JENNER&BLOCK

Recent Developments in Bankruptcy Law, October 2022

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1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a **Automatic stay is not enforceable in the U.S. against a foreign creditor.** The debtor borrowed money in Ireland, securing the loan by various Irish assets. When he defaulted, his Irish creditors pursued and obtained remedies in the Irish courts. The debtor filed a chapter 11 petition to attempt to stay any further foreclosure actions and sued the Irish creditors in the bankruptcy court for contempt for violating the stay. The automatic stay prohibits any act to exercise control over property of the debtor or property of the estate. Property of the estate includes any interest of the debtor in property, wherever located. Therefore, the automatic stay applies to protect the debtor's Irish property. However, a court may not enforce violations of the stay against creditors or other defendants over whom the court does not have personal jurisdiction. Here, the Irish creditors and other actors had no U.S. contacts and so were not subject to an enforcement action in the U.S. courts. *Sheehan v. Breccia Unltd. Co. (In re Sheehan)*, 48 F.4th 513 (7th Cir. 2022).

1.1.b **Authorizing issuance of additional shares in the debtor's corporation does not violate the stay.** The individual debtor, who had embezzled substantial sums from a corporation while he was an officer, owned a 23% interest in the corporation. That interest became property of the estate. The majority shareholder adopted a resolution increasing the number of authorized shares in the corporation but took no action to issue any additional shares. The automatic stay prohibits any act to obtain possession of or exercise control over property of the debtor or of the estate. Merely authorizing the issuance of additional shares does not dilute the estate's interest in the corporation and therefore does not violate the stay. Because the corporate action did not contemplate issuance of new shares, the court did not need to address the issue of whether such an action would have violated the stay. *In re Harrison*, 643 B.R. 399 (Bankr. E.D. N. Car. 2022).

1.1.c **False advertising to the debtor's customers does not violate the stay.** The debtor provided telecommunications services to its customers. After its bankruptcy, its competitor sent advertisements to the debtor's customers implying that the debtor would be going out of business and would not be able to provide services. The automatic stay prohibits any act to obtain possession or control of property of the estate, including any act or proceeding that might dissipate the estate's assets. It protects both executory contracts and goodwill. However, a competitor's competitive efforts to attract customers, standing alone, does not interfere with the debtor's contracts with its customers, and its general advertising questioning the debtor's future longevity does not attempt to obtain possession of or exercise control over the debtor's goodwill. Not every illegal act violates the stay: nothing in the stay suggests that improper advertisements are attempts to obtain control but legitimate ones are not. Therefore, the competitor did not violate the stay. *Windstream Holdings, Inc. v. Charter Commc'ns Inc. (In re Windstream Holdings, Inc.)*, 2022 U.S. Dist. LEXIS 183574 (S.D.N.Y. Oct. 6, 2022).

1.2 Effect of Stay

1.3 Remedies

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **Providing administrative services to a Ponzi scheme may constitute "value."** The debtor conducted a Ponzi scheme. He employed and paid a reasonable price to an administrator to keep records, maintain his website, and handle withdrawal requests and questions from investors. The SEC instituted a receivership proceeding against the debtor. Under the UFTA, a receiver may avoid and recover a transfer made with actual intent to defraud creditors, but not to the extent a transferee gave reasonably equivalent value to the debtor in good faith. Under the Ponzi scheme

presumption, the debtor's transfers are all presumed to be made with actual intent to defraud creditors. A transferee gives value if the debtor's net worth is preserved. Here, the services provided value to the debtor, the debtor incurred a debt for the price of the services, and the payments preserved the debtor's net worth by discharging the debt. Enabling the Ponzi scheme to continue does not negate the value the administrator provided. The administrator's knowledge, if any, of the Ponzi scheme goes to his good faith, not to whether he provided value. *Georgelas v. Desert Hill Ventures, Inc.*, 45 F.4th 1193 (10th Cir. 2022).

2.1.b **Trustee may not rely on FDCPA reach-back based on allowed PBGC claim.** More than four years but within six years before bankruptcy, the debtor paid consultants in connection with an illegal scheme to reduce the apparent underfunding of a private, single-employer defined benefit pension plan. The Pension Benefit Guaranty Corporation, which is a corporation that is 100% owned by the United States, had an allowed claim against the debtor for the benefit of the plan, whose benefits the PBGC guaranteed. Section 544(b) permits the trustee to avoid a transfer avoidable by a creditor holding an allowed unsecured claim. The Federal Debt Collection Procedures Act governs collection of debts owed to the United States, but not debts the United States seeks to collect on behalf of private parties or acquires by assignment. The FDCPA has a six-year reach-back period for the United States to avoid fraudulent transfers. Because the debt to the PBGC is not a debt to the United States, the PBGC could not use the six-year reach-back period here to avoid the transfers to the consultants. Therefore, the trustee may not rely on the PBGC as a triggering creditor under section 544(b) to avoid the transfers. *Shuford v. Kearns (In re JTR1, LLC)*, 643 B.R. 403 (Bankr. W.D. N. Car. 2022).

2.1.c **Safe harbor does not protect refinancing loan for purchase of the debtor's stock.** The debtor was the subject of an LBO. The private equity firm created a holding company that acquired the debtor's stock using the proceeds of a bank loan to the holding company. A month later, the bank loan was refinanced with a loan to the debtor that was guaranteed by the holding company. A chapter 7 case ensued a year later. Section 544(b) permits a trustee to avoid a transfer that is voidable by a creditor holding an allowable unsecured claim. The UVTA permits a creditor to avoid a transfer of an interest of the debtor in property that is made for less than a reasonably equivalent value while the debtor was insolvent and to recover the value of the transfer from the transferee or the entity for whose benefit the transfer was made. If a transfer is avoidable by an unsecured creditor, the trustee need not separately avoid the transfer to recover from the transfer's beneficiary. Section 546(e) prohibits the trustee from avoiding under section 544 a settlement payment in connection with a securities contract to or for the benefit of a financial institution. Section 546(e) does not prohibit a creditor from avoiding such a transfer. The court need not determine whether the trustee may actually avoid the transfer, because "avoidability," not "avoidance," is the element of the trustee's claim. Therefore, the trustee may step into the creditor's shoes and assert the claim for recovery without first avoiding the transfer and without triggering the section 546(e) prohibition. In addition, section 546(e) applies only if the settlement payment is made "in connection with" a securities contract. "In connection with" implies a meaningful connection, consistent with the statute's purpose to protect the securities markets, with the transfer. Because the transfer here was made a month after the holding company's purchase of the debtor's equity securities, it was not made in connection with the purchase. *Petr v. BMO Harris Bank, N.A. ((in re BWGS, LLC)*, 2022 Bankr. LEXIS 2313 (Bankr. S.D. Ind. Aug. 18, 2022).

