JENNER&BLOCK

Recent Developments in Bankruptcy Law, January 2017

(Covering cases reported through 560 B.R. 607 and 839 F.3d 1301)

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

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1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a **Automatic stay does not apply to subpoena to debtor in action against third parties.** The creditor sued the debtor and others for violation of a non-compete agreement. After the creditor obtained an injunction and an award of attorney's fees against the debtor, the debtor filed a chapter 13 case. The bankruptcy court disallowed any additional damage claim. The creditor dropped the debtor from the state court action and continued the action against the other defendants. The creditor sought to depose the debtor for evidence to be used against the other defendants. The automatic stay prohibits the commencement or continuation of a judicial proceeding against the debtor that was or could have been commenced before bankruptcy and any action to recover a claim against the debtor that arose before bankruptcy. The creditor here did not seek recovery on a claim against the debtor, only against the other defendants, and only sought information from the debtor. The automatic stay does not apply to such discovery. *Innerwood & Co., LLC v. Privett (In re Privett)*, 557 B.R. 580 (S.D. Ohio 2016).

1.2 Effect of Stay

1.3 Remedies

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **Actual fraudulent transfer complaint must allege ability to control decision-making and more than "should-have-known" intent.** The debtor filed bankruptcy within one year after its LBO. The trustee sued the debtor's former public shareholders under section 548(a)(1)(A) to avoid the transfers to them to purchase their shares. Section 548(a)(1)(A) permits the trustee to avoid the debtor's transfer made with actual intent to hinder, delay, or defraud creditors. A corporation acts through its agents, so the court must determine its intent through its agents' intent and their ability to control the transaction. The board's special committee was in a position to control the transaction. Officers do not make corporate decisions of this level, but their intent may be imputed to the corporation if they were in a position to control the disposition of property, whether through control of the board or otherwise. The trustee alleged that the debtor's special board committee and its senior officers had the requisite intent and that its senior officers had sufficient control over the special committee's decision to determine the outcome. He alleged that they had 13% voting power, attended all special committee meetings, and manipulated information provided to an outside expert who advised the special committee. These allegations are insufficient to support a finding that the officers controlled the special committee's decision to proceed with the transaction. An allegation that the special committee should have known that the transaction would place assets beyond creditors' reach, which is more a negligence standard, is insufficient to support a finding of actual intent. More is required: either facts raising a strong inference of actual intent, either through direct proof or through badges of fraud, or at least allegations of motive and opportunity or facts constituting strong circumstantial evidence of conscious misbehavior or recklessness. The trustee's allegations do not meet any of these standards, so the court dismisses the complaint. *Kirschner v. Fitzsimons (In re Tribune Fraudulent Conveyance Litigation)*, ___ B.R. ___ (S.D.N.Y. Jan. 6, 2017).

2.2 Preferences

2.2.a **Section 547 does not apply to a transfer from the debtor's Israeli bank account to its Israeli creditor.** The debtor was a New York corporation headquartered in Israel. Within 90 days before its New York bankruptcy, it paid its Israeli lawyer from its Israeli bank account. The bankruptcy trustee sought to avoid the transfer as a preference under section 547. In *Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010), the Supreme Court established a two-step approach to determine whether the presumption against a statute's extraterritorial application applies to a claim. First, the court must inquire whether "the statute gives a clear, affirmative indication that it applies extraterritorially." If not, the court must determine if the litigation involves a domestic or extraterritorial application of the statute by looking at the statute's focus to determine whether the conduct relevant to the statute's focus occurred within or outside the United States. Section 547 does not contain a clear statement that it applies extraterritorially. Some courts have construed section 547's reference to a transfer of "an interest of the debtor in property" to be co-extensive with the same phrase's reach in section 541(a)(1) and so imported section 541(a)(1)'s reference to "wherever located" into section 547's reference, based on the statement in *Begier v. IRS*, 496 U.S. 53 (1990), that the phrase includes property that would have become property of the estate if it had not been transferred. However, *Begier* was intended to limit, not expand, the trustee's avoiding powers, so its reasoning should not stretch section 547's reach to extraterritorial transfers. Turning to the second step, the court concludes that section 547's focus is the initial transfer of property from the debtor. In this case, because that transfer occurred in Israel, section 547 does not reach it, so the court dismisses the complaint. *Spizz v. Goldfarb Seligman & Co. (In re Ampal-American Israel Corp.)*, ___ B.R. ___, 2017 Bankr. LEXIS 49 (Bankr. S.D.N.Y. Jan. 9, 2017).

2.3 Postpetition Transfers

2.4 Setoff

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

2.7.a **Section 550(a) does not apply to foreign subsequent transfer.** The debtor operated a Ponzi scheme. Numerous foreign feeder funds, who solicited investors from outside the United States, invested in the Ponzi scheme and received avoidable transfers from the debtor. The trustee sued numerous investors as subsequent transferees for redemptions of their shares in the feeder funds. Section 550(a) permits the trustee to recover an avoidable transfer from the initial transferee or from an immediate or mediate (subsequent) transferee of the initial transferee. Courts apply a presumption against extraterritorial application of a statute that can be rebutted by a showing that Congress intended extraterritorial application. If not, then the statute apples only if the conduct relevant to the statute's focus occurred in the United States. Although section 541(a)(1) makes property of the debtor, wherever located, property of the estate, the same broad language is absent from the avoiding power sections, and under section 541(a)(3), recovered property does not become property of the estate until after recovery. Therefore, section 550(a)(2) does not suggest Congress intended it to apply extraterritorially. Section 550(a)(2)'s focus is the transfer, not the parties. A transfer does not occur in the United States if the transferor did not maintain its principal operations in the United States and if the transferee is not a U.S. citizen or has a U.S. office used in connection with the transfer and does not use a U.S. bank account for the transfer (other than a correspondent account). The court dismisses the trustee's actions that do not allege these facts. *Sec. Inv. Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC*, ___ B.R. ___, 2016 Bankr. LEXIS 4067 (Bankr. S.D.N.Y. Nov. 22, 2016).

