Recent Developments in Bankruptcy Law, July 2021

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4.1.b **Wind-down activities constitute commercial or business activities for subchapter V eligibility purposes.** The debtor operated a flue gas energy recovery facility, selling steam and electricity to its customers. A dispute with the energy supplier resulted in the termination of the debtor's operation and in litigation against the supplier to recover damages. The debtor filed a chapter 11 petition and elected to proceed under subchapter V. As of the petition date, in addition to pursuing the litigation, the debtor was actively maintaining and preserving its physical assets and working on a sale of the assets. A debtor is eligible to proceed under subchapter V if the debtor is engaged in commercial or business activities. Commercial activities involve "the exchange or buying and selling;" business activities involve dealing or transactions of an economic nature. Subchapter V does not require that the commercial or business activities be the same as the debtor's core or historic operations. Nor does it require the case to result in reorganization of such operations or business, as it permits a plan that may include selling all assets. Because the debtor's activities as of the petition date qualified as commercial or business activities, the court denies a motion to dismiss the case or void the subchapter V election. *In re Port Arthur Steam Energy, L.P.*, ___ B.R. ___, 2021 Bankr. LEXIS 1793 (Bankr. S.D. Tex. July 1, 2021).

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5.1.a **Board-elected officers are not eligible for a KERP.** The debtor in possession adopted a key employee retention plan for about 190 employees, including six employees who were elected as officers by the board of directors. Section 503(c) severely limits KERP payments to insiders. The definition of "insider" includes officer, but the Code does not define "officer." Objective criteria should govern whether an employee is an officer. Under nonbankruptcy law, someone elected to an officer position by the board is an officer and should be treated as such for Bankruptcy Code purposes, whatever the scope of the individual's duties and authority. Therefore, the six employees are not eligible to participate in the KERP. *Harrington v. LSC Comm'ns (In re LSC Comm'ns)*, ___ B.R. ___, case no. 20-CV-5006 (JPO) (S.D.N.Y. July 9, 2021).

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5.5.a **In an individual subchapter V case, good faith does not require best efforts.** The debtor was a high income individual. He proposed a plan that would pay unsecured claims 7.5% over three years. The class of unsecured claims accepted the plan, but one creditor objected to confirmation on good faith grounds. Section 1129(a)(3) requires as a condition to confirmation that the plan be proposed in good faith. Good faith includes pursuing a result that is consistent with the Code's objective and purposes, including preserving going concern value, maximizing property available to creditors, the fresh start, deterring misconduct, expeditious resolution, and achieving fundamental fairness and justice. Thus, courts analyze good faith based on the totality of the circumstances but construe the requirement narrowly to prevent the requirement from importing a judge's subjective moral judgments into the force of law. Confirmation denial should be reserved for egregious cases. The class's acceptance of the plan is important in evaluating good faith. Here, though the debtor might have been able to pay more, the debtor was not taking advantage of the system and did not go overboard in his lifestyle. Given that creditors accepted the plan, the court finds it was proposed in good faith. *In re Walker*, 628 B.R. 9 (Bankr. E.D. Pa. 2021).

6. CLAIMS AND PRIORITIES

6.1 Claims

6.1.a **Unimpaired unsecured claims are entitled to postpetition interest at the federal judgment rate.** The plan provided that the class of unsecured claims was unimpaired. Creditors with a claim must pursue their rights in federal court, subject to federal law. A claim as of the petition date is similar to a federal judgment, whose payment depends on completion of the bankruptcy process, making postpetition interest analogous to post-judgment interest, which is payable at the federal judgment rate. The Code and federal law impose the limitation to the federal judgment rate; the plan is not the source of the limitation. Therefore, use of the federal judgment rate rather than the contract rate does not impair the class under section 1124 for. *Official Comm. v. PG&E Corp.*, 2021 U.S. Dist. LEXIS 96081 (N.D. Cal. May 20, 2021).

