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Recent Developments in Bankruptcy Law, January 2020

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1. AUTOMATIC STAY

1.1 Covered Activities

1.1.a **FERC proceeding to restrict rejection of a power purchase agreement may be subject to the automatic stay.** The debtor had entered into several agreements to purchase power it no longer needed because its reorganization contemplated its exit from the business of selling electricity at retail. The contracts constituted a minimal portion of the debtor's power contracts and were an insignificant portion of the power market. Upon filing its chapter 11 petition, it sought to enjoin FERC from any action regarding the contracts, including any proceeding to prevent rejection in the chapter 11 case or to require the debtor to perform the contracts. The automatic stay prohibits any act to enforce a prepetition obligation, but an action by a governmental unit to enforce its police or regulatory power is excepted from the stay if the action is to effectuate public policy rather than adjudicate private rights. Although FERC enforces public policy through its determination of whether power agreements are just and reasonable in the public interest, the minimal effect of these contracts on the power markets suggests that any FERC role here would be to vindicate the private interests of the contract counterparties, rather than public policy, so the bankruptcy court may properly enjoin FERC from prohibiting rejection and from ordering the debtor in possession to continue to perform the contract after rejection. However, the bankruptcy court's injunction may not deprive FERC of its own jurisdiction to determine whether the automatic stay applies nor prohibit FERC from taking any action whatsoever or enjoin all FERC's regulatory functions. *F.E.R.C. v. FirstEnergy Solutions Corp. (In re FirstEnergy Solutions Corp.)*, 945 F.3d 431 (6th Cir. 2019).

1.1.b **Bankruptcy court may grant stay relief to permit creditors to pursue trustee's avoiding power actions.** The debtor was the subject of an LBO. In connection with the LBO tender offer, the debtor retained as "depositary" a trust company, which performed multiple services for the debtor, including receiving the tendered shares and paying shareholders. Within a year after the LBO, the debtor filed a chapter 11 case. The creditors committee, on behalf of the estate, brought actual fraudulent transfer actions under section 548(a)(1)(A) against the cashed-out shareholders. The bankruptcy court granted creditors stay relief to bring constructive fraudulent transfer actions in nonbankruptcy courts against the cashed-out shareholders, which they did. Whether or not the automatic stay prohibits creditors from pursuing fraudulent transfer actions creditors had before bankruptcy, the bankruptcy court's stay relief permitted creditors to pursue the actions. *In re Tribune Co. Fraudulent Conveyance Litigation*, ___ F.3d ___, 2019 U.S. App. LEXIS 38855 (2d Cir. Dec. 19, 2019).

1.1.c **A creditor who retains repossessed property does not violate the automatic stay.** Before bankruptcy, the car lender repossessed the debtor's car. After bankruptcy, the debtor demanded the lender turn over the car. Section 362(a)(3) stays any "act to exercise control over property of the estate." The stay applies only to an affirmative act to exercise control, not to passive control. Therefore, retaining possession does not violate the automatic stay. Section 542(a) requires a creditor in "possession, custody, or control of property of the estate that the debtor may use, sell, or lease under section 363" or that "the debtor may exempt under section 522" and that is not "of inconsequential value or benefit to the estate" to turnover the property. Bankruptcy Rule 7001(1) requires an adversary proceeding to enforce turnover, which is itself subject to several conditions and contingencies. Accordingly, section 542(a) is not self-effectuating, and the creditor is not required to turn over the property until the court determines the trustee or debtor meets section 542(a)'s conditions. *In re Denby-Peterson*, 941 F.3d 115 (3d Cir. 2019).

1.2 Effect of Stay

1.3 Remedies

1.3.a **Section 363(k) creates a private right of action the debtor may pursue independently of the bankruptcy case.** Investors in a fund filed an involuntary petition against the fund manager but

did not serve it properly. The manager failed to respond, and the court ordered relief. Afterwards, the investors removed the manager from the fund and installed a new one. The manager discovered the bankruptcy and moved to set aside the order for relief for lack of proper service, which the court did. The investors moved to dismiss the case, since they had achieved their objective of removing the manager. After dismissal, the manager sued the investors for damages for violating the automatic stay during the pendency of the case by removing the manager. Section 363(k) creates a private cause of action for stay violation. It exists and may be pursued independently of the underlying bankruptcy case. Accordingly, the bankruptcy court may not, in the dismissal order, limit the debtor's right to bring the action. *Healthcare Real Estate P'ners v. Summit Healthcare Reit, Inc. (In re Healthcare Real Estate P'ners)*, 941 F.3d 64 (3d Cir. 2019).

