchapter V.** Before bankruptcy, the individual debtor owned and operated several small businesses, all of which had become defunct by the petition date. The debtor then became the manager of another business, which he did not own. Numerous investors in the defunct businesses sued the debtor for fraudulent investment

solicitation in the defunct businesses, and the debtor believed he remained liable for some of the defunct companies' outstanding debts. At the petition date, the debtor did not own an interest in any operating business and was not engaged in any business on his own. Subchapter V of chapter 11 applies to a small business debtor, which is a person engaged in commercial or business activities with debts below the statutory maximum. Whether a debtor is "engaged in" business "is inherently contemporary in focus instead of retrospective" and is designed to capture a debtor who needs a reorganization to remain in business. "Commercial or business activities" involve the buying and selling of goods and services and does not describe one who is only an employee of a business. Therefore, the debtor is not eligible for subchapter V. *In re Johnson*, ___ B.R. ___ (Bankr. N.D. Tex. Mar. 1, 2021).

4.1.b **Corporation winding down its business qualifies for subchapter V.** The corporate debtor sold its principal asset for stock in another company and was winding down its business. It had no employees, and its only assets were the stock, a bank account, some receivables, and a law suit claim. It had no intention to reorganize. It was making an effort to realize the assets' value and pay its creditors. It filed a chapter 11 petition and elected to proceed under subchapter V. A debtor is eligible to proceed under subchapter V if, among other things, the debtor "is engaged in commercial or business activities." The Code does not define any of those words, so the court looks to their ordinary meaning. "Is engaged" means currently (as opposed to formerly) engaged as of the petition date. The court uses a "totality of circumstances" test to determine whether the debtor is currently engaged in business. "Activities" differs from "operations," which would imply more active business conduct. Here, the debtor's active bank accounts and accounts receivables, its work pursuing the lawsuit, managing the stock and winding down its business meet the requirement. The legislative history and recent case law support this reading. Therefore, the debtor qualifies to proceed under subchapter V. *In re Offer Space, LLC*, ___ B.R. ___, 2021 Bankr. LEXIS 1077 (Bank. D. Utah Apr. 22, 2021).

4.1.c **Debtor's employment qualifies as "commercial or business activities."** The individual debtor owned an LLC, which he used as a pass-through entity for various businesses, including a business in which the LLC owned a 30% interest. The debtor used to work for that business until it failed shortly before the debtor's bankruptcy and had guaranteed its debts, which caused his bankruptcy and which constituted over 80% of his debts. At the petition date, he was an employee of an unrelated business and worked on the wind-down of the failed business of which he remained as a manager. He filed his petition to adjust his guarantee obligations. Only a "person engaged in commercial or business activities" at least 50% of whose debts arose from such activities is eligible to proceed under subchapter V. Based on its ordinary meaning, dictionary definitions, use of a similar phrase ('engaged in business') in section 1304, "commercial or business activities" has a broad meaning. The tense of "engaged in," as used in the eligibility provision and other Code provisions, indicates the eligibility requirement applies as of the petition date. Because the debtor's commercial or business activities related to the LLC, relating to the wind-down of the failed business, and relating to his new employment, he qualifies to proceed under subchapter V. *In re Ikalowych*, ___ B.R. ___, 2021 Bankr. LEXIS 997 (Bankr. D. Colo. April 15, 2021).

4.1.d **A hotel is not single asset real estate.** The debtor operated a 79-room hotel. It had 15 employees, who provided room cleaning, laundry, internet, phone, bus and trailer parking, business, breakfast and pool and fitness center services. It filed a chapter 11 petition and elected to proceed under subchapter V, which denies eligibility to "a person whose primary activity is the business of owning single asset real estate," which the Code defines as "real property constituting a single property or project ... on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto." Because of the services the debtor provides in addition to simply renting rooms, the debtor is not a single asset real estate debtor and is eligible for subchapter V. *In re ENKOGS1, LLC*, ___ B.R. ___ (Bankr. M.D. Fla. Apr. 20, 2021).