2.7.b **Comity prevents trustee from recovering subsequent transfers made by foreign transferor that is the subject of a foreign proceeding.** The debtor operated a Ponzi scheme. Numerous foreign feeder funds, who solicited investors from outside the United States, invested in the Ponzi scheme and received avoidable transfers from the debtor. The trustee sued numerous investors as subsequent transferees for redemptions of their shares in the feeder funds. Some of the initial transferees were subject to liquidation proceedings in their home countries. The liquidators in those proceedings brought claims against the funds' investors to avoid and recover transfers under local law. Section 550(a) permits the trustee to recover an avoidable transfer from the initial transferee or from an immediate or mediate (subsequent) transferee of the initial transferee. Comity "is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the righs of its own citizens or of other persons who are under the protection of its laws." Comity of courts defers to proceedings in foreign courts; comity of nations does not require parallel proceedings but defers to another country to execute its laws. Comity applies in bankruptcy cases and proceedings. The foreign courts have a greater interest in regulating the activities of their debtors that gave rise to the trustee's subsequent transfer claims. The United States has little or no interest in regulating those transfers. Permitting the trustee to sue investors in foreign entities whose own liquidators also asserted claims against them could interfere with the foreign courts' ability to enforce their own laws; it would allow the trustee to reach around the foreign laws and subject the defendants to duplicative claims. Therefore, the court dismisses the claims on the basis of comity. *Sec. Inv. Protection Corp. v. Bernard L. Madoff Inv. Secs. LLC*, ___ B.R. ___, 2016 Bankr. LEXIS 4067 (Bankr. S.D.N.Y. Nov. 22, 2016).

3. BANKRUPTCY RULES

3.1.a **Court denies motion to seal Rule 7007.1 corporate ownership statement.** Bankruptcy Rule 7007.1 requires a party to an adversary proceeding to file a statement of corporate ownership, identifying any entity that owns 10% or more of the party's equity interests. Section 107(a) provides that all documents filed in a bankruptcy case are public records, but section 107(b)(1) permits a court to protect an entity with respect to a trade secret or confidential commercial information by permitting a document to be filed under seal. The defendant in an adversary proceeding sought a court order permitting the filing of its corporate ownership statement under seal, on the ground that its owners were investors, and their identity was confidential for their own protection and to protect the defendant from competitors' attempts to lure away the investors. Section 107(a) embodies a strong public policy of transparency, and section 107(b)(1) does not create a haven for those who seek privacy for its own sake. Rule 7007.1 permits the court to avoid a conflict of interest by informing the court who interested parties are, but it also permits the public to know to promote public confidence in the judiciary's integrity. Absent a clear showing of commercial harm from disclosure of a party's owners, section 107(b) does not permit sealing a corporate ownership statement. *Motors Liquidation Co. Avoidance Action Trust v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.)*, 561 B.R. 36 (Bankr. S.D.N.Y. 2016).

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.2 Involuntary Petitions

4.2.a **Court denies a structured dismissal during the involuntary gap period.** During the involuntary gap period, the alleged debtor agreed to transfer to one of the petitioning creditors certain assets whose value was uncertain due to clean-up obligations, recognize the validity of the other petitioning creditors' previously disputed claims, sell the alleged debtor's real estate and distribute the sale proceeds to all unsecured creditors who elected to participate. In exchange, upon the alleged debtor's performance of its obligations, the petitioning creditors would dismiss the petition. Unsecured creditors who did not participate in the distribution would retain any rights they had against the alleged debtor. Section 303(j) permits dismissal of an involuntary petition upon consent only after notice to all creditors. After notice, one creditor objected. Courts sometimes permit structured dismissals during a case, after the order for relief, even though they might arguably violate certain Code provisions such as the plan process requirements or the absolute priority rule in a chapter 11 case or section 726(a)'s distribution rules in a chapter 7 case. Bankruptcy Rule 1013(a) requires a court to resolve an involuntary petition "at the earliest practicable time." Neither the Code nor the Rules provide any authority for the kind of agreement proposed here, and approving an agreement that provides for dismissal only after the alleged debtor performs the agreement's obligations might violate Rule 1013(a). The court denies approval of the agreement. *In re Positron Corp.*, 556 B.R. 291 (Bankr. N.D. Tex. 2016).

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.1.a **Secured creditor may not direct distribution of property of the estate through a carve-out.** The chapter 7 trustee sold the estate's encumbered property. The secured creditor agreed to a carve-out from the sale proceeds "to pay the allowed administrative expenses of the chapter 7 estate and the allowed general unsecured claims in the case," but the order approving the agreement provided only that the carve-out amount would be transferred to the estate. Section 726(a) establishes priorities for distribution of property of the estate, which may not be altered by agreement or court order. Although a secured creditor may distribute property that it receives from the estate in any way it determines, it may not direct the distribution of property of the estate. Therefore, the trustee must distribute the carve-out proceeds in accordance section 726(a)'s priorities. *In re MCO Wash, Inc.*, 555 B.R. 159 (Bankr. E.D.N.Y. 2016).