2. AVOIDING POWERS

2.1 Fraudulent Transfers

2.1.a **Section 546(e) applies to an LBO transaction effected through a financial institution.** The debtor was the subject of an LBO. In connection with the LBO tender offer, the debtor retained as "depositary" a trust company, which performed multiple services for the debtor, including receiving the tendered shares and paying shareholders. Within a year after the LBO, the debtor filed a chapter 11 case. The bankruptcy court granted creditors stay relief to bring constructive fraudulent transfer actions in nonbankruptcy courts against the cashed-out shareholders, which they did. Section 546(e) provides that notwithstanding sections 544 and 548, a trustee may not avoid, among other things, a transfer by or to a financial institution in connection with a securities contract. Section 101(22) defines "financial institution" to include a trust company and its customer, when the trust company is acting as agent or custodian for a customer. A customer is one for whom the financial institution provides services, and an agent is one who acts for the customer. A securities contract includes a contract to repurchase securities. Although the share purchases here were redemptions, redemption includes repurchase. Because the debtor contracted with the trust company to provide it services and the trust company acted as the debtor's agent in performing those services in connection with the purchase of its shares, the debtor was a financial institution whose transfers are insulated from avoidance under section 546(e). Therefore, the cash transfers to the former shareholders are shielded by section 546(e). . *In re Tribune Co. Fraudulent Conveyance Litigation*, ___ F.3d ___, 2019 U.S. App. LEXIS 38855 (2d Cir. Dec. 19, 2019).

2.1.b **Section 546(e) applies to postbankruptcy creditor actions to avoid transfers.** The debtor was the subject of an LBO. In connection with the LBO tender offer, the debtor retained as "depositary" a trust company, which performed multiple services for the debtor, including receiving the tendered shares and paying shareholders. Within a year after the LBO, the debtor filed a chapter 11 case. The bankruptcy court granted creditors stay relief to bring constructive fraudulent transfer actions in nonbankruptcy courts against the cashed-out shareholders, which they did. Section 546(e) provides that notwithstanding sections 544 and 548, a trustee may not avoid, among other things, a transfer by or to a financial institution in connection with a securities contract, which the court determined applied to the share purchases. State laws are preempted to the extent of any conflict with a federal statute, such as when state law stands as an obstacle to the accomplishment of Congress's objectives. A presumption against preemption arises when Congress legislates in a traditionally state law area. Here, however, the area is Congress's authority over bankruptcy, not state debtor-creditor law, defeating any presumption against preemption. Congress's purpose in enacting section 546(e) was extensive protection of the securities markets, which conflicts with permitting creditor fraudulent transfer actions to avoid transactions that are subject to section 546(e). Therefore, the court dismisses the creditor constructive fraudulent transfer actions. *In re Tribune Co. Fraudulent Conveyance Litigation*, ___ F.3d ___, 2019 U.S. App. LEXIS 38855 (2d Cir. Dec. 19, 2019).

2.1.c **For purposes of the avoiding powers, the debtor has a sufficient interest in property obtained by fraud or illegal means.** The debtor conducted a combined Ponzi/pyramid scheme. New participants received an invoice from the debtor for their "membership" fees, but most paid the invoice directly to the existing participant who recruited them, and the existing participant's account with the debtor was debited by the amount of payment. After bankruptcy, the trustee obtained an order determining net winners and net losers based on total cash in/cash out from each participant, regardless of whether the participant had paid the debtor directly or had paid the recruiting participant. The trustee then brought preference and fraudulent transfer actions against net winners. A group of net losers brought a class action against net winners for unjust enrichment. The trustee sought to enjoin that action. A trustee may avoid a transfer of property of the debtor under section 547 (preference) or 548 (fraudulent transfer). For these purposes, "property of the debtor" is property that would have become property of the estate if it had not been transferred, including property in which the debtor did not have a possessory interest. Transactions induced by fraud are merely voidable, not void. Here, because the debtor designed and implemented the payment system, moneys paid by new participants to recruiters were functionally the same as money paid to the debtor, and since none of the participants sought to void the transactions, the debtor had an interest in those funds. *Darr v. Dos Santos (In re Telexfree, LLC)*, 941 F.3d 576 (1st Cir. 2019).

2.1.d **Under the Texas UFTA, a transferee who knows facts that raise a suspicion of fraud takes in good faith only if the transferee investigates.** The debtor conducted a Ponzi scheme. An investor received substantial transfers (withdrawals) from the debtor. The investor knew of facts relating to the withdrawal that would have raised suspicion in a reasonable person that the transaction was fraudulent. However, the investor did not investigate. If the investor had investigated, he would not have been able to uncover the fraud, that is, the investigation would have been fruitless. The UFTA gives a transferee who takes for reasonably equivalent value and in good faith a defense to avoidance of a fraudulent transfer. Good faith requires honesty in fact that is reasonable in light of the known facts and no willful ignorance of fraud. A transferee on inquiry notice of fraud does not meet that standard unless the transferee investigates, because the transferee is charged with constructive knowledge of the facts an investigation would reveal. But failing to investigate amounts after knowing facts that create a suspicion of fraud amounts to willful ignorance, whether or not an investigation would have revealed the fraud. Therefore, a transferee who knows facts sufficient to create a suspicion of fraud is not in good faith without a diligent investigation. *Janvey v. GMAC, L.L.C.*, ___ Tex. ___, 2019 Tex. LEXIS 1267 (Dec. 20, 2019).

2.2 Preferences

2.3 Postpetition Transfers

2.4 Setoff

2.5 Statutory Liens

2.6 Strong-arm Power

2.7 Recovery

2.7.a **Trustee may not recover fraudulently transferred property that the transferee returned to the debtor.** Before bankruptcy, the debtor fraudulently transferred funds to his sister-in-law. Before long, the sister-in-law transferred the funds to the debtor. The trustee sued to avoid the initial transfer, which the sister-in-law conceded. The trustee also claimed a right to recover the transferred funds under section 550(a), which permits a trustee "to recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property." To "recover" means to get back or regain. Once the property has been returned to the debtor, it can no longer be recovered. Therefore, the trustee may not recover the property transferred to the sister-in-law. *Whitlock v. Lowe (In re DeBerry)*, 945 F.3d 943 (5th Cir. 2019).