4.1.e **Affiliates' debt disqualifies subchapter V filing.** Four affiliates filed chapter 11 cases and elected to proceed under subchapter V. One of the affiliates only held real estate and so, as a single asset real estate debtor, was not eligible for subchapter V. The sum of the debts of the three other affiliates was less than $7.5 million, but adding the debts of the real estate affiliate put the aggregate debt of the group over $7.5 million. Section 101(51D) defines "small business debtor" as (A) a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning single asset real estate) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than" $7,500,000.00 and (B) "does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than" $7,500,000.00. Although the three debtors might have qualified under subparagraph (A), the aggregate debt limit for the entire group of affiliates makes them ineligible to proceed as small business debtors under (B), even though the affiliate who put them over the debt limit is not itself eligible for subchapter V. *In re 305 Petroleum, Inc.*, 622 B.R. 209 (Bankr. N.D. Miss. 2020).

4.2 Involuntary Petitions

4.2.a **Court must consider avoidance defenses in counting eligible petitioning creditors.** One creditor filed an involuntary petition against the debtor. In the 90 days before the petition date, the debtor had made payments on account of antecedent debts to 15 of the 25 creditors listed on the debtor's schedules. Section 303(b) requires at least three creditors join an involuntary petition, unless the debtor has fewer than 12 creditors, determined without counting any creditor who is an insider or received a voidable transfer. Section 547(b) makes avoidable a transfer by the debtor to or for the benefit of a creditor, for or on account of an antecedent debt, made within 90 days before the petition date, that permits the creditor to receive a greater percentage of the creditor's claim than it would have received in a hypothetical chapter 7 case. However, section 547(c) provides that a transfer is not avoidable under section 547(b) if, among other things, the transfer is made in the ordinary course of business and according to ordinary business terms to pay an ordinary course claim. Because section 303(b) excludes a creditor from the count only if the creditor received a voidable transfer, the court must determine whether the creditor would have a section 547(c) defense and may not rely simply on the fact that the transfer met the avoidance requirements of section 547(b). *Williams v. Roos*, ___ B.R. ___, 2021 U.S. Dist. LEXIS 12560 (W.D. La. Jan. 22, 2021).

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.1.a **Court may excuse compliance with section 345.** The debtor maintained two operating accounts and 20 trust accounts for payments due to state taxing agencies at banks that had not met the requirements of section 345. It sought court approval to maintain its cash management system at those banks, despite noncompliance with section 345. Section 345 requires that moneys of estates be deposited or invested only with institutions that have provided security to the United States in the form of a bond or deposit of specified U.S. securities, "unless the court for cause orders otherwise." Because the "unless" clause is separated from the bond and securities requirements paragraphs by a semicolon, it applies equally to both of them. Any other reading would ultimately lead to the same result: authorizing the court to order otherwise for either form of security. In this case, the debtor's sound operating history, the complexity of its cash management systems, including the separate trust accounts for state authorities, and its progress toward a confirmable plan all provide cause for the court to order otherwise and authorize the debtor in possession to maintain its existing cash management system. *In re King Mt. Tobacco Co.*, 623 B.R. 323 (E.D. Wash. 2020).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **An environmental damage claim arises only after contact or a relationship.** The debtor operated a creosote plant, which caused environmental pollution in a substantial area surrounding the plant. After its chapter 11 case, its liquidating trust reached an agreement with the debtor's predecessor to contribute to a fund for the creditors in exchange for a very broad injunction against any environmental claims, including claims whose holder is not aware of or does not suspect to exist, "to the maximum extent allowed under the law." After the court approved the settlement and issued the injunction, a landowner discovered environmental damage to his property and sued the predecessor for damages. Whether the injunction applies depends on when the landowner's claim arose. A claim arises upon conduct fairly giving rise to the claim if there is some minimum contact or relationship between the plaintiff and defendant such that the claim is identifiable. Because of both fairness and due process concerns, the test requires that the relationship was such that both parties knew liability could arise. Although the lawsuit alleges the pollution caused damages many decades before the suit, it alleges that the landowner did not discover the pollution until after the injunction. The release of pollutants alone does not constitute the requisite contact or relationship. Therefore, the injunction does not apply to the claim. *Tronox Inc. v. Anadarko Petro. Corp. (In re Tronox Inc.)*, ___ B.R. ___, 2021 U.S. Dist. LEXIS 31208 (S.D.N.Y. Feb. 19, 2021).