6.2 Priorities

6.2.a **Claims for the purchase price of a private flight service membership are entitled to priority.** The debtor provided private flights to its "members." To become a member, a consumer was required to pay the debtor a fixed amount, which would entitle the consumer to a certain number of flight hours. The debtor maintained a ledger recording the amount paid and the deductions for flight hours used. The payments were nonrefundable unless the debtor terminated the agreement with the consumer. Section 507(a)(7) grants priority to a claim "arising from the deposit … of money in connection with the purchase … of property or … services … that were not delivered or provided." A "deposit" is the giving of money to another who promises in exchange to return goods or services. Where a membership is part of a dependent, open transaction for future services and contains no independent value, the membership purchase price is a deposit for future services, not a completed purchase of a membership. Therefore, the claims are entitled to priority. *In re Superior Air Charter, LLC*, 627 B.R. 241 (Bankr. D. Del. Apr. 9, 2021).

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to reject the contract. *In re Brick House Props., LLC*, 2021 Bankr. LEXIS 1585 (Bankr. D. Utah June 11, 2021).

9.1.b **Prepetition contract repudiation renders contract not executory.** Six months before bankruptcy, the debtor cancelled the remaining open purchase orders under a supply contract, claiming the supplier had provided parts that did not comply with contract specifications. The supplier disputed the debtor's claim and right to cancel the remaining purchase orders, but the parties did no further business after the cancellation. An executory contract is one under which some performance remains due on both sides. Where a party clearly repudiates a contract, the other party is relieved of any remaining performance obligation. Therefore, the contract is no longer executory. *In re Cornerstone Valve LLC*, 2021 Bankr. LEXIS 1120 (Bankr. S.D. Tex. April 27, 2021).

10. INDIVIDUAL DEBTORS

10.1 Chapter 13

10.2 Dischargeability

10.2.a **Section 523 discharge exceptions do not apply in a non-individual subchapter V case.** A corporate subchapter V debtor confirmed a plan under section 1191(b), the subchapter V cram-down provision. Creditors brought a nondischargeablity complaint. Section 1192 provides that if the plan is confirmed under section 1191(b), "the court shall grant the debtor a discharge of all debts … except any debt … of the kind specified in section 523(a)." Section 523(a) provides that a "discharge under section … 1192 … does not discharge an individual debtor from any debt" listed in the subsection. Because section 523(a) applies only to individual debtors, the reference to it in section 1192 does not apply to non-individual debtors. The court therefore dismisses the dischargeability complaint. *Gaske v. Satellite Rests. Inc. (In re Satellite Rests. Inc.)*, 626 B.R. 871 (Bankr. D. Md. 2021).

10.3 Exemptions

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11. JURISDICTION AND POWERS OF THE COURT

11.1 Jurisdiction

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11.4 Sovereign Immunity

11.4.a **Sovereign immunity does not bar post-effective date action against a state.** During bankruptcy, the debtor in possession agreed to lease the state some estate property. Separately, the state also filed a proof of claim for environmental damage. The plan created a liquidating trust, which assumed all the property of the estate and was to make distributions to creditors. After a dispute arose about the lease, the state took over the leased facility without paying rent, relying on its police power to protect the environment and public safety. The take-over persisted after the effective date. The liquidating trustee sued the state to recover for the inverse condemnation of the leased facility, both before and after the effective date. A state generally has sovereign immunity against suit in the federal courts, but immunity in bankruptcy cases is limited, because in the Constitution, the states waived their immunity in certain bankruptcy proceedings. In sum, "States cannot assert a defense of sovereign immunity in proceedings that further a bankruptcy court's *in rem* jurisdiction no matter the technical classification of that proceeding," including the court's exercise of *in rem* jurisdiction over the debtor's property, the equitable

distribution of property, and the discharge. A proceeding's function, not its form, governs. Here, the trustee's action against the state furthers the court's jurisdiction over the debtor's and the estate's property and over equitable distribution, in that it prevents the state from recovering on its proof of claim without answering to the trustee's claim. The post-effective date source of a portion of the trustee's claim does not matter to the immunity waiver, because the property to be recovered was in compensation for the trust's assets and furthers the equitable distribution of the estate among creditors. *Davis v. Calif.(In re Venoco LLC)*, 998 F.3d 94 (3d Cir. 2021).