2.7.b **Recovery action defendant has burden of proof of non-avoidability of initial transfer as defense to recovery.** The trustee avoided a fraudulent transfer by a default judgment and then sued a subsequent transferee for recovery of the avoided transfer. The subsequent transferee defendant sought discovery on the avoidability of the initial transfers. Section 550(a) permits the trustee to recover a transfer "avoided under section 544, 545, 547, [or] 548 … of this title." Section 550(b)(1) denies the trustee recovery from a subsequent transferee "that takes for value …, in good faith, and without knowledge of the voidability of the transfer avoided." If the recovery action defendant was not a party to the avoidance action and if the trustee need not prove the avoidability of the transfer in the recovery action, the recovery action defendant could be denied due process in the determination of an essential element of the recovery cause of action. Still, because section 550(a) permits recovery of an "avoided transfer," the trustee need not prove the avoidability of the initial transfer as part of the cause of action for recovery under section 550(a). However, because one defense is that the subsequent transferee defendant did not have knowledge of the voidabilty of the initial transfer, the defendant may address the avoidability issue by showing the transfer was not avoidable. Thus, the burden of proof shifts from the trustee to the defendant to show non-avoidability, thereby preserving the defendant's due process rights. However, if the avoidance judgment was a default judgment, the trustee has the burden of proving the avoidability of the initial transfer. *Yip v. Google, LLC (In re Student Aid Center, Inc.)*, 608 B.R. 583 (Bankr. S.D. Fla. 2019).

3. BANKRUPTCY RULES

4. CASE COMMENCEMENT AND ELIGIBILITY

4.1 Eligibility

4.1.a **State court order against hospital closure does not prohibit chapter 7 filing.** Within a few months after a community hospital was acquired, the acquirer sought approval to close from the state review board, because the hospital was losing substantial amounts of money. The review board approved. The village where the hospital was located sought court review of the decision. The court issued a preliminary injunction against any action to close the hospital. While that order was on appeal, the hospital filed a chapter 7 case. The village moved to dismiss on the grounds that the filing violated the state court order. Section 109 of the Code specifies which entities are eligible to file a bankruptcy petition. Any contrary state law is superseded by the Supremacy Clause and may not restrict the authority of a debtor to file bankruptcy. Therefore, the court denies the motion to dismiss. *In re Westlake Prop. Holdings, LLC*, 606 B.R. 772 (Bankr. N.D. Ill. 2019).

4.1.b **A district court receivership order may enjoin involuntary petition.** The debtor was part of a corporate group whose members had guaranteed a loan and had commingled assets. The debtor defaulted, and the creditor sought a receivership in district court over all the debtor's assets. The debtor consented to the receivership. The receivership order enjoined all persons from "commencing, prosecuting, continuing or enforcing any suit or proceeding against or affected [debtor] or any part of the Receivership Assets." Three creditors filed an involuntary petition against the debtor in a different district. Because an involuntary petition is a suit or proceeding against the debtor and affects the debtor's assets, which were part of the receivership estate, the order covered the filing of an involuntary petition. Relying on case law from other circuits, the court determines it has authority to enjoin a bankruptcy filing. It concludes it should do so in this case because the receivership process is superior to a bankruptcy on the facts of this case: the receiver has already begun the process of selling the debtor as a going concern, the lender agreed to bear the receivership costs, the court permitted all creditors and other parties in interest to appear and be heard, and the local rules require a receivership administration to be similar to that in a bankruptcy case. In addition, the receivership court has complete jurisdiction over the debtor's property and the authority to protect that jurisdiction. Therefore, the court orders the

petitioning creditors to dismiss the involuntary petition. *Big Shoulders Cap., LLC v. San Luis & Rio Grande RR, Inc.*, ___ B.R. ___, 2019 U.S. Dist. LEXIS 199341 (N.D. Ill. Nov. 18, 2019).

4.2 Involuntary Petitions

4.2.a **Court must require filing of list of creditors if debtor disputes numerosity requirement for filing an involuntary petition.** The alleged debtor filed a motion to dismiss the involuntary petition under Rule 12(b)(6), claiming one of the three petitioners was an investor, not a creditor. The bankruptcy court determined resolution of the motion required a trial but did not require the debtor to file an answer, as required under Bankruptcy Rule 1018, or to file a list of creditors. The court also denied discovery to the petitioning creditors. After trial, the court determined the debtor had more than 12 creditors and that only two qualifying creditors had joined the petition and dismissed the petition. Rule 1003(b) requires an alleged debtor who contests an allegation that it has fewer than 12 creditors to file a list of creditors to allow petitioning creditors to solicit others to join the petition. Contesting such an allegation is properly made in an answer to the petition, which the court should require if it denies a motion to dismiss under Rule 12(b)(6). Here, the court did not require an answer and so did not require the filing of the list. That constituted error. The court should require both an answer and the list whenever there is a dispute over the number of creditors. Though Rule 1013 requires disposition of a petition at the earliest possible time, Rule 1018 makes the discovery rules applicable, so a court should not dispense with discovery just to expedite trial. For these reasons, the appellate court remanded the case to the bankruptcy court for further proceedings. *Hayden v. QDOS, Inc. (In re QDOS, Inc.)*, 607 B.R. 338 (9th Cir. B.A.P. 2019).