2.1.d **Termination of ownership interest before transfer precludes fraudulent transfer liability.** The debtor provided retail electric service to its customers. When it failed to pay the wholesaler, the regulator terminated its right to service retail customers. Upon the termination, the regulator transferred the customers to a new provider. The trustee may avoid a transfer of an interest of the debtor in property if made within two years before bankruptcy for less than reasonably equivalent value while the debtor was insolvent. In this case, because the termination of the debtor's right to service its customers terminated before the customers were transferred to the new provider, the new provider did not receive an interest of the debtor in property and is not liable for a fraudulent

transfer. *Nelms v. TXU Retail Energy Co. LLC (In re Gritty Energy LLC)*, 2022 Bankr. LEXIS 2888 (Bankr. S.D. Tex. Oct. 6, 2022).

2.2 Preferences

2.2.a **Postpetition claim payment under section 503(b)(9) does not defeat subsequent new value preference defense.** The debtor purchased and, within 90 days before the petition date, paid for goods from a supplier. At the petition date, some of the supplier's invoices remained unpaid, including for shipments the debtor received within 20 days before the petition date. The supplier filed an administrative expense claim under section 503(b)(9) for those invoices. Section 547(b) allows the trustee to avoid payments made within 90 days before the petition date as a preference if various other conditions are met, but section 547(c)(4) gives a preference defendant a defense to the extent the defendant, after the preference, provided new value to the debtor "not secured by an otherwise unavoidable security interest" and for which the debtor "did not make an otherwise unavoidable transfer to or for the benefit" of the creditor. First, in this context, "otherwise unavoidable" means unavoidable under a provision other than section 547(c)(4), not generally under section 547. Thus, if a transfer to the creditor is avoidable for any reason, including as a preference, the creditor may rely on the subsequent new value defense with respect to the new value for which the debtor made the transfer. Second, the subsequent new value defense does not specify whether the "otherwise unavoidable transfer" must have been made pre- or postpetition. The first two uses of the word "transfer" in section 547(b) and 547(c)(4) apply only to prepetition transfers. The third use, in section 547(c)(4)(B), should similarly be read to apply only to prepetition transfers. The section's title, "Preferences," suggests that it applies only in the 90-day prepetition period. If only prepetition "new value" provides a defense, then (B) should similarly be read to apply only to prepetition transfers. Therefore, the unavoidable postpetition claim payment under section 503(b)(9) is not an "otherwise unavoidable transfer" that defeats the supplier's subsequent new value defense. *Auriga Polymers Inc. v. PMCM2, LLC*, 40 F.4th 1273 (11th Cir. 2022).

2.3 Postpetition Transfers

2.3.a **Filing a C corporation tax return is a transfer of property of the estate.** After the chapter 11 C corporation case was converted to chapter 7, the shareholders caused the corporation to file, without the chapter 7 trustee's approval, tax returns for the chapter 11 years. Section 549 permits a trustee to avoid a postpetition transfer of property of the estate that was not authorized. The filing of a corporate tax return has a significant effect of the estate's net assets and therefore fits within the broad definition of estate property and therefore is a transfer because it disposes of an estate asset or results in the disposing of or parting with an interest in property. Accordingly, the court denies the shareholders' motion to dismiss the trustee's complaint under section 549 to avoid the filing of the returns as unauthorized postpetition transfers. *Harker v. GYPC, Inc. (In re GYPC, Inc.)*, 639 B.R. 739 (Bankr. S.D. Ohio 2022).

2.4 Setoff

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

3. BANKRUPTCY RULES

3.1

3.1.a **A claims agent may not adjudge the validity of a claim transfer.** The court ordered the allowance of a rejection damages claim and required the claimant to file a proof of claim within 30 days. The claimant did not do so. Shortly before the order, the claimant transferred the claim to a

claim dealer. The dealer filed evidence of transfer under Rule 3001(e)(1), which addresses transfers of claims before a proof of claim is filed. Because no proof of claim had been filed, the claims agent, in accordance with Rule 3001(a)(1), did not send notice of the transfer, but because no proof of claim had been filed, it paused processing the transfer on the claims register. Later, when reconciling the claims register, the claims agent sent a Notice of Defective Transfer to the transferor and transferee. The claimant then filed a proof of claim, but naming its affiliate. It later withdrew that claim and filed on behalf of the proper entity. After that, the claims agent sent notice of transfer to the transferor and transferee. Neither objected to the transfer, and the claims agent updated the register accordingly, When the transferee's subsequent transferee objected to the claims agent's notice of subsequent transfer, the claims agent reversed both transfers. The claims agent is appointed under 28 U.S.C. § 156(c), which authorizes the clerk to contract claims processing, and has only the authority the clerk would have. The clerk does not have the authority to adjudge the validity of the claim transfer; nor does a claims agent. Therefore, the court orders the claims agent to record the claim transfer. *In re LATAM Airlines Grp. S.A.*, 2022 Bankr. LEXIS 2528 (Bankr. S.D.N.Y. Sept. 13, 2022).

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.2 Involuntary Petitions

4.3 Dismissal

4.3.a **District court reverses dismissal of chapter 7 asbestos case.** The debtor had been out of business for 20 years but was still the defendant in 27,000 asbestos personal injury actions in state courts. It had some cash from a settlement with its insurers and claims against other insurers that could be used to fund the administrative expenses of a case and provide a distribution to claimants. It filed a chapter 7 case to allow a trustee to pursue the claims and provide a distribution to claimants who could establish their claims. Section 707(b) requires a court to dismiss a case filed in bad faith. 28 U.S.C. § 157(b)(5) requires that personal injury tort claims be heard in the district court, not the bankruptcy court. Those requirements do not divest the bankruptcy court of jurisdiction over the underlying bankruptcy case or make the bankruptcy proceeding useless. Chapter 7 provides a collective mechanism to address the claims of numerous creditors and to provide for equitable distribution, thus preventing and substituting for the creditors' race to dismember the debtor or grab its assets first. Therefore, the district court reverses the bankruptcy court's dismissal of the chapter 7 case for bad faith. *In re Nash Engineering Co.*, 2022 U.S Dist. LEXIS 139985 (D. Conn. Aug. 5, 2022).