12. PROPERTY OF THE ESTATE

12.1 Property of the Estate

12.1.a **Litigation funder's lien on personal injury action proceeds did not survive bankruptcy.** Before bankruptcy, the debtor obtained financing to pursue a personal injury tort action. Under New York law, a personal injury action is not assignable, but proceeds are. The debtor assigned and granted a security interest in the proceeds of the action to the financier. The debtor filed a chapter 7 petition before obtaining a judgment in the action. The financier filed a proof of secured claim. The trustee settled the action, and the financier claimed the proceeds. Property of the estate includes all the debtor's interests in property, notwithstanding applicable nonbankruptcy law to the contrary, so the action became property of the estate. Under section 541(a)(6), proceeds of the action became property of the estate only when received. Before that, the proceeds did not exist. The assignment of future proceeds operates only as a future lien and does not relate back to the assignment date. Therefore, the debtor's prepetition assignment and grant of a security interest in the action's proceeds was ineffective to vest in the financier any rights that survived the filing of a bankruptcy petition, and the proceeds became property of the estate, unencumbered by the financier's claimed interests. *In re Reviss*, 628 B.R. 386 (Bankr. E.D.N.Y. 2021).

12.2 Turnover

12.3 Sales

13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

13.1 Trustees

13.1.a **Chapter 7 trustee does not succeed to committee's right to bring estate action against prepetition lenders.** The debtor in possession's financing agreement stipulated to the validity of the debtor's prepetition LBO financing and waived all claims of the debtor and the estate against the lender but permitted the unsecured creditors committee or "any party-in-interest, including a … trustee appointed or elected during the [75-day] Investigation Period" to challenge the validity of the prepetition financing. The committee brought a fraudulent transfer action against the prepetition lenders. Later, the case converted to chapter 7. Upon conversion, the committee ceased to exist. The trustee sought to substitute for the committee in the action. Because the trustee did not bring an action within the Investigation Period, the trustee may not assert a challenge to the financing. The committee's right to bring the action is not transferrable. The committee's claims are derivative of the DIP's, because the DIP granted the rights to the committee. But because the DIP barred itself from bringing those claims, the trustee, who succeeds only to such rights as the debtor and the estate had, could not. *Official Committee v. The CIT Group/Business Credit, Inc. (n re Jevic Holding Corp.)*, 2021 Bankr. LEXIS 1203 (Bank. D. Del. May 5, 2021).

13.1.b **Trustee's appellate standing does not depend on a pecuniary interest.** The bankruptcy court awarded counsel for the debtor in possession fees for services performed before the chapter 11 trustee was appointed. Two creditors objected and appealed. During the appeal, the creditors

settled with counsel but not with the trustee and sought to dismiss the appeal, arguing the appeal was moot and the trustee did not have standing to appeal. Ordinarily, for standing to appeal, a party must show a direct and adverse pecuniary interest that the order affected. However, trustees can never show they were pecuniarily affected, because they have no pecuniary interests in the cases they administer. Their standing arises from their duty to enforce the bankruptcy law in the public interest. Here, the trustee was responsible for paying the fees if they were awarded and therefore had an interest in determining whether they were proper. The court finds the trustee has standing and affirms the fee award on the merits. *Edwards Family P'ship v. Johnson (In re Cmty. Home Fin. Servs.)*, 990 F.3d 422 (5th Cir. 2021).