6.1.b **Dissolved corporation that continued to manage a pension plan remained the plan's sponsor.** The debtor sponsored an ERISA-governed pension plan. The debtor filed bankruptcy in 1992, and its sole shareholder filed bankruptcy a few years later, surrendering all of his stock to the trustee. Shortly thereafter, the debtor dissolved under state law. Nevertheless, the pension plan continued to operate, and the debtor's shareholder/CEO continued to sign plan documents on the debtor's behalf, as plan sponsor. When the plan ran low on funds in 2012, the PBGC and the shareholder reached a settlement of his remaining liability in which he conveyed all his powers and authority to PBGC. Six years later, the PBGC sued 19 corporations the shareholder then owned under a controlled group liability theory. State law governing dissolution does not govern the status of the dissolved corporation for ERISA purposes, because state law cannot be used to defeat federal law. Because the dissolved corporation continued to serve as plan sponsor and to authorize payments from the plan, it remained the plan sponsor despite its dissolution. Therefore, the shareholder's currently owned companies are liable under the controlled group theory for the plan's underfunding. *Pension Ben. Guar. Corp. v. 50509 Marine LLC*, 981 F.3d 927 (11th Cir. 2020).

6.2 Priorities

6.2.a **Administrative expense priority is determined by benefit to the estate.** The debtor proposed a plan based on a merger agreement with a buyer. The court confirmed the plan, but the merger never consummated, because the buyer could not obtain regulatory approval for the transaction. The debtor ultimately sold to another buyer in a transaction that borrowed heavily from the structure and documentation of the first transaction, including by avoiding certain risks that defeated the first transaction. The buyer sought reimbursement of its expenses as an administrative expense claim. Section 503(b)(1)(A) allows the actual and necessary costs and expenses of administration as administrative expenses. An expense that does not confer a benefit on the estate is not necessary. A prospective buyer's efforts may qualify if they promote a

more competitive bidding process by inducing a bid or encourage due diligence that leads to a bid on which other bidders can rely. The allowable amount is not necessarily the costs incurred but is measured by actual benefit to the estate, including intangible benefits that cannot be measured precisely. The courts may use hindsight in measuring the benefit. The buyer's efforts here benefitted the estate in helping to set up the ultimately successful transaction, so the buyer is entitled to allowance of an administrative expense claim. The court of appeals remands for a determination of the benefit and any offsetting costs. *In re Energy Future Holdings Corp.*, ___ F.3d ___ (3d Cir. Mar. 15, 2021).

6.2.b **Court enforces broad subordination agreement, denies standing to subordinated creditor**. The creditors' subordination agreement provided all payments on the subordinated claim would be made directly to the senior creditor, granted the subordinated creditor's voting rights to the senior creditor, and prohibited the subordinated creditor from taking any position in a bankruptcy case contrary to the priorities and other rights of the creditors under the agreement. The debtor proposed a plan to pay the senior creditor about 35% of its claim, with a small distribution to the subordinated creditor, which would be redirected to the senior creditor under the subordination agreement. Section 1126(a) permits the holder of a claim to accept or reject a plan. The subordination agreement provision granting the subordinated creditor's vote to the senior creditor does not override section 1126(a), because prebankruptcy agreements do not override contrary Code provisions. Section 510(a), which requires the court to enforce a subordination agreement, applies only to priorities, not to other provisions, such as voting rights, and Rule 2018(c) permits voting only by a creditor or its agent, which the senior creditor was not. Therefore, the subordinated creditor may vote its claim. Section 502(b)(2) requires allowance of a claim except to the extent not enforceable under nonbankruptcy law. Although the subordination agreement granted all payment rights associated with the claim to the senior creditor, the claim remained enforceable and therefore was allowed over the debtor's objection. Section 1109(a) grants a party in interest the right to appear and be heard on any issue in the case. Therefore, the subordinated creditor had standing to appear and be heard, despite the subordination agreement. However, prudential standing limits a party in interest's ability to participate when the party is raising another person's legal rights or when its interests would not be affected by the proceeding. Because the debtor's value, combined with the subordination agreement's effect, left no possibility that the subordinated creditor would recover anything in the case, the court denies prudential standing to the creditor. *In re Fencepost Productions, Inc.*, ___ B.R. ___, 2021 Bankr. LEXIS 845 (Bankr. D. Kan. Mar. 31, 2021).