5.1.b **A creditor who has been paid in full is not a party in interest.** The debtor's former employer and competitor sued the debtor before bankruptcy for stealing trade secrets and for breach of fiduciary duty, among other things. After bankruptcy, the bankruptcy court adjudicated the dispute and granted the creditor judgment. The debtor then proposed a plan that classified the creditor separately and provided for payment in full of the creditor's claim on the effective date. The creditor objected to confirmation. The debtor moved to pay the creditor in cash in full before confirmation. The creditor objected to being paid in full before confirmation, because it wished to pursue its confirmation objection anyway and feared that it would no longer have standing if its claim was paid. It told the court that its purpose in objecting was to put the debtor out of business because the debtor was bad for the industry. Section 1109(b) gives a party in interest the right to appear and be heard, and section 1128 gives a party in interest the right to object to confirmation. Neither section defines "party in interest," but courts have found that it encompasses an entity with a pecuniary interest that might be affected by the case. An interest as a competitor does not qualify an entity as a party in interest. Therefore, the court authorizes pre-confirmation payment of the claim and denies the soon-to-be former creditor the right to object to confirmation. *In re RnD Eng'g, LLC*, 556 B.R. 303 (Bankr. E.D. Mich. 2016).

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statement and Voting

5.5 Confirmation, Absolute Priority

5.5.a **Section 11233(d) requires cure payment to include interest at the default rate.** The debtor defaulted on a mortgage loan, which provided for an increased interest rate after a default. It filed a chapter 11 case and proposed a plan that would sell the mortgaged propery and cure the default by paying the accelerated amount of the loan and interest to date of payment at the nondefault rate. *In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338 (9th Cir. 1988), held that section 1123(a)(5), which permitted cure under a plan, permitted the debtor to avoid all consequences of a default and therefore to pay interest at the nondefault rate. Congress later added section 1123(d), which provides "the amount necessary to cure the default shall be determined in accordance with the underlying agreement and nonbankruptcy law." Section 1123(d) reverses *Entz-White* by requiring payment in accordance with the agreement and nonbankruptcy law, rather than based on a bankruptcy-based definition of "cure." Here, the agreement and nonbankruptcy law required payment of the default rate interest to cure the default. *Pacifica L 5 LLC v. New Invs. Inc. (In re New Invs. Inc.)*, 840 F.3d 1137 (9th Cir. 2016).

5.5.b **"Impaired accepting class" requirement applies on a per-plan basis**. The administratively consolidated debtors comprised a holding company, two mezzanine borrower holding companies and two operating subsidiaries that each owned real estate. The operating debtors had issued notes secured by mortgages on their real property; the mezzanine debtors had issued notes secured by their interests in the operating debtors. The real estate's value was less than the mortgage debt. The debtors proposed a plan that crammed down the mortgage and mezzanine lenders, neither of whom accepted the plan, but other classes of creditors accepted the plan. The mezzanine lenders were the sole creditors of the mezzanine debtors. Section 1129(a)(10) permits confirmation of a plan that impairs at least one class of claims only if "at least one class of claims that is impaired under the plan has accepted the plan." Because section 1129(a)(10) refers to acceptance by a class that is impaired "under the plan," it applies on a per-plan basis, not on a per-debtor basis. *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.)*, 554 B.R. 894 (D. Ariz. 2016).

5.5.c **Secured cram-down note does not require a due-on-sale clause.** The debtors comprised a holding company, two mezzanine borrower holding companies and two operating subsidiaries that each owned real estate. The operating debtors had issued notes secured by mortgages on their real property; the mezzanine debtors had issued notes secured by their interests in the operating debtors. The real estate's value was less than the mortgage debt. The lenders made the section 1111(b) election. The debtors proposed a plan that crammed down the mortgage and mezzanine lenders with a 21-year bullet maturity note with a present value equal to the stipulated value of the real property and with a due-on-sale clause that did not apply from years five to fifteen after issuance. The absence of a due-on-sale clause during that ten-year period does not affect the present value of the note, and nothing in section 1129(b) requires a due-on-sale clause. Therefore, the note complies with that section's cram-down requirements. *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.)*, 554 B.R. 894 (D. Ariz. 2016).

5.5.d **Trust Indenture Act permits a foreclosure restructuring transaction that deprives note holders of the practical (but not legal) right to payment.** The debtor, worth about $1.0 billion, had issued $1.3 billion in secured debt and $200 million in unsecured notes. The debtor's arguably-solvent parent guaranteed the unsecured notes. The notes indenture released the guarantee automatically upon a majority vote of noteholders or a release of a parent guarantee of the secured notes. The debtor was unable to pay all interest and principal on the debts as they became due, but a bankruptcy filing would have rendered it ineligible for federal programs that provided the majority of its revenue. It initiated restructuring negotiations with its secured debt holders. Before concluding a restructuring deal, the secured debt holders agreed to an interim extension of some obligations and received a parent guarantee. Further negotiations resulted in a complete restructuring agreement under which the secured debt holders would release the parent guarantee, foreclose on their security interest under Article 9, bid in their claims, and, upon acquiring the assets, sell them back to a new subsidiary of the parent, which would purchase them by issuing debt and equity to secured debt holders and equity to consenting unsecured note holders. Section 316(b) of the Trust Indenture Act provides a note holder's right to receive payment of principal and interest or to bring suit for enforcement of payment "shall not be impaired or affected" without the holder's consent. The indenture contained an identical prohibition. The TIA's purpose is to prevent nonconsensual modification of payment rights by contract through a collective action clause. It is not intended to prevent a restructuring transaction through a foreclosure, which was a common restructuring technique when Congress adopted the TIA. A broader reading that prohibited transactions that affected the practical, but not the legal, right to payment based on whether the transaction was intended as an involuntary debt restructuring would create uncertainty in the application of section 316(b), depriving the system of needed uniformity for this boilerplate provision. Because the transaction did not alter the note holders' legal right to payment, it did not violate the TIA's involuntary modification prohibition. A strong dissent argues otherwise, based on its view of the statute's plain language, claiming that the decision permits an issuer to accomplish indirectly what the statute prohibits it from accomplishing directly. *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp.*, ___ F.3d ___, 2017 U.S. App. LEXIS 782 (2d Cir. Jan. 17, 2017).