13.1.c ***Barton* doctrine does not apply after a receivership concludes.** After the conclusion of a state court receivership, the plaintiff, whose property the receiver administered, sued the receiver and others under a conspiracy theory. Under *Barton v. Barbour*, 104 U.S. 126 (1881), a court lacks jurisdiction over an action against a federal court receiver unless the appointing court has given permission for the action. The doctrine arises from the *in rem* nature of a receivership and the resulting protection of property that is subject to the receivership and is *in custodia legis*. Once the receivership concludes, there is no longer a receivership estate to protect, so *Barton* protection ends. However, a receiver and counsel are entitled to judicial immunity for acts within the scope of the receiver's authority, even if their acts were "in error, malicious, or … in excess of[the appointing court's] jurisdiction." *Chua v. Ekonomou*, ___ F.3d ___, 2021 U.S. App. LEXIS 17755 (11th Cir. June 15, 2021).

13.2 Attorneys

13.2.a **An adequate ethical screen defeats a disqualification motion.** A partner at the defendant's law firm, who billed 300 hours to an adversary proceeding over three years, left the firm to join the firm representing the plaintiff. Her new firm immediately implemented an ethical screen that prohibited her from sharing any information she learned in the representation, from accessing any information in the new firm's files about the litigation, from discussing the matter with anyone at her new firm, and from sharing in any part of the fee from the litigation. Model Rule 1.10(a)(2) permits a screen to protect an attorney's duty of confidentiality to prevent disqualification, which should be granted only in exceptional circumstances. Here, there was no indication that the attorney or her new firm would not abide fully with the screen. Her limited involvement in this major litigation indicated that she was not a critical part of the trial team that would make this an exceptional case. Therefore, the court denies the defendant's disqualification motion. *Maxus Liquidating Trust v. YPF S.A. (In re Maxus Energy Corp.)*, 626 B.R. 249 (Bankr. D. Del. 2021).

13.3 Committees

13.4 Other Professionals

13.5 United States Trustee

13.5.a **2017 U.S. Trustee fee increase is constitutional and applies to pending cases.** In 2017, Congress amended 28 U.S C. § 1930(a)(6) to increase U.S. Trustee fees, effective January 1, 2018, including to then-pending chapter 11 cases. The fees are entitled to priority as an administrative expense. At the time, section 1930(a)(7) authorized but did not require the Judicial Conference to charge the same fees in chapter 11 cases pending in Bankruptcy Administrator district. The Judicial Conference increased fees effective October 1, 2018, but not for then-pending cases. The debtor filed its chapter 11 case in 2008. Under its confirmed plan, a liquidating trustee administered the case. The trustee brought an action to recover the difference in fees it paid compared to the fees it would have paid in a Bankruptcy Administrator district. Laws on the subject of bankruptcies must apply uniformly to a defined class of debtors and be geographically uniform. The uniformity requirement does not prohibit a law that addresses regionally isolated problems. Here, the U.S. Trustee program suffered budgetary pressures, while the Bankruptcy Administrator program did not. Because the fee increase was directed to addressing the budget problems in the U.S. Trustee districts, it qualified as a law that addressed

only a regionally isolated problem. *Siegel v. Fitzgerald (In re Circuit City Stores, Inc.)*, 996 F.3d 156 (4th Cir. 2021).

13.5.b **2017 U.S. Trustee fee increase is unconstitutional.** In 2017, Congress amended 28 U.S C. § 1930(a)(6) to increase U.S. Trustee fees, effective January 1, 2018, including to then-pending chapter 11 cases. The fees are entitled to priority as an administrative expense. At the time, section 1930(a)(7) authorized but did not require the Judicial Conference to charge the same fees in chapter 11 cases pending in Bankruptcy Administrator district. The Judicial Conference increased fees effective October 1, 2018, but not for then-pending cases. In 2020, Congress amended section 1930(a)(7) to require the Judicial Conference to charge the same fees, although the Judicial Conference has not yet implemented the change with respect to cases that were pending on October 1, 2018. The debtor filed its chapter 11 case in December 2017. It later brought an action to recover the difference in fees it paid compared to the fees it would have paid in a Bankruptcy Administrator district. A law imposing fees on bankruptcy estates is a law on the subject of bankruptcies, because it affects the recoveries of creditors, who may receive payment only after payment of the U.S. Trustee fees. Therefore, it must comply with the Constitution's uniformity requirement. The treatment of estates in U.S. Trustee districts differs from their treatment in Bankruptcy Administrator districts and is therefore non-uniform. Non-uniformity may be justified by a geographically isolated problem. However, in this case, the difference between the U.S. Trustee districts and the Bankruptcy Administrator districts, though geographically isolated, is based on a geographical distinction Congress created, which cannot then be used to justify additional geographical differences. Therefore, the fee increase is unconstitutional, and the debtor in possession is entitled to the refund. *Clinton Nurseries, Inc. v. Harrington (In re Clinton Nurseries, Inc.)*, 998 F.3d 56 (2d Cir. 2021).

13.5.c **Litigation trust disbursements are not subject to U.S. Trustee fees.** On the debtor's plan effective date, the estate transferred claims against a third party to a litigation trust for the benefit of creditors. The transfer to the trust was in consideration of the releases of claims against the debtor, and for tax reasons, the parties were required to treat the transfer as a transfer directly to the trust beneficiaries, followed by a contribution by the beneficiaries to the trust. Upon the transfer, the debtors and their estates had no further interests in the trust assets or the trust. During the calendar quarter in which the trust transfer was made, the estate paid U.S. Trustee fees under 28 U.S.C. § 1930(a), based on the amounts included in the transfer. Later, the trust settled the litigation against the third party and received a payment, which it distributed to the trust beneficiaries. Section 1930(a)(6) requires payment of U.S. Trustee fees each quarter in every chapter 11 case based on the amount of "disbursements" until the case is closed or dismissed. Courts have interpreted "disbursements" to mean those made by or on behalf of a debtor or its estate and those in which the debtor or estate had some interest in or control over the money disbursed. Because the debtor and the estate had no interest in the litigation proceeds, the transfer to the trust was actually to and for the benefit of the trust beneficiaries, and the estates had paid a U.S. Trustee fee based on the distribution to the trust, the disbursement of litigation proceeds were not by or on behalf of the debtor and were not subject to the U.S. Trustee fee. *In re Paragon Offshore, PLC*, Case no. 16-10386-CSS (Bankr. D. Del. June 28, 2021).

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

15.1.a **Chapter 15 filing as a tactic to stay U.S. litigation does not constitute bad faith warranting refusal of recognition.** Minority shareholders derivatively sued a Bermuda company in New York over a refinancing and a large dividend. After the court dismissed the action and before the time for appeal had run, the company entered a members voluntary liquidation in Bermuda. After many more years of litigation and the depletion of most of the assets of the Bermuda company, leaving it insolvent, the liquidators initiated a Bermuda court-supervised liquidation proceeding.

The liquidators then sought an anti-suit injunction from the Bermuda court. In response, the New York plaintiffs sought a TRO to enjoin the anti-suit action. After a stand-still on those matters, the liquidators sought recognition of the Bermuda liquidation as a foreign main proceeding under chapter 15 to ensure the Bermuda proceedings would be binding and enforceable in the United States so as to preclude the New York plaintiffs, under the automatic stay, from continuing the New York action. The recognition petition met all the requirements for recognition under chapter 15, but the New York plaintiffs argued that the court should deny recognition because the petition was filed in bad faith as a litigation tactic. Section 1506 permits the court to refuse to take an action that would be manifestly contrary to U.S. public policy. Courts generally do not apply this section to prohibit recognition where the debtor has engaged in bad faith. However, though the liquidators clearly sought recognition as a litigation strategy and their action might constitute bad faith under a different Bankruptcy Code chapter, in chapter 15, section 1506 does not examine whether the debtor's actions violate public policy but whether the foreign court's procedures and protections do not comport with U.S. public policy. Here, the Bermuda court's do, so the liquidators' motivation in filing the chapter 15 petition does not warrant denial of recognition. *In re Culligan Ltd.*, 2021 Bankr. LEXIS 1783 (Bankr. S.D.N.Y. July 2, 2021).