6.2.c **Texas oil and gas producers' security interest is junior to perfected security interest in Delaware debtor's receivables.** Texas oil and gas producers sold minerals to the debtor, a Delaware corporation, who sold them prepetition to refineries and commodity traders. The downstream purchasers paid for the minerals postpetition. The debtor's bank debt was secured by a security interest in receivables and bank accounts, including the bank accounts where the downstream purchasers' payments were deposited, which the bank perfected by filing for the receivables and a control agreement for the accounts. A Texas nonuniform UCC Article 9 provision grants an automatic, perfected, purchase-money security interest to the producers. UCC section 9-301 provides that the law of the debtor's jurisdiction of incorporation governs perfection, priority, and enforcement of a security interest. Since the debtor is a Delaware corporation, the Delaware UCC governs the relative priority of the bank's and the producers' security interests. Delaware does not have the nonuniform provision protecting oil and gas producers, so the uniform first-to-file rule applies. Since the bank filed its financial statement before any of the producers filed theirs, the bank's security interest takes priority. *Deutsche Bank Trust Co. Americas v. U.S. Energy Devel. Corp. (In re First River Energy, L.L.C.)*, 986 F.3d 914 (5th Cir. 2021).

7. CRIMES

8. DISCHARGE

8.1 General

8.2 Third-Party Releases

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.2.a **Dischargeability exceptions do not apply in corporate subchapter V case.** The corporate debtor sought confirmation of its plan under section 1191(b), the cramdown provision. Section 1192, rather than section 1141(d), provides for the debtor's discharge under a plan confirmed under section 1191(b). It provides for "a discharge of all debts provided in section 1141(d)(a)(A) … except any debt … of the kind specified in section 523(a)." Section 523(a) provides, "A discharge under section … 1192 …does not discharge an individual debtor from any debt" described in one of 19 paragraphs. Because section 523(a) applies only to an individual debtor, the debts of the kind specified in that section are only debts owing by an individual. Just as in a non-subchapter V chapter 11 case, a subchapter V corporate debtor's discharge is not subject to the exceptions to discharge contained in section 523(a). *Gaske v. Satellite Restaurants Inc. Crabcake Factory USA) (In re Satellite Restaurants Inc. Crabcake Factory USA)*, ___ B.R. ___. 2021 Bankr. LEXIS 652 (Bankr. D. Md. Mar. 19, 2021).

10.3 Exemptions

10.4 Reaffirmations and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.2 Sanctions

11.3 Appeals

11.3.a **Equitable mootness doctrine survives *Mission Products* decision.** A Puerto Rico agency (COFINA) confirmed a plan under PROMESA that restructured its bonds and resolved disputes over its entitlement to sales and use tax revenues. The agency implemented the plan, distributed billions of dollars of restructured securities, and discharged all claims against it, including claims under its pre-existing bonds. A court should dismiss an appeal as equitably moot based on whether the appellant has pursued with diligence all available remedies to obtain a stay, whether the "plan proceeded to a point well beyond any practicable appellate annulment," and whether providing relief would harm innocent third parties. Under *Mission Prods. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (2019), an appeal is moot under Article III only when it is "impossible for a court to grant any effectual relief whatever." Where there remains a live controversy and relief is possible by reversing the confirmation order, the appeal is not constitutionally moot. Instead, equitable mootness bears on how to resolve the dispute, more like a rule of equitable laches, in that the passage of time and a party's inaction can render relief inequitable. Equitable considerations are particularly appropriate in considering plan confirmation, which is inherently an equitable proceeding. Therefore, any constitutional mootness analysis from

Mission Products does not apply here. *Pinto-Lugo v. Fin. Oversight and Mgmt. Bd. (In re Fin. Oversight and Mgmt. Bd.)*, 987 F.3d 173 (1st Cir. 2021).