4.3 Dismissal

5. CHAPTER 11

5.1 Officers and Administration

5.2 Exclusivity

5.3 Classification

5.4 Disclosure Statement and Voting

5.5 Confirmation, Absolute Priority

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Related private equity funds are not a partnership-in-fact for MPPAA withdrawal liability purposes.** A private equity firm created several investment funds, which were each structured as limited partnerships. The firm created and appointed the general partners of each of the funds. Two of the funds acquired a portfolio company: they formed an LLC, which formed a holding company, which owned the portfolio company. Their ownership interests in the LLC were 70% and 30%. The portfolio company was a participant in a multi-employer pension plan. Under the Multi-Employer Pension Plan Amendments (MPPAA), when a participant withdraws from a plan, it is liable for its portion of the plan's unfunded liabilities. Any entity that qualifies as a trade or business and is under common control with and owns 80% or more of the withdrawing employer is jointly and severally liable for the withdrawal liability. MPPAA regulations provide an entity is under common control as provided under tax law. Under tax law, a partnership-in-fact is determined based on the parties' agreement and their conduct in executing its terms, their contributions, and their control over income and capital, and on whether each party is a principal (rather than an employee or agent), the business is conducted in the parties' joint name, they file partnership returns, maintain separate books and records, or exercise mutual control over the

enterprise. Here, the funds, through their general partners, sought investments together and developed a common plan for acquisition and operation of portfolio companies, and their principals controlled the portfolio companies. However, the funds did not intend to conduct the portfolio company's business jointly, disclaimed a partnership, had few common investors, filed separate tax returns, maintained separate books and records and bank accounts, and did not operate in parallel. Based on these facts, the funds were not a partnership-in-fact and therefore were not liable for the debtor's withdrawal liability. *Sun Capital P'ners III, LP v. N.E. Teamsters & Trucking Indus. Pension Fund*, 943 F.3d 49 (1st Cir. 2019).

6.1.b **Trustee may settle a claim that is subject to a creditor's objection.** A creditor filed an adversary proceeding objecting to and seeking equitable subordination of another creditor's claim. While the adversary proceeding was pending, the trustee settled with the other creditor and filed a motion under Rule 9019 for approval of the settlement, which would have mooted the adversary proceeding. Section 502(a) permits any party in interest to object to a claim and imposes a correlative duty on the court to hear and resolve any such objection. A bankruptcy court may discharge its duty by hearing the evidence on approval of the settlement and need not hear full litigation on the claim objection itself. If the court is satisfied the settlement meets the requirements for approval of a settlement, it may approve and thereby moot the claim objection. *Hamon v. DVR, LLC (In re DVR, LLC)*, 606 B.R. 80 (D. Colo. 2019).

6.1.c **Court disallows default interest on a secured claim as an unenforceable penalty.** After a successful auction, the senior lien creditor's claim became oversecured. The creditor sought allowance of postpetition interest at the 18% default rate under the loan agreements, which was about 10% to 14% higher than the contract rate on the creditor's loans. Section 502(b)(2) disallows postpetition interest, but section 506(b) authorizes allowance on an oversecured claim. Section 506(b) does not specify the interest rate, but courts have held that the contract rate is the presumptive rate. The presumption in favor of the contract rate may be overcome by equitable considerations or if applicable nonbankruptcy law would render the rate unenforceable. Applicable nonbankruptcy law here permits a lender to charge any rate, but it also disallows any contract term that imposes a penalty, rather than liquidated damages, upon a default. To be enforceable, the term must reflect "a reasonable prediction of the harm caused by the breach and … of a kind difficult to estimate accurately." The creditor adduced no evidence to support satisfaction of that test. Therefore, the court disallows the default rate under nonbankruptcy law. A court may disallow the contract rate on equitable grounds based on the reasonableness of the difference between the default and non-default rate, the relative distribution rights of other creditors, and whether the higher rate compensates the creditor for any loss (or is a disguised penalty). Based on these factors, the court concludes the default rate should be disallowed on equitable grounds as well. *In re Family Pharmacy, Inc.*, 605 B.R. 900 (Bankr. W.D. Mo. 2019).

6.2 Priorities

6.2.a **Guarantee of tax claim is entitled to tax priority.** A company settled a dispute with the IRS by agreeing to pay a tax claim over an extended period. Another company, which was owned by the same individuals who owned the tax debtor, guaranteed the payment of the taxes. The guarantor filed a chapter 11 case, and the IRS filed a proof of claim on the guarantee as a priority tax claim. The debtor objected that the claim was not entitled to the tax priority because the claim arose under a contractual guaranty, not as a tax against the debtor. Section 507(a)(8) grants priority to "allowed unsecured claims of governmental units, only to the extent that such claims are for" various taxes. The IRS's claim was for a tax, even though the tax was not imposed on the debtor. Therefore, the claim was entitled to priority under section 507(a)(8). *In re Cent. Proc. Servs.*, 606 B.R. 712 (Bankr. E.D. Mich. 2019).