5.5.e **Secured-for-unsecured bond exchange offer does not violate the Trust Indenture Act.** The bond issuer offered its qualified institutional buyers (QIBs) an exchange of its unsecured notes for secured notes in a reduced face amount. Many QIBs accepted. Two non-QIBs brought a class action to enjoin the exchange and for damages, claiming that their claims were subordinated and would fare worse if the issuer filed bankruptcy. Article III standing requires an injury in fact that is concrete and particularized and actual or imminent, not conjectural or hypothetical, that is fairly traceable to the defendant's actions and will likely be redressed by a favorable decision. Injury that might happen from a future bankruptcy is hypothetical, not actual, and does not give the plaintiffs standing. Section 316(b) of the Trust Indenture Act protects a bondholder's right to receive payment of principal and interest on the bonds when due. The provision protects minority bondholders from majority holders' collusively agreeing to modify the bonds' payment terms. Courts have interpreted the provision broadly to prohibit an exchange offer only where the exchange effects an out-of-court quasi-bankruptcy reorganization by transferring assets or removing or materially modifying an affiliate guarantee or a security interest. The proposed exchange here does neither and is therefore not prohibited by the TIA. The court also dismisses claims for breach of the implied covenant of good faith and fair dealing arising from the indenture's "equal treatment" provision and a claim for unjust enrichment. *Waxman v. Cliffs Natural Res. Inc.*, ___ F. Supp. 3d ___ (S.D.N.Y. Dec. 6, 2016).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Court allows make-whole premium on repayment of notes in chapter 11.** The debtor issued secured notes that permitted the debtor to redeem them before a specified date with payment of a "make-whole" premium. The debtor considered refinancing the notes before bankruptcy but did not because of the high make-whole cost. It filed bankruptcy several months later. The notes accelerated automatically by their terms upon the filing. The debtor in possession obtained financing to pay the notes, which were over-secured. The holders demanded payment of the make-whole. Notes are "redeemed" whenever the issuer pays them off, whether before, at or after maturity. The redemption here was "optional," despite the acceleration, because the debtor had the option to reinstate the notes under a plan but instead carried through on its prepetition proposal to refinance the notes in bankruptcy. Therefore, the make-whole is allowed. The court does not address whether the make-whole constitutes post-petition interest. *Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 842 F.3d 247 (3d Cir. 2016).

6.1.b **Surety may retain owner's payment if it incurs a payment obligation before contractor's bankruptcy.** The debtor contractor obtained surety bonds to protect project owners. Shortly before the petition date, the debtor notified both the surety and the owners that it was ceasing work on the projects the next day. The surety sent the owners a letter the next day demanding that they not make any additional payments to the debtor under the contracts. A few days later, the debtor filed bankruptcy. The owners made three payments under the contracts, one before the debtor ceased work, one between cessation and bankruptcy, and one after bankruptcy. The surety filed a UCC-1 financing statement identifying payments under the contracts as collateral and obtained a state court attachment between cessation and bankruptcy. Against the bankruptcy trustee's claim for the payments, the surety asserted a right of subrogation. Section 509 permits subrogation among codebtors but does not preempt equitable subrogation principles in bankruptcy. Equitable subrogation applies when the subrogee pays in full, but not as a volunteer, an obligation for which it is not primarily liable. When the surety incurs the legal obligation to the owner, it subrogates to the contractor's right to the remaining payments. If that occurs before bankruptcy, the right to payment becomes the surety's property, not property of the estate. Here, the surety became obligated to the owner upon the debtor's cessation of work. Therefore, the surety was entitled to the second and third payments but not the first. *Dwyer v. The Ins. Co. of the State of Pa. (In re Pihl, Inc.)*, 560 B.R. 1 (Bankr. D. Mass. 2016).