11.4 Sovereign Immunity

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a **Fraudulent debtor's payoff of secured loan does not give rise to aiding and abetting breach of fiduciary duty claim.** The debtor borrowed substantial amounts from the bank to acquire and construct real property, which collateralized the bank's loans. The debtor was also borrowing from investors, without disclosing the debtor's precarious financial state and fraudulent activities. With numerous judgments against it and the bank pressing for payment, the debtor sold the property for about half of the bank's appraised value and paid the bank off. After bankruptcy, the trustee sued the bank for aiding and abetting breach of fiduciary duty and for conspiracy to breach fiduciary duty, based on the debtor's managers' bargain sale of the property. A claim for aiding and abetting breach of fiduciary duty requires showing a breach, the defendant's actual knowledge of the breach, and the defendant's substantial assistance in the breach. Substantial assistance involved affirmative help or failure to act when required to do so, enabling the breach to occur. Mere inaction will not suffice. The trustee did not allege any facts showing the bank knew of the debtor's total debts and that if the property had been sold for more, other creditors could have been paid. The trustee also did not allege the bank took any action to assist the breach, only that it was protecting itself in collecting a legal, secured debt in the face of a borrower that it knew was defrauding other creditors. A conspiracy claim requires showing a conspiracy between two or more people, an unlawful act, an overt act in pursuit of the conspiracy, and damage. Here, the trustee alleged the breach of fiduciary duty as the unlawful act. Because the trustee failed to allege the bank knew of the breach of fiduciary duty, the trustee's conspiracy claim also fails. *Dillworth v. Amerant Bank, N.A. (In re Bal Harbour Quarzo, LLC)*, 623 B.R. 903 (Bankr. S.D. Fla. 2020).

12.2 Turnover

12.3 Sales

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.2 Attorneys

13.2.a **Bankruptcy costs in a mass torts case are not defense costs recoverable from the debtor's general liability insurers.** The debtor had been sued for numerous torts, for which it claimed insurance coverage. When the suits became too numerous, the debtor filed chapter 11 to stem, manage, and resolve the litigation. The debtor sued its insurers for costs related to its bankruptcy, claiming they are covered defense costs under the insurance policies. Under applicable state law, the insurer's duty to defend is purely contractual. The policies required the insurers to pay costs of defense of any suit against the debtor the insurers defend but denied reimbursement to the debtor for any costs the debtor incurred without the insurers' consent. In light of the policy limitations, the debtor's reason for filing bankruptcy—to resolve the suits against it—is not relevant to the insurers' liability for bankruptcy costs. The bankruptcy bars debt collection, but does not eliminate liability and therefore is not a civil suit against the insured. Objections to claims do not arise in a "suit" covered by the policies. Finally, the chapter 11 case is not a defense strategy that the debtor may control in responses to the insurers' reservation of rights to defend. Therefore, the bankruptcy costs are not covered defense costs under the policies and may not be

recovered from the insurers. *USA Gymnastics v. Ace Am. Ins. Co. (In re USA Gymnastics)*, 624 B.R. 443 (S.D. Ind. 2021).

13.3 Committees

13.3.a **Court orders appointment of additional committee.** The archdiocese debtor filed chapter 11 to address numerous sexual abuse claims but also had substantial unsecured commercial creditors. The U.S. trustee appointed a committee comprising six abuse claimants and one commercial creditor but later removed the commercial creditor. The committee participated vigorously in the case, espousing positions particularly favorable to abuse claimants, but not so vigorously with respect to ordinary commercial issues. The commercial creditor moved for the appointment of an additional committee to represent commercial creditors generally. Section 1102(a) requires the U.S. trustee to appoint one committee and authorizes the U.S. trustee to appoint one or more additional committees to assure adequate representation of creditors or equity holders. Section 1102(a)(4) authorizes the court to direct the U.S. trustee to change the membership of a committee, or to appoint one or more additional committees, to assure adequate representation. A committee owes a fiduciary duty to the entire class of creditors represented by the committee, whether or not a particular subgroup of the class is a committee member. A subgroup may be adequately represented only if it has a meaningful voice on the committee in relation to its position in the case. Determining whether a committee adequately represents all creditors, including a subgroup, and whether to order appointment of additional members or an additional committee requires consideration of the committee's ability to function, the nature of the case, various constituencies' standing and desires and their ability to participate even without an official committee. Here, the uniform committee membership, the complex case nature, and the potentially divergent interests of abuse and commercial claimants create a need for an additional committee to represent the commercial creditors adequately. The court orders the U.S. trustee to appoint such a committee. *In re The Roman Catholic Church of the Archdiocese of New Orleans*, ___ B.R. ___, 2021 Bankr. LEXIS 302 (Bankr. E.D. La. Feb. 8, 2021).