6.2.b **Statutory priority under section 507(a) does not prevent equitable subordination.** A creditors' committee member asserted a first priority domestic support claim. When pressed by the trustee on the scope, extent, and priority of the claim and whether the creditor would permit payment of the expenses necessary to administer the estate's assets, the creditor evaded the

question. When the trustee and her professionals later filed interim compensation applications, the creditor objected on the ground that her claim had priority over the administrative expenses, and it was unclear whether there would be sufficient assets to satisfy her claim. The creditor's failure to disclose her position on payment of the expenses necessary to administer the estate until after fee applications were filed violated her fiduciary duty of full disclosure, because it enabled the trustee and her professionals to expend time and effort in administering the estate, which they likely would not have done if they had known the first priority domestic support obligation would consume all available assets. A court may equitably subordinate a claim if the creditor acted inequitably resulting in harm to other creditors and subordination is not inconsistent with the Bankruptcy Code. If subordinating a claim that has priority under the Code is inconsistent with the Code, then even secured and general unsecured claims, whose priority the Code specifies, could not be subordinated. Based on the breach of fiduciary duty, the court subordinates the creditor's claim to the extent necessary to pay administrative expense claims. *Naylor v. Farrell (In re Farrell)*, ___ B.R. ___, 2019 Bankr. LEXIS 3782 (Bankr. C.D. Cal. Nov. 15, 2019).

7. CRIMES

8. DISCHARGE

8.1 General

8.2 Third-Party Releases

8.2.a **Article III does not prevent a bankruptcy judge from confirming a plan with a third-party release of related-to claims.** As part of a global settlement, the debtor's plan provided for a substantial contribution by its shareholders and a non-consensual third-party release of all claims that creditors might have against them. Even as a non-Article III judge, a bankruptcy judge may resolve matters that are integral to the restructuring of the debtor-creditor relationship, which includes actions that stem from the bankruptcy itself or necessarily are resolved in the claims allowance process. The focus is on the content of the proceeding addressing the matter and is not limited to the context of the claims allowance process. Here, the issue is the confirmation of the plan, which is integral to the restructuring of the debtor-creditor relationship. As such, the judge had the constitutional authority to confirm the plan and release the third-party claims. *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019).

8.2.b **Equity receivership court may issue a bar order against third-party investor claims.** A federal equity receiver asserted claims against insurance brokers arising from an enormous Ponzi scheme in which the brokers played a material role. Numerous scheme investors, most of whom had claims in the receivership estate, sued the brokers in other courts for essentially the same conduct as the receiver alleged in the receivership action. The receiver settled with the brokers, who insisted on a bar order from the receivership court enjoining the investors from pursing their claims against the brokers. A receivership is designed to take control of all a debtor's assets, including the debtor's claims against third parties, and to distribute them equitably among the debtor's creditors. A receivership solves the collective action problem by channeling all assets and claims into a central forum and controlling the race among creditors to recover on their claims ahead of other creditors. That purpose also informs the court's power to channel claims against third parties, especially where, as here, the claims arise from a singular scheme, not isolated acts, to perpetrate the Ponzi scheme. Because of the finite resources at issue in the litigation, permitting the investors to seek recovery from the defendant brokers for the same conduct for which the receiver seeks recovery would resurrect the collective action problem. The bar order is within the receivership court's jurisdiction and is appropriate because the investors will share in the recoveries through their allowed claims in the receivership. The bar order also does not deprive the investors of their property (their claims against the brokers) without due process. Instead, they participate in the receivership both procedurally and substantively, where their

property interests are protected. Therefore, the court affirms the bar order. *Zacarias v. Stanford Int'l Bank, Ltd.*, 945 F.3d 883 (5th Cir. 2019).

8.2.c **Opt-out third-party release provision is not consensual.** The debtor's plan provided that general unsecured creditors would receive no recovery but that they would be deemed to release certain third parties if they did not opt out of the release provision. The notices and ballots gave a clear description of the instructions for opting out. Creditors may agree to release third parties under a plan without condition, but nonconsensual releases are permitted only upon certain conditions. Under basic contract law, the court may infer consent to the releases only if the creditors accepted a benefit knowing the debtor expected compensation (the release), the debtors led the creditors to believe consent could be manifested through silence and they remained silent intending to consent, or consent can be presumed based on the parties' prior conduct. Because the creditors were to receive no recovery under the plan, there was no evidence of prior dealings, and the court could not find the creditors' failure to opt out evidenced an intent to consent, the releases were not consensual and could not be approved. *In re Emerge Energy Servs. LP*, ___ B.R. ___, 2019 Bankr. LEXIS 3717 (Bankr. D. Del. Dec. 5, 2019).