5. CHAPTER 11

5.1 Officers and Administration

5.1.a **Cryptocurrency debtor may not redact customer names.** The debtor operated a cryptocurrency brokerage and exchange, with over 300,000 customers, including foreign customers, having account balances of over $100. The debtor argued that disclosure of names and physical and email addresses would give competitors an undue advantage in soliciting the debtor's customers. Section 521 requires the debtor to file a list of creditors and a schedule of liabilities, with creditors' names and addresses. Public policy strongly presumes public access to court records. Section 107(b) permits the court to order redaction of confidential commercial information. Section 107(c) permits the court to protect an individual with respect to information whose disclosure would create undue risk of identity theft or other unlawful injury to the individual. Rule 1007(j) permits the court to protect information from disclosure to competitors or others who might make inappropriate or unfair use of the information. These exceptions to the public policy of public access are construed narrowly. Foreign data protection laws prohibit the debtor from disclosing any personal information, including names. Here, disclosure of physical and email

addresses of individual customers could risk identity theft, and they may be filed under seal. However, disclosure of names, without more, does not pose the same risk, and foreign law does not trump U.S. law to prevent public access to records. Therefore, the debtor may redact physical and email addresses, but not customer names or account balances or non-individuals' information in filing its creditor lists and schedules of liabilities. The court notes that other bankruptcy courts hearing cryptocurrency cases have concluded otherwise. *In re Celsius Network LLC*, 2022 Bankr. LEXIS 2672 (Bankr. S.D.N.Y. Sept. 28, 2022).

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statement and Voting

5.5 Confirmation, Absolute Priority

5.5.a **In a solvent case, an unimpaired class of unsecured claims is entitled to postpetition interest at the contract rate.** The solvent debtor's plan left unsecured trade claims unimpaired. Section 1124(1) provides that a class of claims is unimpaired only if the plan leaves unaltered the legal, equitable, and contractual rights of the holders of claims in the class. The common law and the Bankruptcy Act recognized a solvent debtor exception to the general rule that unsecured claims do not accrue postpetition interest. The solvent debtor exception is an equitable right of creditors. Therefore, a plan that does not alter a claim's equitable rights preserves the claim's entitlement to postpetition interest in a solvent case. The Code did not abrogate the exception. For an impaired class in a solvent debtor case, the best interest test of section 1129(a)(7) incorporates indirectly the postpetition interest requirement of section 726(a)(5), which provides for interest at the "legal rate," which is the federal judgment rate. Those sections do not apply to an unimpaired class. Therefore, the interest to which claims in an unimpaired class are entitled is interest at the contractual or default (nonbankruptcy statutory) rate, unless compelling equitable considerations require a different rate. *Ad Hoc Committee of Holders of Trade Claims v. Pac. Gas & Elec. Co. (In re Pac. Gas & Elec. Co.)*, 46 F.4th 1047 (9th Cir. 2022).

5.5.b **In a solvent case, an unimpaired class of unsecured claims is entitled to postpetition interest at the contract rate.** The debtor became solvent during the case. It proposed a plan to leave the class of bond claims unimpaired but to pay the claims only principal, interest accrued at the contract rate to the date of the petition, and postpetition interest at the federal judgment rate. Under section 1124(1), a class of claims is impaired unless the plan leaves unaltered the legal, contractual, and equitable rights of the holders of the claims in the class. Although section 502(b)(2) disallows claims for unmatured postpetition interest, in the absence of a clear Congressional mandate to the contrary, historical precedent imposes a solvent debtor exception to the disallowance of postpetition interest. Here, section 502(b)(2) tracks closely with pre-Code law, section 63 of the Bankruptcy Act, under which the courts enforced a solvent debtor exception. Therefore, it survived the Code's enactment. Because unimpairment requires leaving legal and contractual right unaltered, creditors are entitled to postpetition interest at their contract rate. *Ultra Petro. Corp. v. Ad Hoc Comm. (In re Ultra Petro. Corp.)*, ___ F. 4th ___, 2022 U.S. App. LEXIS 28604 (5th Cir. Oct. 14, 2022).

5.5.c **Recovery for junior class contingent on post-consummation payment in full of senior class does not violate the fair and equitable rule.** The debtor confirmed a cram-down plan that provided for immediate partial distributions to a class of unsecured claims, with contingent later distributions based on litigation recoveries. It provided for distribution to a junior class from litigation recoveries only if the later distributions on the unsecured claims were sufficient to satisfy those claims in full. The unsecured class and the junior class did not accept the plan. Section 1129(b)(2) permits confirmation over a class's nonacceptance of a plan if the plan is fair and equitable to that class by providing that a junior class may not receive or retain any consideration unless the senior class is paid in full. Even though the junior class's contingent recovery right might have some "option" value, the plan's provision that the junior class not receive any recovery

until the unsecured class has been paid in full satisfies that requirement. *NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P. (In re Highland Cap. Mgmt., L.P.)*, ___ F.4th ___, 2022 U.S. App. LEXIS 23237 (5th Cir. Aug. 19, 2022).