6.2 Priorities

6.2.a Court subordinates claim against individual debtor arising from the purchase of a security under section 510(b). The individual debtor joined another investor in acquiring an operating business through an LLC. The debtor defrauded the other investor in making the investment by using stolen funds and by issuing a guarantee that had no financial support behind it. When customers learned of the fraud, the business faltered, and the other investor's investment became virtually worthless. He filed a proof of claim in the debtor's case in the amount of his investments. Section 510(b) requires the court to subordinate "a claim arising from the purchase or sale of a security of the debtor or of an affiliate of the debtor [or] for damages arising from the purchase or sale of such a security … to all claims or interests that are senior or equal to the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock." A claim "arises from" a purchase or sale if it has any connection with the purchase or sale. Section 510(b) applies to a claim arising from the purchase or sale of a security of an affiliate. An affiliate is an entity 20% or more owned by the debtor. Therefore, the purchase need not be from the debtor. Section 510(b) is not limited by its terms to corporate debtors. Here, the other investor's claim is for damages for the purchase of securities in the LLC, which was an affiliate of the debtor. Therefore, the claim qualifies for subordination under section 510(b). The court reviews the three alternative approaches to determining the level of subordination of a claim arising from the purchase or sale of a securitiy of an affilate—subordination to senior or equal claims in the debtor's priority scheme, treatment of the claims as general unsecured claims in the debtor's case and subordinating them to other unsecured claims, and subordinating to the same types of claims against the debtor—and, while favoring the last, concludes that this claim would be subordinated below the debtor's general unsecured claims under any of the approaches. *Liquidating Trust Comm. v. Freeman (In re Del Biaggio)*, 834 F.3d 1003 (9th Cir. 2016).

6.2.b **Court grants Six-Months Rule priority under section 1171(b) to interline charge claims.** The debtor railroad incurred interline freight charges with another railroad. They agreed to swap payments each month, rather than netting the payments. Later, based on increased shipments of a particular commodity, they agreed the debtor would not have to pay the charges for those shipments until it received payment from its customer. Section 1171(b) provides for priority to any unsecured claim that would have been entitled to priority in an equity receivership. This section incorporates the "Six Months Rule," which grants priority to claims for current operating expenses the debtor necessarily incurs within six months before the petition date, where the supplier expected payment from current operating revenues, rather than from general reliance on the debtor's credit. An expense is necessary if the goods or services contribute to the debtor's operation; the supplier needs to show that without them, the debtor would shut down. Therefore, interline charges generally are entitled to priority under the Six Months Rule. Here, the supplier's agreement to wait for payment of some charges until the debtor received payment from its customers was not a security interest that was granted to protect against the debtor's general creditworthiness. Rather, it shows that the supplier was relying on the debtor's operating revenues that were directly related to the interline charges and thus not on the debtor's general credit. Therefore, the claim is entitled to priority under section 1171(b). *Keach v. New Brunswick S. Ry. Co. Ltd. (In re Montreal, M. & A. Ry., Ltd.)*, 558 B.R. 473 (1st Cir. B.A.P. 2016).

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 **Rejection of distributorship agreement terminates distribution rights but not right to use licensed trademark.** The debtor gave a distributor time-limited exclusive rights to distribute its patented and trademarked products within a territory. It also granted a non-exclusive, perpetual, irrevocable, fully-paid license to exploit its products, inventions, designs, works of authorship, and other intellectual property and separately granted a non-exclusive limited license to use the debtor's trademarks during the distribution period. After bankruptcy, the debtor in possession rejected the agreement with the distributor, who then asserted its rights under section 365(n) to retain licensed intellectual property. Section 365(n) provides that a licensee under a rejected license of intellectual property may retain its rights to the licensed intellectual property. The agreement here deals with more than an intellectual property license. The licensee's right to retain its intellectual property rights does not extend to all rights under the agreement. Therefore, the licensee's section 365(n) rights do not protect its distribution rights. The Code's definition of "intellectual property" does not include trademarks. Therefore, section 363(n) does not protect a licensee's right to continue to use trademarks after rejection. However, rejection is not rescission; under section 365(g), it is only a breach. Outside of bankruptcy, a breach does not terminate a licensee's right to use a trademark; following *Sunbeam Prods., Inc. v. Chicago Am. Mfg, LLC*, 686 F.3d 372 (7th Cir. 2012), the result does not differ in bankruptcy. Therefore, the licensee retains the right to use the trademark after rejection. *Mission Prods. Holdings, Inc. v. Old Cold, LLC (In re Old Cold, LLC)*, 559 B.R. 809 (1st Cir. B.A.P. 2016).

9.1.b **Waiver of commodity contract *ipso facto* clause might also waive safe harbor protection.** The debtor supplied a commodity to its customer under a five-year contract. The contract permitted the customer to terminate the contract for the debtor's insolvency or bankruptcy under a standard *ipso facto* clause. In connection with the debtor's bond issuance, the customer agreed that it would not terminate the supply contract under the *ipso facto* clause for bankruptcy if the debtor was performing all its contractual obligations. After the debtor's bankruptcy, the customer claimed that the debtor had not performed and sought to terminate the contract under the *ipso facto* clause. Section 556 permits a contract counterparty who is a commodity broker or forward contract merchant to terminate a commodity contract "because of a condition of the kind specified in section 365(e)(1)" despite section 365(e)'s prohibition on such termination. The conditions specified in section 365(e) include insolvency and bankruptcy and the other terms in a standard *ipso facto* clause. Here, the supplier had waived the right to terminate under the *ipso facto* clause if the debtor was performing and therefore sought to terminate only because of the debtor's alleged nonperformance. Nonperformance is not a condition of the kind specified in section 365(e). Therefore, section 556's safe harbor did not apply to permit termination. *In re La. Pellets, Inc.*, ___ B.R. ___, 2016 Bankr. LEXIS 2679 (Bankr. W.D. La. Jul. 22, 2016).