8.3 Environmental and Mass Tort Liabilities

9. EXECUTORY CONTRACTS

9.1

9.1.a **Bankruptcy court has paramount jurisdiction over rejection of FERC-regulated power purchase agreement.** The debtor had entered into several power purchase agreements that it no longer needed, because its reorganization contemplated its exit from the business of selling electricity at retail. Upon filing its chapter petition, it sought to enjoin FERC from any action regarding the contracts, including any proceeding to prevent rejection in the chapter 11 case or to require the debtor to perform the contracts. Under the filed rate doctrine, a contract that is subject to FERC regulation and that is filed with FERC has been held to be like a federal regulation over which FERC has exclusive jurisdiction and that FERC may enforce by a specific performance order. However, because of chapter 11's strong policy favoring financial rehabilitation, FERC's jurisdiction must yield in part. Accordingly, for purposes of the Bankruptcy Code, a filed rate contract is an ordinary contract that is susceptible to rejection, and the bankruptcy court has concurrent jurisdiction with FERC to determine whether a contract may be rejected. Because of the importance of reorganization and the role Congress has given the bankruptcy court, its jurisdiction is primary, while FERC may still exercise jurisdiction over matters other than whether the debtor in possession may reject the contract, and may be heard on public interest issues in the bankruptcy court. And because of Congress's policy under the Federal Power Act to regulate power contracts, in determining whether to authorize rejection, the bankruptcy court must apply a higher standard than the business judgment standard, considering the impact of assumption or rejection on the public interest, including the effect on consumers and tangential contract provisions to ensure the equities balance in favor of the court's decision. *F.E.R.C. v. FirstEnergy Solutions Corp. (In re FirstEnergy Solutions Corp.)*, 945 F.3d 431 (6th Cir. 2019).

9.1.b **Medicaid provider agreement is not an executory contract.** In its chapter 11 case, a hospital moved to sell all its assets and to transfer its state Medicaid provider agreements. The state objected on the ground that the provider agreements were executory contracts and could not be assigned without assumption and cure of substantial outstanding amounts as required under section 365. A provider agreement is a mechanism by which a hospital may receive payments from the state for medical services. Its terms are entirely governed by statute and regulation, impose only statutory and regulatory obligations on the provider, and impose no obligations on the state. As such, the provider agreements are not contracts but are statutory entitlements or licenses that may be sold under section 363, free and clear of any claims. *In re Verity Health Sys. Of Calif., Inc.*, 606 B.R. 843 (Bankr. C.D. Cal. 2019).

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.2.a **Court applies *Brunner* narrowly and discharges student loans.** The debtor borrowed for college and law school. The debtor qualified under the means test of section 707(b) for chapter 7. His living expenses of approximately $4,000 per month exceed his monthly income of approximately $2,500 at the time of the bankruptcy. While the debtor's loans were in deferment or forbearance, no payments were due, and no late fees were charged. When deferment ended, the loan went into income-based repayment for a year before going back into forbearance, and the debtor made payments during the year and thereafter, despite forbearance. The debtor made one payment under standard repayment terms before the loan went into default and was accelerated. To be eligible for a monthly repayment plan after the default, the debtor would have to rehabilitate the loan by agreeing to make nine voluntary, reasonable, and affordable monthly payments during 10 consecutive months. Such an agreement was not before the court. *In re Brunner*, 831 F.2d 395 (2d Cir. 1987), permits discharge of an educational loan under the undue hardship test of section 523(a)(8) only if based on current income and expenses, the debtor cannot maintain a minimal standard of living, additional circumstances exist indicating this state of affairs is likely to persist for a significant portion of the repayment period, and the debtor has made a good faith effort to repay the loans. The debtor cannot maintain a minimal standard of living with $1,500 monthly negative income. Because the loan was accelerated and fully due as of bankruptcy, there was no remaining repayment period, so that state of affairs was likely to last through the remaining repayment period. *Brunner*'s good faith prong speaks to past payments, not to future potential agreements to repay or to the debtor's reason for taking the loan or filing bankruptcy. Here, the debtor made most loan payments when due and even some that were not due. He meets the good faith effort test, and the court discharges the loans. *Rosenberg v. N.Y. State Higher Educ. Servs. Corp. (In re Rosenberg)*, ___ B.R. ___, 2020 Bankr. LEXIS 73 (Bankr. S.D.N.Y. Jan. 7, 2020).

10.2.b **Private non-qualified student loans are dischargeable.** The debtor obtained a loan to study for the bar exam. Several years later, he filed bankruptcy and sought to discharge the loan. Section 523(a)(8) excepts from discharge (A)(i) an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit …; or (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or (B) any other educational loan that is a qualified educational loan, as defined in section 221(d)(1) of the Internal Revenue Code." The lender agreed the debtor's loan did not qualify under (A)(i) or (B). "Educational benefit" in (A)(ii) must be read in context with "scholarship or stipend." Those terms apply to benefits that are contingently repayable, for example, if a student does not remain employed with the employer who advanced the loan or does not complete a program funded by the school. It cannot be read broadly to include direct loans without rendering (A)(i) and (B) largely superfluous. Therefore, it does not apply to private, non-qualified educational loans. *Crocker v. Navient Solutions, L.L.C.*, 941 F.3d 206 (5th Cir. 2019).

10.3 Exemptions

10.4 Reaffirmations and Redemption

11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

11.1.a **Only the home court may enforce the discharge injunction.** The debtor obtained a discharge in Texas. A private student loan lender pursued him after his discharge, so he brought an action in the Texas bankruptcy court to declare the loan discharged and to enforce the discharge injunction. Another debtor who had received his discharge in Virginia joined the action and sought

class certification. Generally, only the court issuing an injunction may enforce compliance, because the contempt power protects the dignity and authority of the issuing court. Although the discharge order does not contain an injunction, which is statutory, the same rule applies. Accordingly, only the bankruptcy court that issued the discharge may enforce the discharge injunction. Class certification to include debtors from other districts is improper. *Crocker v. Navient Solutions, L.L.C.*, 941 F.3d 206 (5th Cir. 2019).

11.1.b **A counterclaim that addresses allowability of the claim is a constitutionally core proceeding that is not subject to arbitration.** The loan agreement between the debtor and her lender had an arbitration clause. After the debtor filed her chapter 13 petition, the creditor filed a proof of claim asserting amounts owing under the loan. The debtor filed an adversary proceeding objecting to the claim and asserting counterclaims on behalf of herself and all other similarly situated debtors, claiming her loan violated state usury laws and seeking affirmative recovery. The Federal Arbitration Act requires a federal court to enforce an arbitration agreement unless Congress has shown an intention to preclude waiver of judicial remedies. Congress shows such an intention if compelling arbitration would inherently undermine a statute's animating purpose. One of the Bankruptcy Code's animating purposes is to facilitate the efficient reorganization of an estate through the centralization of disputes concerning a debtor's legal obligations. Thus, if a proceeding is constitutionally core, arbitration would inherently conflict with the Code's purposes. An objection to claim is constitutionally core, and a proceeding to recover money that shares common questions of fact and law with the claim and seeks to reduce or recoup the amount claimed is also constitutionally core. Because the counterclaims here challenged the legality of the underlying loan and therefore directly sought to reduce the allowable amount of the claim, the proceeding was constitutionally core. Arbitration would inherently conflict with an animating purpose of the Code, so the bankruptcy court properly denied arbitration. *Allied Title Lending, LLC v. Taylor*, ___ B.R. ___, 2019 U.S. Dist. LEXIS 183729 (E.D. Va. Oct. 22, 2019).

11.2 Sanctions

11.3 Appeals

11.3.a **Conclusive determination of stay relief motion is a final order.** On the eve of trial in state court, the debtor filed a chapter 11 case. The creditor moved for stay relief to permit the litigation to proceed. The bankruptcy court denied the motion. The creditor filed a proof of claim, which the bankruptcy court tried and disallowed. The bankruptcy court then confirmed a plan. The creditor appealed the stay relief denial and the disallowance only after the disallowance. Section 158(a) gives the district courts appellate jurisdiction over final orders of the bankruptcy courts. Rule 8002(a) requires the appellant to file the notice of appeal within 14 days after entry of the final order. Although a civil action involves a single unit of litigation that concludes with a final order, a bankruptcy case involves multiple proceedings, each of which can be a unit of litigation resulting in a final order. A stay relief ruling does not address the merits of the claim resolution but disposes of a procedural unit separate from other proceedings in the case, including claim resolution. The stay relief ruling only directs where and when claim resolution will occur. Accordingly, it is a discrete unit of litigation, and an order conclusively resolving the stay relief motion is a final order that is immediately appealable. *Ritzen Group, Inc. v. Jackson Masonry, LLC*, 589 U.S. ___, 139 S. Ct. ___, 2020 U.S. LEXIS 526 (Jan. 14, 2020).

11.4 Sovereign Immunity

11.4.a **Sale free and clear of state's interest does not violate the Eleventh Amendment.** The debtor in possession sold real property that was subject to an easement in favor of a state agency free and clear of all interests under section 363(f). The Eleventh Amendment denies federal courts of jurisdiction over an action against a state. However, it does not prevent a federal court from dealing with property in which the state has an interest, because doing so is an action *in rem* and does not seek affirmative relief against the state. Therefore, the bankruptcy court's order authorizing the sale free and clear of the state's easement did not violate the Eleventh

Amendment. *Port of Corpus Christi Auth. v. Sherwin Alumina Co., L.L.C. (In re Sherwin Alumina Co., L.L.C.)*, 932 F.3d 404 (5th Cir. 2019).

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a **Avoidance actions are property of the estate.** The debtor conducted a combined Ponzi/pyramid scheme. New participants received an invoice from the debtor for their "membership" fees, but most paid the invoice directly to the existing participant who recruited them, and the existing participant's account with the debtor was debited by the amount of payment. After bankruptcy, the trustee obtained an order determining net winners and net losers based on total cash in/cash out from each participant, regardless of whether the participant had paid the debtor directly or had paid the recruiting participant. The trustee then brought preference and fraudulent transfer actions against net winners. A group of net losers brought a class action against net winners for unjust enrichment. The trustee sought to enjoin that action. The trustee's avoidance actions are property of the estate. Section 362(a)(3) stays any act to exercise control over property of the estate. Therefore, the class plaintiffs' attempt to reach the same proceeds in the hands of the net winners violates the automatic stay and should be enjoined. *Darr v. Dos Santos (In re Telexfree, LLC)*, 941 F.3d 576 (1st Cir. 2019).

12.2 Turnover

12.3 Sales

12.3.a **Section 363(f) permits sale free and clear of an easement.** The debtor in possession sold real property that was subject to an easement in favor of a state agency. Section 363(f) permits sale of property of the estate free and clear of all interests. Although an easement is a property interest of the easement holder, it is an encumbrance that burdens property of the estate and therefore is an interest that may be extinguished by a free and clear sale. *Port of Corpus Christi Auth. v. Sherwin Alumina Co., L.L.C. (In re Sherwin Alumina Co., L.L.C.)*, 932 F.3d 404 (5th Cir. 2019).

12.3.b **To the extent provided in sale order, a committee may challenge a portion of a credit bid after a sale closes.** The second lien lender advanced debtor-in-possession financing and proposed to purchase the estate's assets through a credit bid of its entire $63 million secured claim. The court approved bidding procedures. No other bidders appeared. The creditors committee claimed $7 million of the lender's claim should be recharacterized as equity. The DIP financing order preserved the committee's right to challenge the validity and enforceability within a "challenge period," which the committee did by filing an adversary proceeding. The sale order provided it did not affect any rights or remedies the committee might have against the lender. After the sale closed, the lender moved to dismiss the challenge based on the sale. Although the lender could have reduced its bid to its full claim minus the challenged portion, it did not do so. Because the sale order preserved the committee's rights and remedies and because a portion of the lender's consideration was the challenged amount, the court could provide a remedy if the challenged amount was recharacterized. Therefore, the court permits the challenge to proceed. *Emerald Cap. Advisors v. Victory Park Cap Advisors, LLC (In re Katy Liquidating, Inc.)*, 607 B.R. 398 (D. Del. 2019).

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.2 Attorneys

13.3 Committees

13.3.a **Committee member's fiduciary duty includes duty of disclosure.** A creditors' committee member asserted a first priority domestic support claim. When pressed by the trustee on the scope, extent, and priority of the claim and whether the creditor would permit payment of the expenses necessary to administer the estate's assets, the creditor evaded the question. When the trustee and her professionals later filed interim compensation applications, the creditor objected on the ground that her claim had priority over the administrative expenses. It was unclear whether there would be sufficient assets to satisfy her claim. Creditors' committee members owe fiduciary duties of care and loyalty to the creditors whom they represent. Those duties include the duty of full disclosure. The creditor's failure to disclose her position on payment of the expenses necessary to administer the estate until after fee applications were filed violated that duty, because it enabled the trustee and her professionals to expend time and effort in administering the estate, which they likely would not have done if they had known the first priority domestic support obligation would consume all available assets. *Naylor v. Farrell (In re Farrell)*, ___ B.R. ___, 2019 Bankr. LEXIS 3782 (Bankr. C.D. Cal. Nov. 15, 2019).

13.4 Other Professionals

13.5 United States Trustee

14. TAXES

14.1.a **Straddle-year taxes are not entitled to tax priority or full administrative priority.** The debtor shut down most of its operations before it filed its chapter 11 petition in October. It had only minimal income between the petition date and year end. The IRS filed an administrative expense claim for the taxes for the full calendar year. Section 507(a)(8)(A) grants eighth priority to income tax claims "for a taxable year ending on or before the date of the filing of the petition." Because the taxable year here ended after the petition date, the tax claim is not entitled to eighth priority. Section 503(b)(1)(B) grants administrative expense priority to taxes "incurred by the estate." An income tax is incurred on the last day of the taxable year. However, prepetition income on which the tax is imposed is not earned by the estate; and administrative expense priority should be given only to obligations that resulted in a benefit to the estate. Accordingly, the tax associated with prepetition income is not "incurred by the estate." Only the tax arising from the postpetition income is entitled to administrative expense priority. *In re Affirmative Ins. Holdings, Inc.*, 607 B.R. 175 (Bankr. D. Del. 2019).

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **Rule 7004(f) does not apply to service of a chapter 15 recognition petition, and Rule 60(b) does not apply to termination of a recognition order.** The bankruptcy court recognized a foreign proceeding concerning an individual debtor. The debtor moved for an order terminating recognition on the ground, among others, that the court did not have personal jurisdiction over the debtor. Section 1517(d) permits termination or modification or a recognition order if the basis for recognition was flawed or the grounds for recognition have ceased to exist. Bankruptcy Rule 9024, applying Civil Rule 60(b), permits a court to grant relief from a final judgment, order, or proceeding for mistake, inadvertence, surprise, excusable neglect, newly discovered evidence, or fraud. Because section 1517(d) specifies the grounds for terminating or modifying a recognition order, Rule 60(b) does not apply to a recognition order. Bankruptcy Rule 7004(f) provides for serving a summons to establish personal jurisdiction over an individual. Bankruptcy Rule 2002(g) governs service of a chapter 15 petition and notice of a recognition hearing. A chapter 15 case is an *in rem* proceeding involving only the debtor's property in the United States and does not require personal jurisdiction over the debtor. Therefore, Rule 7004(f) does not apply, and the court properly issued the recognition order without establishing personal jurisdiction over the debtor. *In re Foreign Econ. Indus. Bank*, 607 B.R. 160 (Bankr. S.D.N.Y. 2019).

15.1.b **Section 1521(a)(4) discovery is not limited to the United States.** The foreign representative sought from the debtor and her lawyer discovery of documents held by the debtor's attorneys and agents outside the United States. Section 1521(a)(4) permits the court to grant relief "providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities." By its terms, it is not limited to discovery within the United States. Fed. R. Civ. Proc. 45, which authorizes subpoenas and is incorporated into Bankruptcy Rule 9016, is also not limited to the United States. Therefore, a subpoena in a chapter 15 case may reach documents held outside the United States, as long as they are in the possession, custody, or control of the person to whom the subpoena is directed. *In re Markus*, 607 B.R. 379 (Bankr. S.D.N.Y. 20019).