5.5.d **Backstop commitment fees and plan treatment were reasonable.** The debtor searched for financing from multiple sources. Ultimately, it engaged in a mediation with some of its largest unsecured creditors and reached agreement on their financing of a plan. The "Commitment Creditors" agreed to backstop a notes offering in exchange for the right to buy up to 50% of the notes in exchange for discharge of 50% of the amount of their unsecured claims as well as a contribution of approximately 20% of the face value of the notes in cash and for a backstop fee of 20% of the face amount of the notes. The effect was to give them the ability to purchase a disproportionately greater share of the notes than other creditors in the same class. The bankruptcy court determined that the Commitment Creditors were subject to substantial risk in their commitment and that the payments to them were reasonable based on the risk, the value, and backstop fees in other cases. Section 1123(a)(4) requires that holders of claims in the same class receive equal treatment under the plan on account of their claims. Here, any advantage to the Commitment Creditors did not violate the equal treatment requirement because it was in compensation for their commitment and the accompanying risk, not in payment of their claims, and the result of a reasonable search for financing, not an inside deal to favored creditors. *Ad Hoc Group of Unsecured Claimants v. LATAM Airlines Group, S.A. (In re LATAM Airlines Group., S.A.)*, 2022 U.S. Dist. LEXIS 157534 (S.D.N.Y. Aug. 31, 2022).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **A make-whole is unmatured postpetition interest.** The debtor's bonds contained a make-whole provision that required the debtor to pay the bondholders an additional payment if the bonds' maturity was accelerated and interest rates had dropped. Roughly speaking, the payment was calculated as the discounted present value of all future payments due on the bonds, including interest payments, minus the accelerated principal. Section 502(a) allows claims as of the petition date. Section 502(b)(2) disallows any claim for unmatured interest. The disallowance applies equally to the economic equivalent of interest. Make-whole payments are designed to compensate a lender for a loss of future interest if reinvestment rates have declined. As such, they are the economic equivalent of unmatured postpetition interest. *Ultra Petro. Corp. v. Ad Hoc Comm. (In re Ultra Petro. Corp.)*, ___ F. 4th ___. 2022 U.S. App. LEXIS 28604 (5th Cir. Oct. 14, 2022).

6.1.b **Lenders must return mistaken payment.** By failing to check a proper box on a computer screen that provided for payments on a syndicated loan, the agent bank mistakenly paid the lenders the full amount outstanding on the loan several years before it was due, rather than paying just the current interest amount. The agent requested the lenders to return the mistakenly disbursed funds the next day. Many refused. Generally, a payor may recover a mistaken payment. However, under the discharge-for-value rule, the payee need not return the payment that was in discharge of a debt if the payee had no knowledge the payment was mistaken. In this context, "knowledge" includes inquiry notice—whether the facts were sufficiently troublesome that a reasonably prudent investor would have made reasonable inquiry that would have revealed the error. Here, the facts that the payment was not due, that the lenders received no notice (as ordinarily required) that the payment would be made, and that the debtor was in severe distress, with the notes trading at 20% of their face amount, all raised questions about whether the payment was intended or mistaken. As a result, the lenders must return the mistaken payment to the agent. *Citibank, N.A. v. Brigade Cap. Mgmt, LP*, 49 F.4th 42 (2d Cir. 2022).

6.2 Priorities

6.2.a **Failed adequate protection priority amount is based on proposed disposition or use as of the petition date.** On the petition date, it appeared that the debtor would sell its assets, not reorganize as a going concern, although it was unclear whether the sale would be an orderly liquidation/going concern sale or a forced liquidation. Ultimately, the sale was a going concern liquidation. Section 507(b) gives priority to the claims of a secured creditor to the extent that adequate protection of the value of its collateral provided to the creditor turned out to be inadequate and the collateral value decreased during the case. Section 506(a) requires valuation in light of the purpose of the valuation, the proposed use or disposition of collateral, and in conjunction with any hearing of the disposition or use affecting the creditor's interest. When the creditor sought a priority claim under section 507(b), the bankruptcy court valued the collateral as of the petition date using a "net orderly liquidation value" basis. Because an orderly liquidation sale was a possibility at the petition date, that valuation method was proper, without regard to how the collateral was ultimately used or disposed of. *ESL Invs., Inc. v. Sears Holdings Corp. (In re Sears Holdings Corp.)*, ___ F.4th ___, 2022 U.S. App. LEXIS 28584 (2d Cir. Oct. 14, 2022).

6.2.b **DIP's postpetition breach of prepetition contract may entitle counterparty to administrative expense claim.** Prepetition, the debtor entered into a service contract. The contract permitted the counterparty to extend the term unilaterally, which it did, both pre- and postpetition. The debtor's plan rejected the contract. The counterparty claimed the debtor in possession breached the contract during the chapter 11 case, before rejection, and filed an administrative expense claim for breach damages. Section 503(b)(1) allows the actual and necessary costs and expenses of preserving the estate as administrative expenses. It must arise from a transaction between the counterparty and the debtor in possession, not the debtor, and is allowable only to the extent the consideration was both supplied to and beneficial to the estate. However, to the extent that the damage claim was within the parties' fair contemplation at the time of contracting, the claim could be a contingent prepetition claim. But "fair contemplation" does not end the inquiry. For if the counterparty provided value to the estate at the debtor in possession's request, the counterparty is entitled to an administrative expense claim to the extent of the benefit to the estate. Although the parties argued the state law question of whether the postpetition extensions constituted new, postpetition contracts entitling the counterparty to allowance of an administrative expense or were part of the prepetition executory contracts, the questions whether a contract is an executory contract under section 365 and whether a claim is entitled to administrative expense priority is a bankruptcy law question. Here, the counterparty continued postpetition to provide services to the estate, so the district court remands for determination of the reasonable value of those services. *Fin. Of Am. LLC v. Mortgage Winddown LLC (In re Ditech Holding Corp.)*, 2022 U.S. Dist. LEXIS 172793 (S.D.N.Y. Sept. 23, 2022).

6.2.c **Postpetition attorneys' fee award against the estate is denied administrative expense priority.** The debtor's insurer denied coverage on a prepetition claim. The trustee sued the insurer for damages arising from its bad faith denial of coverage and lost. A state statute awards attorneys' fees to the prevailing party in such litigation. A claim arises based on the timing of the debtor's or trustee's conduct. Here, the claim could not arise until the trustee sued, because the state statute awarding attorneys' fees applied only upon commencement of the litigation. Therefore, the claim is a postpetition claim. The definition of "creditor" includes only the holder of a prepetition claim. Therefore, the insurer was not a creditor. A claim is entitled to administrative expense priority only if it arises from a transaction with the estate that directly and substantially benefits the estate. Defending against the trustee's lawsuit does not meet those criteria. However, *Reading v. Brown*, 391 U.S. 471 (1968), grants administrative expense priority to a claim arising from the wrongful conduct of a receiver or trustee in operating the debtor's estate. Under circuit precedent, only a claim arising from operation of the debtor's business involving tortious or otherwise wrongful conduct qualifies under the *Reading* test. Here, the claim does not meet those criteria and is disallowed. *In re Greenway Park, LLC*, 2022 Bankr. LEXIS 2734 (Bankr. W.D. Okla. Sept. 29, 2022).