9.1.c **Tenant who remains in possession under rejected lease may recoup amounts owing from debtor in possession landlord from the rent reserved under the lease.** The debtor leased a portion of its premises for a nightclub. The lease required the tenant to pay percentage rent and to pay the debtor for capital improvements to the space and required the landlord to pay the tenant a portion of the capital expenses to the extent the percentage rent exceed specified thresholds. The debtor in possession rejected the lease. The tenant elected under section 365(h) to remain in possession. The debtor in possession then sold the real property free and clear of all claims and interests except for the tenant's rights under section 365(h). Section 365(h) permits a tenant to remain in possession of a leasehold under a rejected lease and, as its sole remedy, offset any damages resulting from the landlord's post-rejection nonperformance against the rent reserved under the lease. Rejection is a debtor's determination not to perform, not a termination, and does not alter the parties' substantive rights. Rejection relieves the debtor landlord from its affirmative obligations under the lease, other than the obligation to allow continued possession and the tenant's use and quiet enjoyment, except to the extent that failure to perform would interfere with the tenant's possession, use and quiet enjoyment. But rejection does not relieve the tenant of its obligations under the lease if it remains in possession. Recoupment allows one party to reduce its payment obligation to another for amounts the other owes it arising from the same transaction. Here, the lease required the landlord to reimburse the tenant a portion of the capital expenses. Although the sale of the premises was free and clear of all claims and interests, the tenant's recoupment right under the lease arises from the same transaction that gives rise to its rent obligation. Therefore, the tenant may recoup its claim for that payment from the rent it owes under the lease. *IDEA Boardwalk, LLC v. Polo N. Country Club, Inc. (In re Revel AC, Inc.)*, ___ B.R. ___, 2016 Bankr. LEXIS 3805 (Bankr. D.N.J. Oct. 21, 2016).

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.3 Exemptions

10.4 Reaffirmations and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a **Bankruptcy court may not hear challenge to Medicare provider agreement termination.** The Secretary of Health and Human Services, acting through the Commissioner of Social Security, notified the debtor nursing home that she would terminate its Medicare and Medicaid provider agreements. The debtor filed a chapter 11 case. The bankruptcy court enjoined termination, determined that the Secretary did not have proper grounds to terminate the agreements, and ultimately confirmed a plan that substituted the injunction under the confirmation order for the original injunction. 42 U.S.C. § 405(h) prohibits review of the Secretary's termination decision except as provided in the Medicare statute and prohibits any action against the Commissioner of Social Security "under section 1331 or 1346 of Title 28 to recover on any claim arising under this subchapter." Section 1334 of title 28 grants the district courts pervasive bankruptcy jurisdiction, so at first glance, it does not appear to be included in section 405(h)'s prohibition. However, section 405(h) derived from an unenacted codification of a prior version of the section that referenced a prior title 28 section, which included a reference to the bankruptcy jurisdictional statute. Unenacted codifications may not change a statute's meaning, and Congress's later enactment of the erroneous codification should not be read to adopt a change. Therefore, the section 405(h) prohibition continues to preempt bankruptcy jurisdiction over challenges to the Commissioner's determinations. *Fla. Agency for Health Care Admin. v. Bayou Shores SNF, LLC (In re Bayou Shores SNF, LLC)*, 828 F.3d 1297 (11th Cir. 2016).

11.1.b **Section 904 prohibits a bankruptcy court from remedying municipality's constitutional violation.** After the city filed its chapter 9 case, its water department disconnected some of its residents' water supplies for nonpayment. The residents sued in the bankruptcy court for declaratory and injunctive relief to restore their service, alleging violations of constitutional procedural due process and equal protection rights, among other things. Section 904 provides, "Notwithstanding any power of the court … the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—(1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property." Although a municipality's governmental powers do not include the power to violate the Constitution, section 904 provides that the remedy for the violation does not lie in the bankruptcy court. Section 904's prohibition is thorough, to protect federal-state relations in the context of the complete financial overhaul undertaken in a chapter 9 case. While a federal court may enforce constitutional rights against a municipality in general, it may not do so in a chapter 9 case, because of the risk such a power would vest in the court overseeing the debt adjustment proceeding. *Lyda v. City of Detroit, Mich. (In re City of Detroit, Mich.)*, 841 F.3d 684 (6th Cir. 2016).

11.1.c ***Barton* applies to creditors committee members, but not to prepetition claims.** The former lawyer of the chapter 11 debtor's former principal became creditors committee chair. After the bankruptcy, the former principal sought to bring claims against the lawyer for using confidential information to his detriment in the bankruptcy and in various tort and contract claims for the prepetition representation. *Barton v. Barbour*, 104 U.S. 126 (1881), deprives a federal court of jurisdiction over a claim against an officer that a court has appointed for actions the officer took in an official capacity unless the appointing court grants leave to sue. The bankruptcy court concluded *Barton* applied to committee members, denied the former principal permission to bring the claims in district court and heard and dismissed the claims. The creditors committee's role overlaps with the trustee's role in efforts to maximize the estate's value. In addition, a committee performs various tasks related to and in support of administering the case. Therefore, the *Barton* doctrine should apply equally to committee members. But *Barton* does not cover claims for prepetition conduct, which the former principal may bring in district court without leave of the bankruptcy court. *Blixseth v. Brown (In re Yellowstone Mountain Club, LLC)*, 841 F.3d 1090 (9th Cir. 2016).