13.4 Other Professionals

13.5 United States Trustee

13.5.a **2017 UST fee increase does not apply to pending cases and would be unconstitutional otherwise.** The debtor filed a chapter 11 case in 2016. In 2017, Congress increased the chapter 11 U.S. trustee fee schedule under 28 U.S.C. § 1930(a)(6) with respect to "disbursements made in any calendar quarter that begins on or after the date of enactment." The U.S. trustee applied the new schedule to the debtor's case. By contrast, in the bankruptcy administrator districts, the amended schedule applied nine months later and not to pending cases. After a structured dismissal, the debtor sued the U.S. trustee for a refund of the increased fees it had paid. Legislation is prospective unless Congress expressly provides otherwise. Unlike other provisions in the same enacting statute and in prior amendments to the same schedule, the fee schedule amendment did not say it applied to pending cases. Although the "disbursements" language in the effective date provision suggests application to pending cases, the lead-in to section 1930(a), "The parties commencing a case under title 11 shall pay ... the following fees," fixes the fee payment obligation at the petition date. The fee calculations in later quarters are ministerial based on the schedule that the statute imposed at the filing date. Therefore, without express language that the amendment applied to pending cases, it did not. If it did, the disparity between the fee schedule in the U.S. trustee districts and in the bankruptcy administrator districts would violate the Constitution's Bankruptcy Uniformity Clause. *In re USA Sales v. Office of the U.S. Trustee*, ___ B.R. ___, 2021 U.S. Dist. LEXIS 64396 (C.D. Cal. Apr. 1, 2021)

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **Court recognizes Indonesian proceeding, despite exclusion of bondholders' vote, but refuses to enforce plan.** The Indonesian debtor's subsidiary issued bonds under a New York-law governed indenture. The issuer loaned the funds to the debtor, who issued a note to the issuer and directly guaranteed the bonds. The debtor commenced and concluded a suspension of payments proceeding in Indonesia in which the issuer's claim under the note was allowed and the indenture trustee's claim was not. The plan in that proceeding provided for a very long-term, contingent payout to the issuer on the bonds and released various subsidiary guarantors of the bonds. Objecting bondholders brought an action in New York state court for a judgment on their bonds, which they obtained. In response, the debtor sought the appointment of a foreign representative in the Indonesian court, who then filed a chapter 15 case in New York to obtain recognition and enforcement of the suspension of payments plan. Chapter 15 provides for recognition of a foreign proceeding, which is a collective proceeding, on a foreign representative's petition. A collective proceeding considers the obligations of all creditors, for the creditors' general benefit, even if some creditors are not allowed to participate. Despite the disallowance of the indenture trustee's claim and the bondholders' inability to vote on the plan, the proceeding was collective because it considered the obligations of all creditors. A court may enforce a foreign proceeding's plan if there was just treatment of all holders and protection of U.S. creditors against prejudice and inconvenience in claims processing and is based on comity principles. A court may grant comity only if the foreign proceeding complied with fundamental standards of procedural fairness, did not violate U.S. laws or public policy, and was not affected by fraud. A U.S. court may recognize and enforce a third-party release in a foreign proceeding if the foreign proceeding meets these requirements. Here, the record was insufficient to show how the third-party release was presented to and justified in the foreign proceeding. Therefore, the court denies enforcement without prejudice. *In re PT Bakrie Telecom TBK*, ___ B.R. ___, 2021 Bankr. LEXIS 1014 (Bankr. S.D.N.Y. Apr. 15, 2021).