6.2.d **Court subordinates to general unsecured claims an unauthorized postpetition loan.** During its chapter 11 case, without court approval under section 364, the debtor in possession borrowed from an insider to acquire real property. The lender asserted an administrative claim for the loan amount. Section 503(b) allows claims for actual amounts necessary to the preservation of the estate and grants them priority over prepetition claims. Section 364 permits the court to authorize nonordinary course postpetition loans with administrative expense priority. Failure to obtain prior approval defeats a claim for administrative expense priority. The nature of the transaction here was not in the debtor's ordinary course of business. A court may grant administrative expense priority to an unauthorized postpetition loan on equitable principles. To do so, the court must find that the court would have approved the loan before it was made, the loan would not impair creditor interests, and the property acquired with the loan proceeds would provide a substantial distribution to creditors, all measured as of the time the loan was made. None of those factors were present here. Section 503(b)(3) allows an administrative expense claim of a creditor and certain other specified entities for making a substantial contribution to the case. An insider lender is not among the specified entities and so may not rely on the substantial contribution provision. Therefore, the court denies administrative expense priority to the loan. The court may disallow the claim in its entirety, but here, the court allowed it and subordinated it to the claims of general unsecured creditors based on the insider's inequitable conduct. *Norcross Hospitality, LLC v. Jones (In re Nilhan Devs., LLC),* 2022 U.S. App. LEXIS 22291 (11th Cir. Aug. 11, 2022).

7. CRIMES

8. DISCHARGE

8.1 General

8.1.a **Chapter 11 discharges a reorganized debtor who continues in business for only a limited time.** The debtor confirmed a plan that provided for continuation of its business for a limited period, ending in a wind-down and liquidation of its then-remaining assets. Section 1141(d) denies a discharge to a corporate debtor that does not engage in business after plan consummation if the plan provides for liquidation of all or substantially all property of the estate. Even a temporary continuation of business after consummation suffices to permit a discharge, Because the plan here provides for continuation of the business, albeit for a limited time, discharge is proper. *NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P. (In re Highland Cap. Mgmt., L.P.)*, ___ F.4th ___, 2022 U.S. App. LEXIS 23237 (5th Cir. Aug. 19, 2022).

8.2 Third-Party Releases

8.2.a **Fifth Circuit reaffirms limitation on plan exculpation but permits a bankruptcy court gate-keeping function for post-confirmation litigation,** The debtor's principal was particularly litigious. Shortly after the petition date, the court replaced him with an independent board, which effectively acted as a trustee, and a CEO. The debtor confirmed a plan that provided for continuation of the debtor's business through a managing general partner and the creation of a liquidating trust to pursue litigation recoveries for unpaid creditors. It provided for exculpation of the board, the CEO, the reorganized debtor, the trust, and the creditors committee members, except for acts constituting gross negligence or willful misconduct, and imposed an injunction against litigation against any of them without prior bankruptcy court approval that the litigation stated a colorable claim. Section 524(e) provides that a discharge does not release a nondebtor from any claims. However, chapter 11 permits exculpation of only the debtor, a trustee, and the committee for conduct during the chapter 11 case and in implementing the plan. The independent directors acted effectively as a chapter 11 trustee and are therefore entitled to limited qualified immunity and exculpation. Exculpation of any other parties violates section 524(e). Therefore, the exculpation of the reorganized debtor and the post-consummation trust are impermissible. Under the *Barton* doctrine, a bankruptcy court may perform a gatekeeping function by requiring leave of court before litigation against estate fiduciaries. Therefore, the gatekeeping injunction in this case

is permissible, even for parties who are not exculpated. *NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P. (In re Highland Cap. Mgmt., L.P.)*, ___ F.4th ___,2022 U.S. App. LEXIS 23237 (5th Cir. Aug. 19, 2022).

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

9.1.a **Section 365(b)'s "cure, compensate, and assure" provision applies to nonmaterial defaults.** The debtor's landlord complained to the debtor of several nonfinancial defaults relating to the debtor's use of the premises. When the landlord threatened enforcement action, the debtor filed a chapter 11 petition. During the case, it paid rent into an escrow account. When the court ruled that it was not entitled to do so, the debtor paid the rent to the landlord and later, upon becoming aware of the requirement, paid the landlord a late payment penalty. The debtor then moved for approval of assumption of the lease. If there has been a default under a lease, section 365(b) conditions approval of assumption of a lease on cure of the default, compensation for any loss occasioned by the default, and adequate assurance of future performance. Because section 365(b) speaks only of a "default," it is not limited to material defaults or defaults that have already been cured. However, where the default is nonfinancial and the only form of adequate assurance is the debtor's reaffirmation of its obligations under the lease, the assumption process adequately provides such assurance. *Smart Cap. Invs. I v. Hawkeye Entert., LLC (In re Hawkeye Entert., LLC)*, 49 F.4th 1232 (9th Cir. Sept. 23, 2022).

9.1.b **A surety bond is not an executory contract.** Before bankruptcy, the debtor obtained surety bonds to guarantee performance of its obligations to mineral rights lessors. The surety's obligations to the lessors were irrevocable, but once it issued the bonds, it had no further obligations to the debtor, only to the guaranteed lessors. In connection with obtaining the bonds, the debtor entered into indemnification agreements with the surety, obligating the debtor to pay the surety or provide collateral under certain circumstances. Under its chapter 11 plan, the debtor assumed all contracts not rejected. The surety bonds were not among the contracts listed for rejection. After the effective date, the reorganized debtor defaulted on some of the leases, the lessors demanded payment from the surety, and the surety demanded the reorganized debtor reimburse it or post collateral. An executory contract is one under which "performance remains due to some extent on both sides and … the failure of either party to complete performance would constitute a material breach" that would excuse the other party's further performance. Here, whether or not the surety had remaining performance obligation to the debtor, the bonds are irrevocable, so the debtor's failure to perform under the indemnity agreement would not constitute a breach excusing the surety's performance to the lessors. Therefore, the contract is not executory, it was not assumed under the plan, and the surety may not enforce any obligations under the indemnity agreement against the reorganized debtor. *Argonaut Ins. Co. v. Falcon V, L.L.C. (In re Falcon V, L.L.C.)*, 44 F.4th 348 (5th Cir. 2022).

9.1.c **Assumption is not a ratification**, The debtor in possession assumed an executory contract that it alleged was procured by fraud and subject to rescission. Under applicable nonbankruptcy law, ratification waives any right to void or rescind a contract for fraud, but the ratification must be an unequivocal expression of intent to forego any ability to void the contract. Section 365 permits assumption of an executory contract. Although court approval is required, the approval process is a summary proceeding that addresses only the debtor in possession's business judgment and cure of any defaults. Assumption is *cum onere*—with all burdens and benefits. Therefore, by assumption, the debtor in possession does not lose its right to challenge the validity of the contract. *Astria Health v. Cerner Corp. (In re Astria Health)*, 640 B.R. 758 (Bankr. E.D. Wash. 2022).

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.2.a **Takings Clause claims are not dischargeable in a municipal bankruptcy case.**. The debtor confirmed a plan under PROMSEA Title III, which parallels chapter 9. Numerous creditors asserted claims under the Fifth Amendment for takings of their property before the bankruptcy. Section 944(b) provides for a general discharge. However, the Constitution's Bankruptcy Clause is subject to the Fifth Amendment's Takings Clause, and a bankruptcy case may not effect a taking without compliance with the Fifth Amendment. The Takings Clause provides a specific remedy for a taking—just compensation. Therefore, it is not dischargeable in a bankruptcy case. *Fin. Oversight & Mgmt. Bd. v. Cooperativa de Ahorro (In re Fin. Oversight & Mgmt. Bd.)*, 41 F4th 29 (1st Cit. 2022).

10.2.b **A PACA claim is dischargeable.** The debtor purchased produce from a supplier who was registered under the Perishable Agricultural Commodities Act but did not pay for the produce. PACA provides that produce received by a buyer and all proceeds "shall be held … in trust for the benefit of all unpaid suppliers … until full payment of the sums owing." The PACA regulations provide that trust assets "are to be preserved as a nonsegregated 'floating' trust" and that "[c]ommingling of trust assets is contemplated." Section 523(a)(4) excepts from discharge any debt for "fraud or defalcation while acting in a fiduciary capacity." This discharge exception applies only to a technical trust, where there is a trustee who holds an identifiable *res* for the benefit of an identifiable beneficiary. In addition, the trust relationship must impose sufficient trust-like duties on the trustee, including the duty to segregate trust assets and not use them for non-trust purposes, and the trust relationship must have been created before the act or fraud or defalcation creating the debt. PACA establishes the trustee, the *res*, and the beneficiary, but because it permits commingling and use of trust assets for non-trust purposes, it does not sufficiently impose trust-like duties on the trustee to qualify as a technical trust. As a result, any trust results only from the act or fraud or defalcation and does not exist before hand. Therefore, a PACA trust is not a technical trust who breach gives rise to a discharge exception under section 523(a)(4). *Spring Valley Produce, Inc. v. Forrest (In re Forrest)*, 47 F.4th 1229(11th Cir. Aug. 31, 2022).

10.2.c **State bar client security fund reimbursement obligation is dischargeable.** An attorney was disbarred after he embezzled money from his clients. The state bar has a client security fund that reimburses clients for any such losses and then subrogates to the clients' claims against the attorney. Section 523(a)(7) makes nondischargeable any debt for a fine or penalty payable to or for the benefit of a governmental unit that is not in compensation for actual pecuniary loss. Here, the fact that the client security fund steps in to pay the client victim does not make its claim, through subrogation, against the attorney not in compensation for actual pecuniary loss. To the contrary, the claim is precisely to compensate for the loss. Therefore, it is dischargeable. *Kassas v. State Bar of Calif.*, 49 F.4th 1158 (9th Cir. 2022).

10.3 Exemptions

10.4 Reaffirmations and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a **Arbitration agreement does not apply to avoidance actions.** The debtor contracted with a professional adviser for prebankruptcy workout services. They were unsuccessful, at least in part because of the adviser, and the debtor filed a chapter 7 case. The agreement contained a broad arbitration agreement. The trustee brought an action against the adviser asserting state law claims for breach of fiduciary duty aiding and abetting breach of fiduciary duty, negligence/

professional malpractice, fraud, civil conspiracy, unjust enrichment, and breach of contract and Bankruptcy Code claims to avoid and recover fraudulent transfers and preferences under sections 547 and 548(a)(1) and for recovery of all transfers under § 550. The Federal Arbitration Act favors enforcement of arbitration agreements. The trustee's state law claims that arise under the agreement between the debtor and the adviser are governed by the agreement, including the arbitration provision. However, the trustee's avoiding power claims are brought on creditors' behalf under claims created by the Bankruptcy Code, independent of any contract. As such, the agreement's arbitration provision does not bind the trustee, and he may bring the claims in the bankruptcy court. *Fort v. Kibbey (In re Oaktree Med. Centre, P.C.)*, 640 B.R 649 (Bankr. S. Car. 2022).

11.2 Sanctions

11.3 Appeals

11.3.a **Appeal from cram-down distribution and plan exculpation provisions is not equitably moot.** The debtor confirmed and consummated a cram-down plan that included broad exculpation provisions for the debtor, its directors, the creditors committee, the reorganized debtor and its management, and a liquidating trust. Creditors with claims in the nonaccepting class appealed. Analysis of whether an appeal from a confirmation order for a substantially consummated plan is equitably moot proceeds on an issue-by-issue basis. A court must consider whether appellants obtained a stay, whether the plan was substantially consummated, and whether the relief requested would affect the plan's success or non-parties' rights. Although section 1127 does not permit post-consummation plan modification, it does not limit appeals, and reversal of a plan provision on appeal does not violate the anti-modification provision. Moreover, "equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process." Therefore, the court of appeals denies the motion to dismiss the appeal for equitable mootness. *NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P. (In re Highland Cap. Mgmt., L.P.)*, ___ F.4th ___, 2022 U.S. App. LEXIS 23237 (5th Cir. Aug. 19, 2022).