11.1.d **Bankruptcy court may adjudicate claims against a committee member for postpetition conduct.** The former lawyer of the chapter 11 debtor's former principal became creditors committee chair. After the bankruptcy, the former principal sought to bring claims against the lawyer for using confidential information to his detriment in the bankruptcy and in various tort and contract claims for the prepetition representation. *Barton v. Barbour*, 104 U.S. 126 (1881), deprives a federal court of jurisdiction over a claim against an officer that a court has appointed for actions the officer took in an official capacity unless the appointing court grants leave to sue. The bankruptcy court concluded *Barton* applied to committee members, denied the former principal permission to bring the claims in district court and heard and dismissed the claims. *Stern v. Marshall*, 564 U.S. 462 (2011), limits the bankruptcy court's power to adjudicate traditional common law claims but not core proceedings that stem from the bankruptcy itself, even if they involve traditional tort or contract claims. By their nature, *Barton* claims concern actions taken in a bankruptcy officer's official capacity and therefore cannot exist independently of the bankruptcy case. Therefore, the former principal's claims against the lawyer for postpetition conduct stem from the bankruptcy case itself, so *Stern* does not preclude the bankruptcy court from adjudicating them. *Blixseth v. Brown (In re Yellowstone Mountain Club, LLC)*, 841 F.3d 1090 (9th Cir. 2016).

11.2 Sanctions

11.3 Appeals

11.3.a **Appeal from sale order authorizing sale of entire business in place is not moot.** The debtor in possession sold its assets in a section 363 sale. The court found the purchaser was in good faith. After the sale, the buyer made substantial payments on the debtor's prepetition and postpetition debts that it assumed in the sale, separately purchased the debtor's inventory, hired all the debtor's employees, and started marketing and selling products to customers. The losing bidder appealed but did not obtain a stay pending appeal. Section 363(m) provides that reversal or modification of an order approving a sale to a good faith purchaser may not affect the validity of the sale, unless the sale was stayed pending appeal. However, an appeal may challenge a good faith finding. To that extent, the appeal is not moot, and the appellate court may hear the appeal. An appeal is equitably moot if the appellate court cannot grant effective relief. Here, because the sale's principal effect was simply to transfer ownership of the business and there was no material third party reliance, the transactions are capable of being unwound. Therefore, the appeal is not equitably moot. *Mission Prod. Holdings, Inc. v. Old Cold, LLC (In re Old Cold, LLC)*, 558 B.R. 500 (1st Cir. B.A.P. 2016).

11.3.b **Equitable mootness doctrine does not apply to a jurisdictional challenge.** The bankruptcy court confirmed a plan that enjoined the Department of Health and Human Services from terminating the debtor's Medicare and Medicaid provider agreements. The debtor implemented the plan. The Department appealed on the ground that the Medicare statute deprived the bankruptcy court of jurisdiction to hear the dispute between the Department and the debtor and to enjoin termination. The district court reversed on the ground that the bankruptcy court lacked jurisdiction. The debtor appealed. The equitable mootness doctrine prevents a court from hearing an appeal where effective relief is impossible. The court of appeals agreed with the district court that the bankruptcy court lacked subject matter jurisdiction. The lower court's lack of jurisdiction precludes it from issuing the challenged order, and the appellate court must vacate it. Therefore, the equitable mootness doctrine cannot apply. *Fla. Agency for Health Care Admin. v. Bayou Shores SNF, LLC (In re Bayou Shores SNF, LLC)*, 828 F.3d 1297 (11th Cir. 2016).

11.3.c **Section 363(m) applies to a settlement that is structured as a section 363 sale.** The trustee settled claims against the debtor's principal lender by selling the lender the estate's claims against the lender and third parties in exchange for cash and a waiver of the lender's claims against the estate. The bankruptcy court approved the transaction both as a sale under section 363(b) and as a settlement under Rule 9019. The objector did not obtain a stay pending his appeal. Section 363(b) authorizes the trustee to sell property of the estate after notice and a hearing. Section 363(m) prohibits a reversal or modification of an order authorizing a sale from affecting the validity of a sale to a good faith purchaser. A cause of action is intangible property of the estate, which can be sold under section 363. Section 363(m) applies to such a sale. Because the objector did not obtain a stay pending appeal, his appeal is moot. *Adeli v. Barclay (In re Berkely Del. Court, LLC)*, 834 F.3d 1036 (9th Cir. 2016).