11.3.b **A magistrate judge may not hear a bankruptcy appeal.** The losing party in the bankruptcy court appealed the order, and the parties consented to the district court's reassignment of the appeal to a magistrate judge, who affirmed the bankruptcy court's ruling. Section 158 of title 28 permits bankruptcy appeals to the district court or to a bankruptcy appellate panel. Despite the broad language in section 636(c) of title 28 governing referral to magistrate judges of matters pending in the district courts, the express language of section 158 governs and prohibits referral of bankruptcy appeals, even with consent of the parties, to a magistrate judge. *S. Cent. Houston Action Council v. Oak Baptist Church*, 38 F.4th 471 (5th Cir. 2022).

11.4 Sovereign Immunity

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.2 Turnover

12.3 Sales

12.3.a **Trustee cannot sell water rights free and clear of a forfeiture action.** The debtor owned disputed water rights. Under applicable state law, water rights constituted only a right to use a certain amount of water, not ownership of the water itself. The public owned all water. Failure to use the rights for a certain period forfeited the rights. Nearby landowners claimed the debtor had forfeited the rights and brought a forfeiture action in state court before the debtor's bankruptcy. Success in the forfeiture action results only in the water rights being returned to the state's water pool, not in an injunction or money judgment. In the bankruptcy, the trustee moved to sell the

water rights free and clear of any adverse interest. Section 363(f) permits a sale of property of the estate free and clear of disputed interests. Because the forfeiture action would not result in a money judgment or injunction, the plaintiffs do not hold claims against the estate or any interest in the debtor's water rights. Therefore, section 363(f) does not permit sale free and clear of the forfeiture action. *In re Sugarloaf Holdings, LLC*, 640 B.R. 270 (Bankr. D. Utah. 2022).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.2 Attorneys

13.2.a **Court may reduce fees based on results obtained.** Trustee's counsel investigated and drafted a complaint to pursue a claim that could have recovered $1.6 million for the estate. After presenting the draft complaint to the defendant, the trustee was able to settle for only $38,000. Counsel applied for fees of $37,000. The bankruptcy court awarded only 50%. Section 330(a)(3) permits, but does not require, a bankruptcy court to award fees based on the nature, the extent, and the value of the services, taking into account all relevant factors. Section 330(a)(4) prohibits the court from allowing fees for, among other things, services that were not reasonably likely to benefit the estate. By listing "all relevant factors" in a non-exclusive list, section 330(a)(3) does not prohibit the court from considering the results obtained. Section 330(a)(4)'s provision requiring a court to consider whether services were likely beneficial at the time rendered, without hindsight, does not suggest otherwise. It permits but does not require a court to award fees for services that were likely to benefit the estate, even if the services did not do so, and bars the court from disallowing fees in every case where the services were unsuccessful. In this case, because the fees almost equaled the recovery, the bankruptcy court did not abuse its discretion in considering the results obtained and reducing the fee award to 50% of the amount requested. *In re Village Apothecary, Inc.*, 45 F.4th 940 (6th Cir. 2022).

13.2.b **Approval of employment of named attorney includes the attorney's law firm.** The trustee employed an individual as special counsel and obtained court approval of employment of just the individual lawyer. While employed by the trustee, the lawyer changed law firms twice, submitted fee applications that included time spent by other lawyers at his firms, and did not file disclosures under Rule 2014(a) for any of the three law firms. Section 327(a) permits the trustee to employ a professional who is disinterested and does not have an interest adverse to the estate. Rule 2014(a) requires a professional to disclose all connections with parties in interest to assist the court and creditors in evaluating whether the professional qualifies under section 327(a). Rule 2014(b) permits partners or associates of a named attorney whose employment the court has approved to be employed without further court order. Therefore, the use of attorneys at the lawyer's first firm was permissible, although not a best practice. A literal reading of that Rule also permits use of the later firms as well. However, Rule 2014(a) disclosures are still required for the new firms. *In re Final Analysis, Inc.* 640 B.R. 633 (Bankr. D. Md. 2022).

13.2.c **Model Rule compliance protects against disqualification.** A liquidating trust under a plan sued the debtor's shareholder. A lawyer at a big firm successfully pitched to represent the shareholder and spent a fair amount of time on the matter. In the middle of the litigation, the lawyer joined the plaintiff's law firm, where her fiancé (and later, husband) practiced, which immediately screened her from the new firm's work on the matter, obtained her agreement to comply with the screen, advised the shareholder in writing of the screen, and offered the shareholder periodic updates on compliance with the screen. The shareholder moved to disqualify the new firm in the litigation. Model Rule of Professional Conduct 1.10(a) prohibits a firm from representing a client when any lawyer at the firm would be prohibited, unless the disqualified lawyer is timely screened and written notice of the screen and certification of compliance is given promptly to the former client. The bankruptcy court's local rules incorporated the Model Rules. Compliance with the Model Rules, which do not include any "exceptional

circumstances" additional requirements, is adequate. Therefore, the court denies the shareholder's disqualification motion. *The Maxus Liq. Trust v. YPF S.A. (In re Maxus Energy Corp.)*, 49 F.4th 223 (3d Cir. 2022).

13.3 Committees

13.3.a **A creditor has neither a right to serve nor a pecuniary interest in serving on a committee.** The bankruptcy court removed four committee members because their counsel disclosed confidential information. They appealed. Standing to appeal in a bankruptcy case requires the appellant to be a "person aggrieved," that is, to have a pecuniary interest adversely affected by the order. Removal from a committee does not affect a creditor's pecuniary interest. In some circumstances, a creditor who has been sanctioned may appeal from the sanction order. Removal from the committee is not a sanction, because the creditor has no right to serve on a committee. Therefore, the court dismisses the appeal for lack of standing. *In re Roman Catholic Church of the Archdiocese of New Orleans*, 2022 U.S. Dist. LEXIS 151083 (E.D. La. Aug. 11, 2022).

13.4 Other Professionals

13.4.a **Claims agent may not charge fee for private arrangement with claims trading platform.** The debtor in possession employed a claims agent to receive and record filed proofs of claim and to maintain the claims register for the clerk of court. The claims agent had contracted with a company that runs a claims trading marketplace website to provide the claims register data in special electronic format for the website and to receive a portion of the fee that the company receives for each claim trade. 28 U.S.C. § 156(c) permits the court to use facilities to manage claim processing where paid for by the estate, which includes an estate-hired claims agent. The claims agent is an agent of the clerk. As such, it may not do anything the clerk may not do. Under sections 156 and 1930, the clerk may collect specified fees for specified services and for no others and may not take a fee for assisting a for-profit business. Therefore, the claims agent's agreement with the claims trading website provider violates section 156(c) and may not be approved. *In re Madison Sq. Boys & Girls Club, Inc.*, 642 B.R. 487 (Bankr. S.D.N.Y. 2022).

13.4.b **Court denies financial advisor's request to increase fee cap under section 328(a).** Three months after the COVID-19 pandemic began, the debtor in possession employed a financial advisor to arrange DIP and exit financing and to negotiate a reorganization plan. The engagement letter provided for a monthly fee, a financing fee (a percentage of each financing that the advisor arranged), and a restructuring fee, as well as a fee cap. The case took much longer than expected and required more financing than originally anticipated, primarily because of the length of the COVID-19 pandemic. As a result, the debtor in possession and the advisor requested an increase in the fee cap. The court approved the employment and the fee under section 328(a), which permits approval of employment on any reasonable terms and conditions and permits the court to allow compensation different from the approved amount only if the terms and conditions "provided to have been improvident in light of developments not capable of being anticipated" at the beginning. Showing a need for modification faces a high hurdle. Here, the services actually provided were all covered by the engagement letter; no additional kinds of services were rendered. The financial advisor provided no evidence of the scope and amount of services initially contemplated nor of how the additional time required could not have been anticipated. Therefore, the court denies the supplemental application to modify the terms and conditions of employment, *In re LATAM Airlines Group S.A.*, 2022 Bankr. LEXIS 2553 (Bankr. S.D.N.Y. Sept. 17, 2022).

13.5 United States Trustee

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1

15.1.a **Court grants recognition as foreign main proceeding for debtor incorporated in Cayman and conducting business in China.** The debtor was incorporated in the Cayman Islands and owned numerous subsidiaries incorporated there, managed holding company corporate business there, and worked with legal counsel there, but conducted all its business operations in China. It issued several series of notes, all governed by New York law. When it encountered financial stress, it convened the holders of a substantial majority of one series of notes to negotiate a scheme of arrangement under Cayman law. The negotiations were successful, resulting in a restructuring support agreement that provided for and resulted in the initiation in Cayman of a scheme proceeding, but not a provisional liquidation with the appointment of a provisional liquidator. The Cayman court convened the scheme and ordered a creditors' meeting, voting on the scheme, and the appointment of a foreign representative. All but two creditors (out of 370) holding nearly 95% in amount of the debt approved the scheme. The Cayman court ultimately sanctioned the scheme, which provided for a discharge of the note series in exchange for cash and new notes. The foreign representative sought recognition of the scheme under chapter 15 in New York. Chapter 15 provides for recognition of a foreign proceeding as a foreign main proceeding if the foreign proceeding is in the debtor's center of main interest (COMI) and as a foreign nonmain proceeding if the debtor merely has an establishment in the jurisdiction conducting the foreign proceeding. The Code has a rebuttable presumption that a debtor's place of incorporation is its COMI. In addition, the courts consider whether the debtor's COMI would be ascertainable by third parties based on factors available in the public domain, whether the debtor (including any liquidators or provisional liquidators) conducted business at its putative COMI, and the law that governs the debtor's operations. An establishment sufficient to support recognition as a foreign nonmain proceeding requires nontransitory economic activity in the forum jurisdiction. Neither existence of debts in the forum nor conduct of the foreign proceeding qualifies; rather, there must be assets to administer and some effect on the local marketplace. Here, the creditors expected the scheme to proceed in Cayman, the debtor maintained some corporate activities in Cayman, and Cayman law governed the debtor's corporate operations. Accordingly, the court grants the scheme recognition as a foreign main proceeding. The absence of a provisional liquidation and of a provisional liquidator does not prevent recognition, because where the debtor is able to effect a consensual restructuring without the need for a liquidation proceeding, the court should not burden the process by requiring such a proceeding. The court denies recognition as a foreign nonmain proceeding. *In re Modern Land (China) Co, Ltd.*, 641 B.R. 768 (Bankr. S.D.N.Y. July 18, 2022).

15.1.b **Court denies recognition to proceeding in "letter-box" debtor's place of incorporation.** The debtor incorporated in the Isle of Man. Its directors were located there, but they were employees of a corporate service company, and there was no evidence they independently managed or exercised control of the debtor. The debtor had no creditors, assets, or operations there. After a dispute arose over a sale of an aircraft, resulting in claims against the debtor, it commenced a voluntary winding up proceeding in the Isle of Man. The Isle of Man liquidator sought recognition of the proceeding in the United States under chapter 15. A court may grant recognition of a foreign proceeding as a foreign main proceeding if the debtor's center of main interests is in the jurisdiction where the proceeding is pending. Chapter 15 presumes that a debtor's COMI is where it is incorporated, but the presumption is rebuttable. The court must consider the location of the debtor's headquarters, where the debtor is actually managed, where its assets and creditors are located, and the jurisdiction whose law would apply to most disputes. Here, headquarters, management, operations, assets, creditors, and applicable law were not in the Isle of Man. Therefore, the Isle of Man was not the debtor's COMI. A court may grant recognition as a foreign nonmain proceeding if the debtor has an establishment in the jurisdiction where the proceeding is pending. An establishment requires some presence in the jurisdiction, an economic impact on the local market, maintenance of a minimum level of organization for a period, and the objective appearance to creditors of a local presence. Here, the debtor had none of these on the Isle of

Man, so the court denies recognition as a foreign nonmain proceeding. *In re Petition of Shimmin, as Liquidator of Comfort Jet Aviation, Ltd.*, 2022 Bankr. LEXIS 2932 (Bankr. W.D. Okla. Oct. 14, 2022).