11.4 Sovereign Immunity

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.2 Turnover

12.3 Sales

12.3.a **Court may reconsider and set aside sale approval order under Rules 9023 and 9024.** The debtor manufactured boats. It contracted with a design company to jointly design a new boat and with a manufacturing company to make the tooling needed to produce the boats. The contract with the manufacturer included a license of the design to permit manufacture and a schedule of payment for the manufacturing company's work. The boats were more difficult to build than expected, and the debtor filed a chapter 11 case. The debtor in possession negotiated with the manufacturer and reached a settlement agreement, subject to court approval, under which the manufacturer would waive claims, make a one-time payment and pay royalties for each of the new boats sold during the next seven years. Separately, the debtor in possession moved to sell its assets in whole or in lots, depending on the bids. It did not mention the agreement with the manufacturer in the sale motion or any other sale materials. At the auction, the new boat-related assets were sold separately. The debtor in possession notified the manufacturer of the sale and that it would not seek court approval of the settlement agreement a few days after the sale hearing but before the entry of the sale approval order, which found the purchaser in good faith but did not refer to the license agreement. The sale closed five days after entry of the sale approval order, but the debtor in possession still retained the sale proceeds, and the purchaser had not yet taken physical possession of the assets. Fourteen days later, the manufacturer filed a motion to reconsider under Rule 9023 and to set aside the judgment under Rule 9024. Section 363(m) prohibits an order on appeal from affecting the validity of a sale to a good faith purchaser for value under section 363 unless the sale was stayed pending appeal. Rule 9023 incorporates F.R.C.P. 59(e), which permits a court to alter or amend a judgment to account for new law or new evidence or to correct a clear error of law or prevent manifest injustice. Rule 9024 incorporates F.R.C.P. 60(b), which permits a court to relieve a party from a judgment based on mistake, new evidence, fraud or any other reason that justifies relief. Because section 363(m) refers only to an appeal, it does not prevent a court from altering or amending a judgment or granting relief from a judgment under Rule 9023 or 9024. Here, the nondisclosure to the court of the license agreement and its effect on value is newly discovered evidence that warrants altering the sale order to excise the good faith finding. The nondisclosure, the lack of notice to the manufacturer, and the lack of prejudice to the purchaser provide sufficient reason to justify relief from the sale approval order. Therefore, the court revokes the sale order and orders a new auction, with full notice of all assets and contracts to be included. *In re Gunboat Int'l, Ltd.*, 557 B.R. 410 (Bankr. E.D.N.C. 2016).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.1.a ***Barton* doctrine prohibits subpoena to a liquidating trustee.** The debtor's plan provided for the appointment of a liquidating trustee, who was vested with all remaining assets, including claims against third parties. The trustee maintained staff to deal with discovery and other matters relating to litigation, but as settlements were reached, he dismissed staff. A party with whom he had settled subpoenaed him for additional discovery. To provide it, he would have had to hire professionals and experts, because he no longer employed anyone who had any knowledge of the subject matter of the discovery. *Barton v. Barbour*, 104 U.S. 126 (1881), requires permission of the appointing court before an action may be brought against a court-appointed fiduciary, in part to protect the court-supervised estate from third party claims that are not approved by the court. *Barton* applies to liquidating trustees. *Barton* applies here because compliance with the subpoena would require the trustee to expend funds to hire experts and professionals to comply, which would dissipate trust assets for a purpose that the confirmation order did not contemplate. Therefore, the court enjoins the party's enforcement of the subpoena. *In re Circuit City Stores, Inc.*, 557 B.R. 443 (Bankr. E.D. Va. 2016).

13.2 Attorneys

13.2.a **Court orders payment of committee counsel's fees in excess of carve-out amount after confirmation.** The debtor in possession financing approval order provided that "up to $250,000 in aggregate proceeds of the [secured lender's collateral] may be used to pay fees and expenses of the professionals retained by the Committee that are incurred in connection with investigating (but not prosecuting or bringing a challenge to)" certain claims. Committee counsel investigated and prosecuted the claims. The parties ultimately reached a settlement that resulted in a confirmed plan. Committee counsel applied for approval of $8.5 million in fees. The secured lender objected. A court may not order the payment of administrative expenses from a secured creditor's collateral without the creditor's consent. Under section 1129(a)(9), the court may not confirm a plan that does not provide for payment of administrative expenses. Under section 503(b), committee counsel's fees, to the extent allowed, are administrative expenses. The DIP financing order authorized the carve-out for an investigation but did not limit using the creditor's collateral for payment of administrative expenses. The secured creditor sought plan confirmation under the settlement, impliedly consenting to the payment of administrative expenses. Therefore, the court may allow committee counsel's fees and order their payment. *In re Molycorp, Inc.*, ___ B.R. ___, 2017 Bankr. LEXIS 22 (Bankr. D. Del. Jan. 5, 2017).

13.3 Committees

13.4 Other Professionals

13.4.a **Court questions Blackstone Protocol and allows a banker's transaction fee based on section 328(a) employment order.** The debtor in possession employed an investment banker, agreeing to pay a monthly fee and a "transaction fee" that was payable upon consummation of a restructuring transaction. The court approved the employment under section 328(a), with the "Blackstone Protocol," under which the U.S. trustee (but no other party) reserves the right to object to the banker's fees under section 330(a) at the case's conclusion. The case resulted in a restructuring transaction. The debtor in possession, the unsecured creditors committee and the U.S. trustee agreed on the appointment of a fee examiner and that the fee examiner would have the U.S. trustee's right to object to the banker's fees under section 330(a). The court approved the stipulation and the fee examiner's appointment, but provided in the approval order that the appointment did not change the standard for fee approvals. The banker applied for the transaction fee. The fee examiner objected, but the U.S. trustee did not. Section 328(a) permits the court to approve a professional's employment on any reasonable terms and conditions, which may not be revised except upon the occurrence of unanticipatable circumstances. Section 330(a) permits the court to allow reasonable fees for a professional's actual, necessary services but is mutually exclusive with employment approval under section 328(a). So the Blackstone Protocol might be inconsistent with the statute, unless the possibility of later U.S. trustee objection under section 330(a) is considered one of the terms and conditions of employment, but the court does not reach the issue here, because the U.S. trustee did not object. The appointment of a fee examiner was not an unanticipatable circumstance, so it did not permit the court to vary the terms and condition of employment so as to permit the fee examiner to object under section 330(a). A banker's transaction fee in addition to monthly fees is common in the banking industry outside of bankruptcy and therefore a reasonable term and condition of employment, which the court may approve under section 328(a). If approved in advance under section 328(a), it is not a "bonus" or "fee enhancement" that requires a special showing. The court must allow it if the conditions for paying it under the employment agreement have been met. Here, the conditions were met, so the court allows the fee. *In re Relativity Fashion, LLC*¸ ___ B.R. ___, 2016 Bankr. LEXIS 4339 (Bankr. S.D.N.Y. Dec. 16, 2016).

13.5 United States Trustee

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES