

JENNER & BLOCK

## Recent Developments in Bankruptcy Law, October 2023

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## 1. AUTOMATIC STAY

### 1.1 Covered Activities

1.1.a **Bankruptcy court properly enjoined asbestos litigation against debtor’s former parent following a Texas divisional merger.** The debtor emerged from a Texas divisional merger with all the asbestos liabilities of and an indemnification obligation from its former parent company, which was relieved in the merger of any direct liability for those obligations. It then filed a chapter 11 case and sought a preliminary injunction against asbestos litigation against its former parent that was identical to the litigation against the debtor. A bankruptcy court has related-to jurisdiction over any proceeding whose outcome could conceivably have any effect on the estate. Based on the outcomes of the litigation against the former parent, the plaintiffs’ success could affect the estate because of the former parent’s indemnification claims and the potential for issue preclusion, inconsistent liability, and evidentiary issues. Therefore, the bankruptcy court had related-to jurisdiction to consider the injunction request. To obtain a preliminary injunction, the plaintiff must show, among other things, a likelihood of success on the merits. In a chapter 11 case, “success” means a confirmed plan. The DIP need not show likelihood of confirmation of plan that contains a permanent injunction, which is tested only at the plan confirmation stage, only the realistic possibility of its ability to reorganize. Based on the facts of this case, the bankruptcy court properly issued the preliminary injunction. *Bestwall LLC v. Off. Comm. Of Asbestos Claimants (In re Bestwall LLC)*, 71 F. 4th 168 (4th Cir. 2023).

1.1.b **Automatic stay does not apply to postpetition action to prevent enrollment discrimination.** The plaintiffs brought an action against the debtor in state court to enjoin the debtor from discriminating against applicants for enrollment in school based on their disabilities. They also sought a comfort order from the bankruptcy court that the automatic stay did not apply. Section 362(a)(1) stays the commencement or continuation of any action or proceeding against the debtor that was or could have been commenced before the petition. Even though the debtor’s conduct existed prepetition and the plaintiffs could have sued before the commencement of the case, the action here seeks to enjoin only postpetition conduct. An action based on postpetition conduct is not subject to the automatic stay. Therefore, the state court action may proceed. *In re Roman Catholic Church of the Archdiocese of New Orleans*, 2023 U.S. Dist. LEXIS 131311 (E.D. La. July 28, 2023).

### 1.2 Effect of Stay

### 1.3 Remedies

## 2. AVOIDING POWERS

### 2.1 Fraudulent Transfers

### 2.2 Preferences

### 2.3 Postpetition Transfers

### 2.4 Setoff

### 2.5 Statutory Liens

### 2.6 Strong-arm Power

### 2.7 Recovery

### 3. BANKRUPTCY RULES

### 4. CASE COMMENCEMENT AND ELIGIBILITY

#### 4.1 Eligibility

- 4.1.a **Court reviews subchapter V case law, construes “commercial or business activity” eligibility requirement broadly.** The debtor owned 25% of a business and had guaranteed a 2014 debt of the business. The debtor ceased involvement with the business in 2016. In 2019, the lender sued the business and the debtor and obtained a judgment against the debtor, which the state court characterized as a business debt. The debtor also rented unrelated real estate since 2019. She filed a chapter 11 case and elected to proceed under subchapter V. One of the requirements to proceed under subchapter V is that the debtor “is engaged in commercial or business activity.” “Engaged in” must be construed in the present tense, so eligibility requires that the debtor be currently engaged in the activity as of the petition date. Courts construe “commercial or business activity” broadly, reflecting Congress’ intent to provide wide availability of subchapter V. The phrase does not require operations, only activities, which may include litigating past business obligations and litigating collection actions to recover property for distribution to creditors. Courts must look to the totality of the circumstances, based on the particular facts and circumstances of each case. Here, the debtor’s ownership interest in the former business, her liability on a business debt arising from that business, her litigating the collection action, and her ownership and management of rental real property suffice as commercial or business activities, qualifying her to proceed under subchapter V. *In re Fama-Chiarizia*, 2023 Bankr. LEXIS 2284 (Bankr. E.D.N.Y. Sept. 15, 2023).
- 4.1.b **Uncapped lease rejection damages claim disqualify debtor for subchapter V.** The debtor had two long-term leases that it intended to reject when it filed its subchapter V case. The aggregate, uncapped lease rejection damages claims exceeded \$7.5 million in noncontingent, liquidated debts, which is the maximum liability amount for subchapter V eligibility, but the damage claim amounts capped under section 502(b)(6) were within the eligibility limit. A debt is noncontingent if all the events giving rise to liability have occurred. Here, the signing of the leases created the full liability under them, so the full uncapped damage claim is not contingent. Postpetition events, such as rejection, do not affect eligibility. Therefore, the lease damage claims disqualify the debtor for subchapter V. The court did not consider whether the damage claims might be unliquidated based on any obligation of the lessors to mitigate damages. *In re Macedon Consulting, Inc.*, 652 B.R. 480 (Bankr. E.D. Va. 2023).

#### 4.2 Involuntary Petitions

#### 4.3 Dismissal

### 5. CHAPTER 11

#### 5.1 Officers and Administration

- 5.1.a **Court permits sealing of customer information in cryptocurrency case.** The debtor operated a cryptocurrency site, providing for trading, borrowing, and lending of digital assets. Its individual and institutional customers are also creditors. The customer information is a valuable estate asset, which the debtor spent significant time, money, and resources to develop, and whose disclosure would undermine the debtor’s efforts to sell its business. Section 521 requires the debtor to file a list of creditors and a schedule of assets and liabilities. Section 107(a) provides that all documents filed in a case are public records, except to the extent provided under section 107(b) or 107(c). Section 107(b)(2) requires a court to protect an entity with respect to secret or confidential commercial information, which includes information whose disclosure would provide an unfair advantage to creditors or have a chilling effect on business negotiations, ultimately

affecting the debtor's viability. Based on that standard, the court permits the sealing of the debtor's customer list. Section 107(c) permits the court to protect individuals with respect to any means of identification if disclosure would create undue risk of identity theft or other unlawful injury to the individual. Names, home addresses, and email addresses all qualify, so the debtor may file that information under seal. However, section 107(c) does not apply to institutional creditors or customers, and the debtor may not file information about them under seal. *In re Genesis Global Holdco, LLC*, 652 B.R. 618 (Bankr. S.D.N.Y. 2023).

### 5.2 Exclusivity

- 5.2.a **Court adopts “equitable inquiry” as the standard for extending the time for a debtor to file a subchapter V plan.** The subchapter V debtor was a building contractor whose major creditors were disappointed customers. Shuttering the business would have left them with little or nothing, and it would have damaged the debtor's current customers severely. The court appointed a mediator to try to settle the debtor's disputes with its customer creditors. The court had granted several extensions of the 90-day plan filing deadline to permit the mediation to proceed. The mediation settled all but two claims and continued as to those two claims. The debtor sought a final extension of the plan filing deadline. Section 1189(b) requires the debtor to file a plan within 90 days after the petition date, as extended by the court “if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable.” In construing that phrase, the court relies on the Supreme Court's interpretation of “excusable neglect” in *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'shp.*, 507 U.S. 380 (1993), as stricter than a “for cause” standard and as an equitable inquiry, taking into account all relevant circumstances. Thus, the court rejects “beyond the debtor's control” and a four-factor test considering circumstances within the debtor's control, progress in plan formulation, whether delays are related to those circumstances, and parties' objections, as the standard and instead adopts an equitable inquiry approach. This approach seeks to balance the goals of speed and access to a realistic plan in applying the standard to the facts of the case and considers the term “justly” to be in accordance with justice, law, or fairness. Here, the debtor's efforts to reach settlements, the positive effect of settlements on a successful plan, the potential for prejudice to all parties in failing to reach an agreement, and the reasonable length of the requested extension all support granting the extension. *In re Trinity Legacy Consortium, LLC*, 2023 Bankr. LEXIS 2349 (Bankr. D.N.M. Sept. 25, 2023).

### 5.3 Classification

### 5.4 Disclosure Statement and Voting

### 5.5 Confirmation, Absolute Priority

- 5.5.a **A subchapter V plan may extend a matured secured loan.** The subchapter V debtor proposed a plan that provided for an extension of a matured secured loan for five years, with a bullet payment at the end of the five-year term. Section 1123(a)(5)(E) permits a plan to provide for the satisfaction or modification of any lien, and section 1123(b)(5) permits a plan to modify a secured creditor's rights (with certain exceptions not relevant here). Nothing in the statute provides a different rule for a loan that has already matured. *Hamilton v. Curiel (In re Curiel)*, 651 B.R. 548 (9th Cir. B.A.P. 2023).
- 5.5.b **Loan reinstatement under section 1124(2) requires payment of default rate interest.** The debtor defaulted on a real estate mortgage loan. The lender imposed the default rate of interest provided under the note. In its chapter 11 case, the debtor wished to propose a plan that reinstated the loan, but cure of past due interest at the default rate was not feasible. Section 1124(2) permits a plan to cure and reinstate a defaulted loan without the creditor's consent but excuses cure of any default of a kind specified in section 365(b)(2). Section 365(b)(2)(D) excuses cure of “a default that is a breach of a provision relating to ... (D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or lease.” Section 1123(d) requires that the amounts necessary under a plan to cure a default must be “determined in accordance with the

underlying agreement and applicable nonbankruptcy law.” Because the specific controls the general in interpreting a statute, the specific exception in section 1124(2) of defaults of a kind specified in section 365(b)(2)(D) provides an exception of the general cure determination language of section 1123(d). Because section 1124(2) refers to defaults “of a kind” specified in section 365(b)(2), it is not limited to defaults in executory contracts or unexpired leases and applies equally to defaults of that kind in loan agreements. Based on its grammatical structure, the legislative history, and the context in which it was enacted, the exception to cure requirements in section 365(b)(2)(D) applies not only to a provision relating to a nonmonetary default, but also to any penalty rate relating to a nonmonetary default. The two references in section 365(b)(2)(D)—to “penalty rates” and to “provisions”—cannot be read separately so that the phrase “relating to a nonmonetary default” modifies only “provisions”; it modifies “penalty rates” as well. Thus, the exception to cure does not apply to penalty rates that are unrelated to a nonmonetary default, and the plan must pay the default interest rate to apply section 1124(2) to the loan. *In re Golden Seahorse LLC*, 652 B.R. 593 (Bankr. S.D.N.Y. 2023).

- 5.5.c **The absolute priority rule applies in an individual chapter 11 case, except with respect to after acquired and exempt property.** The debtor proposed a chapter 11 plan under which he would retain both exempt and nonexempt personal assets. The class of unsecured claims did not accept the plan. Section 1129(b)(2) permits confirmation when a class has not accepted the plan so long as any class junior to the nonaccepting class does not receive or retain any property under the plan. However, if the debtor is an individual, the debtor may retain property “included in the estate under section 1115.” Section 1115 includes, in addition to property specified in section 541, property the debtor acquires after the commencement of the case and the debtor’s earnings during the case. The except clause in section 1129(b)(2) applies only to the additional property section 1115 brings into the estate, not to section 541 property. Therefore, the debtor may retain after acquired property under a cram down plan, but not property acquired prepetition. Although section 1129(b)(2) does not permit debtors to receive or retain any property under the plan on account of their interests, section 1123 and section 1141 address only property of the estate in describing the plan’s contents and effect. Exempt property is not property of the estate, and the debtor does not retain exempt property on account of an interest in the debtor. Therefore, the debtor may retain exempt property under a cram down plan. *In re Joseffy*, 2023 Bankr. LEXIS 2218 (Bankr. S.D. Fla. Sept. 8, 2023).

## 6. CLAIMS AND PRIORITIES

### 6.1 Claims

### 6.2 Priorities

- 6.2.a **ACA Shared Responsibility Payment is a tax.** The debtor did not purchase health insurance and, under the Affordable Care Act, was required to make a Shared Responsibility Payment (SRP) in an amount based on his income. A tax on or measured by income is entitled to priority under section 507(a)(8)(A), but a penalty is not. A tax is a pecuniary burden to support the government. A penalty is a payment as punishment for an unlawful act. The IRS collects the SRP and uses it to fund the government. It targets ordinary taxpayers, is paid through an individual’s tax return, and does not apply to those who are exempt from paying taxes. The amount is not exorbitant compared to traditional income taxes, and tax-like considerations drive the amount. Failure to buy health insurance is not illegal, so it is not like a penalty. Therefore, the SRP is a tax entitled to priority under section 507(a)(8)(A). *I.R.S. v. Juntoff (In re Juntoff)*, 76 F. 4th 480 (6th Cir. 2023).

## 7. CRIMES

## 8. DISCHARGE

### 8.1 General

8.1.a **The discharge injunction does not preempt state law claims for post-discharge collection activities.** The debtor confirmed and performed under a chapter 13 plan, receiving a discharge. His ex-wife, who was also liable on the debtor's mortgage loan, did not file bankruptcy. The mortgage lender continued to call the debtor after the discharge to collect. The debtor later sued the lender under state consumer protection laws for the lender's collection activities. Courts presume Congress does not intend to preempt state law. But Congress may preempt state law explicitly ("express preemption") or may so thoroughly occupy the field as to preempt state law ("field preemption"). If compliance with both federal and state law is impossible or if compliance with state law impedes the execution of the full purposes of federal law, then state law is preempted ("conflict preemption"). The discharge injunction in section 524 does not expressly preempt state law, but it also does not provide an express remedy for its violation. Under section 105(a), the court may sanction a creditor who violates the injunction for contempt. But nothing in the injunction or the remedy prevents a creditor from complying with both the discharge injunction and applicable state debtor protection laws, nor does compliance with those laws stand as an obstacle to the accomplishment of the full purpose of the discharge injunction. Therefore, state debtor protection laws are not preempted by the discharge injunction and its remedies. *Guthrie v. PHH Mort. Corp.*, 79 F. 4th 328 (4th Cir. 2023).

8.1.b **Failure to change credit report from "charged off" to "bankruptcy discharge" may violate the discharge injunction.** After the debtor obtained her discharge, she asked her creditor to change the tradeline on her credit report from "charged off" to "discharged in bankruptcy," claiming that the failure to change the trade line created indirect pressure in violation of the discharge injunction to repay the discharged debt. The creditor refused. She brought an action against the creditor in the bankruptcy court seeking to hold the creditor in contempt for violating the discharge injunction. The discharge injunction under section 524(a) bars any attempt to collect a discharged debt. Under *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019), a party may be held in contempt for violating the discharge injunction only "if there is no fair ground of doubt as to whether the order barred the creditor's conduct." If the debtor's allegation is true, there is little doubt that the failure to correct the tradeline was an indirect attempt to collect a discharged debt, so the debtor adequately stated a claim for contempt. *Bruce v. Citigroup Inc.*, 75 F. 4th 297 (2d Cir. 2023).

### 8.2 Third-Party Releases

### 8.3 Environmental and Mass Tort Liabilities

## 9. EXECUTORY CONTRACTS

9.1.a **Contract with a corporation is not a personal services contract.** The corporate debtor contracted with a television network to produce and deliver a series of shows. The contract gave the network approval rights over key personnel, including "talent, executive producers, showrunner, director, etc.," but did not identify specific individuals for those roles. A debtor in possession may assume and assign an executory contract, except one that is absolutely nonassignable as a matter of applicable nonbankruptcy law. Here, applicable nonbankruptcy law prohibits assignment of a personal services contract without the counterparty's consent. A personal services contract is one in which a special relationship exists between the parties or the particular skill of one of the parties is unique such that no substitute performance could satisfy the contract's requirements. Generally, however, a contract with a corporation is not a personal services contract. Because the debtor is a corporation and the contract does not specify particular

individuals to perform, the contract is not a personal services contract, and the debtor in possession may assume and assign it. *In re Vice Group Holding Inc.*, 652 B.R. 423 (Bankr. S.D.N.Y. 2023).

- 9.1.b **A deferred payment settlement agreement is not an executory contract.** The debtor settled a large claim by agreeing to make installment payments over time. After the debtor completed payments, the creditor would release the claim, but it maintained the claim until the payments were made. Section 365 permits the debtor to assume an executory contract. An executory contract is one under which performance remains due to some extent on both sides, such that a material breach by one party would excuse performance by the other. Under this settlement agreement, the creditor had no obligations it could breach. Therefore, the contract was not executory under section 365, and the debtor in possession may not assume it. *In re Svenhard's Swedish Bakery*, 653 B.R. 471, (9th Cir. B.A.P. 2023).

## 10. INDIVIDUAL DEBTORS

### 10.1 Chapter 13

### 10.2 Dischargeability

### 10.3 Exemptions

### 10.4 Reaffirmations and Redemption

## 11. JURISDICTION AND POWERS OF THE COURT

### 11.1 Jurisdiction

- 11.1.a **Bankruptcy courts are not bound by Article III constraints.** A creditor brought an adversary proceeding against the debtor to determine dischargeability and for judgment on the debt. The creditor also filed a proof of claim for the debt. The bankruptcy court found the debt dischargeable. The parties agreed that determination of a dischargeable debt amount would not be meaningful and so agreed to dismiss the debt determination claim without prejudice so the creditor could appeal the dischargeability determination without having to litigate the debt. Congress granted the bankruptcy courts' appellate courts' jurisdiction only over final orders (with some exceptions not relevant here). Litigation parties may not manufacture finality by agreement, such as by agreeing to dismiss without prejudice one count of a two-count complaint. If the dischargeability order is not final, neither the district court nor the court of appeals would have jurisdiction over an appeal from that partial final judgment. The jurisdiction of the Article III courts, including the district courts and courts of appeal, is limited to cases or controversies. A live (not moot) dispute is a condition to jurisdiction. A dischargeability determination moots the claim determination because the dischargeability determination prevents the creditor from collecting any part of the discharged debt from the debtor. However, the bankruptcy courts are not Article III courts and therefore are not bound by Article III's jurisdictional limits, even though their authority is by referral from the district courts. They may hear and determine moot cases, including the claim determination. As a result, the order dismissing the dischargeability claim, though it mooted the claim determination, did not render the dismissal a final order; there was still more for the bankruptcy court to do in the adversary proceeding, even though the "more" was a moot controversy. Because the bankruptcy court's order was not a final order, the court vacates the district court's ruling on the appeal and dismisses the appeal in the court of appeals. *Kiviti v. Bhatt*, 80 F. 4th 520 (4th Cir. 2023).

- 11.1.b **Bankruptcy court may not certify nationwide class for violation of discharge injunction.** After the debtor obtained her discharge, she asked her creditor to change the tradeline on her credit report from "charged off" to "discharged in bankruptcy," claiming that the failure to change the trade line created indirect pressure in violation of the discharge injunction to repay the

discharged debt. The creditor refused. She brought a nationwide class action against the creditor in the bankruptcy court seeking to hold the creditor in contempt for violating the discharge injunction. The discharge injunction is like any other injunction and brings with it the same enforcement mechanisms. A court may enforce only its own injunction, not an injunction issued by another court. Therefore, the bankruptcy court may not entertain a nationwide class to enforce the injunctions issued by other bankruptcy courts. *Bruce v. Citigroup Inc.*, 75 F. 4th 297 (2d Cir. 2023).

- 11.1.c **Bankruptcy court has related-to jurisdiction over third-party actions that might reduce claims.** A foreign debtor's joint liquidators obtained recognition under chapter 15 in the U.S. A creditor sued numerous entities in the bankruptcy court to avoid and recover transfers from the foreign debtor that the creditor alleged were trust funds the debtor held for the creditor. The court has related-to jurisdiction over any proceeding that could have a conceivable effect on the estate. The creditor's success in the third-party litigation would reduce its allowable claim and thereby potentially increase the dividend payable to other creditors. Therefore, the bankruptcy court has related-to jurisdiction. *Universal Life Ins. Co. v. Lindberg (In re PB Life & Ann. Co., Ltd.)*, 2023 U.S. Dist. LEXIS 132615 (S.D.N.Y. July 31, 2023).
- 11.1.d **Bankruptcy court has jurisdiction to interpret and apply plan exculpation clause.** The debtor's plan terminated its collective bargaining agreement and withdrew from its multi-employer pension plan, triggering substantial withdrawal liability for the debtor and its control persons. Although the plan discharged the debtor, it did not release its control persons from plan withdrawal liability. However, the plan exculpated the control person and his attorneys from any liability "related to any act or omission based on the negotiation, execution, and implementation of any transactions approved by the Bankruptcy Court." The pension plan trustees sued the debtor's control person for the withdrawal liability. The control person sued the law firm that represented him during the chapter 11 case in state court for malpractice, alleging that they failed to negotiate a release and failed to advise him that he was not being released. The law firm removed the action to the bankruptcy court. A bankruptcy court has post-confirmation jurisdiction over any dispute that has a close nexus to the plan or proceeding or that arises in the bankruptcy case. A bankruptcy court may consider the terms of a confirmed plan in determining whether it has post-confirmation jurisdiction. A bankruptcy court always has jurisdiction to interpret and apply the plan's terms. Here, the litigation turns on the effect of the exculpation clause in the plan, which the bankruptcy court may interpret and enforce. In addition, the dispute arose only because of the bankruptcy case and therefore arose in the case under title 11. Therefore, the court has jurisdiction. *Murray v. Willkie Farr & Gallagher LLP*, 2023 Bank. LEXIS 2507 (Bankr. S.D. Ohio. Oct. 5, 2023).
- 11.1.e **Section 1412's venue transfer provision does not apply to a related proceeding.** Prepetition, the debtor sued its union in federal district court for labor law violations. Postpetition, the debtor in possession moved to transfer venue of the action to the district where the bankruptcy case was pending. Section 1412 permits a district court to transfer venue of "a case or proceeding under title 11" to another district. The bankruptcy court has only related-to jurisdiction over the pending proceeding. By its terms, section 1412 applies only to "cases or proceedings under title 11," unlike the broader language in section 1409(a), which specifies proper venue for "a proceeding arising under title 11 or arising in or related to a case under title 11." The narrower language in section 1412 should be construed not to apply to related-to proceedings. Therefore, the general federal venue transfer section, section 1404, applies. *Yellow Corp. v. Int'l Brotherhood of Teamsters*, 2023 U.S. Dist. LEXIS 183598 (D. Kan. Oct. 12, 2023).
- 11.1.f **Bankruptcy court does not have related-to jurisdiction over a fraudulent transfer indemnification claim.** The Ponzi-scheme debtor made payments to an investor, who endorsed the checks to his lessor. The trustee sued the lessor to avoid and recover the payments. The lessor brought a third-party complaint in the bankruptcy court against the investor under an indemnification provision in the lease. A bankruptcy court has related-to jurisdiction over an action that could have any conceivable effect on the estate. That jurisdiction does not generally include a proceeding involving a non-debtor unless the proceeding involves property in which the debtor

or estate has a legally cognizable interest. Here, the estate has no legally cognizable interest in the third-party complaint, and any judgment would direct the investor to pay the lessor, not the trustee. Therefore, the court does not have related-to jurisdiction. *Silverman v. 741 Dyslexington LLC (In re Nat'l Events Holdings, LLC)*, 2023 Bankr. LEXIS 1861 (S.D.N.Y. July 26, 2023).

- 11.1.g **Court denies arbitration involving interpretation of plan exculpation clause.** The debtor's plan terminated its collective bargaining agreement and withdrew from its multi-employer pension plan, triggering substantial withdrawal liability for the debtor and its control persons. Although the plan discharged the debtor, it did not release its control persons from plan withdrawal liability. However, the plan exculpated the control person and his attorneys from any liability "related to any act or omission based on the negotiation, execution, and implementation of any transactions approved by the Bankruptcy Court." The pension plan trustees sued the debtor's control person for the withdrawal liability. The control person sued the law firm that represented him during the chapter 11 case in state court for malpractice, alleging that they failed to negotiate a release and failed to advise him that he was not being released. The law firm removed the action to the bankruptcy court. The law firm's engagement letter with the control person provided for arbitration of any dispute arising from the engagement. The Federal Arbitration Act requires the enforcement of a contractual arbitration clause unless enforcement would inherently conflict with the underlying purpose of another federal statute. Although a court generally does not have discretion to refuse enforcement of an arbitration clause in a noncore proceeding, the court may refuse in a core proceeding if enforcement would inherently conflict with the Code. A conflict would arise if arbitration would defeat the Code's goal of centralized resolution of purely bankruptcy issues, the need to protect against piecemeal litigation, and a bankruptcy court's inherent power to enforce its own orders. Here, the dispute centers on the enforcement of the plan's exculpation clause, which the court approved in the confirmation order. *Murray v. Willkie Farr & Gallagher LLP*, 2023 Bankr. LEXIS 2507 (Bankr. S.D. Ohio. Oct. 5, 2023).

### 11.2 Sanctions

- 11.2.a **Bankruptcy court has inherent sanctions authority.** The foreign representative subpoenaed documents from the individual debtor's attorney, who refused to comply. The attorney brought a motion to quash. The court denied the motion and ordered the attorney to produce the documents by a deadline. Upon granting a consensual extension, the court warned the attorney he would be sanctioned if he did not comply. Again, he refused to comply. The foreign representative brought a sanctions motion, seeking coercive civil contempt sanctions and an award of attorneys' fees, which the court granted after a noticed hearing. Bankruptcy courts have multiple sources of sanctions authority for both contempt and non-contempt violations, such as discovery violations. All courts, including bankruptcy courts, have inherent power to sanction for contempt, which is not governed by rule or statute. Courts also have inherent sanctioning authority in noncontempt circumstances, but that authority is a last resort, must be used sparingly, and must be specifically invoked as the basis for sanctions. Sanctioning an attorney requires a finding of bad faith when the attorney is acting as an advocate for a client rather than as an officer of the court. Section 105(a) applies only to enforcement of the Code, not the Rules, such as Rule 45 governing subpoenas. Unlike Rules 26 and 37, Rule 45 has no enforcement mechanism and does not expressly provide for sanctions. Therefore, to enforce compliance with a subpoena under Rule 45 and finding bad faith, the bankruptcy court properly relied on its inherent authority. *Worms v. Rozhkov (In re Markus)*, 78 F. 4th 554 (2d Cir. 2023).
- 11.2.b **Section 105(a) does not create a private right of action for abuse of process.** After their plans were confirmed, the debtors sued a creditor in bankruptcy court for abuse of process during the bankruptcy case, relying on section 105(a). There is no federal common law tort for abuse of process. A federal private right of action must be explicitly created by Congress. Section 105(a) does not provide a private right of action, except to enforce Bankruptcy Code provisions, such as the automatic stay. A proceeding is core if by its nature it can arise only in the context of a bankruptcy case and is non-core if its existence does not depend on the Code and could proceed in another court. The abuse of process claim exists independent of the bankruptcy case, so the

court does not have core jurisdiction over the claim. The court has related-to jurisdiction if the claim's outcome could have any conceivable effect on the estate. After confirmation, the dispute must have a close nexus to the bankruptcy case or the plan. Here, the claim is unrelated to either, so the court does not have related-to jurisdiction. Accordingly, the court dismisses the case. *Buenviaje v. Charnetsky*, 2023 U.S. Dist. LEXIS 114044 (C.D. Cal. June 29, 2023).

### 11.3 Appeals

### 11.4 Sovereign Immunity

## 12. PROPERTY OF THE ESTATE

### 12.1 Property of the Estate

- 12.1.a **Tort insurance policy proceeds may be property of the debtor when insufficient to pay all tort victims.** The debtor operated a truck that caused a crash, killing two. The survivors of one of the occupants sued the debtor for damages; survivors of the other made a demand on the debtor's insurer for the full policy limits of \$1 million. The insurer paid the demand and informed the plaintiffs that policy limits had been exhausted. The plaintiffs then filed an involuntary petition against the debtor, and after the order for relief, the trustee sued the survivors whom the insurer paid to recover the payment as a preference. A preference is a transfer of an interest of the debtor in property. Although the debtor had no interest in the insurance proceeds, an exception exists in the Fifth Circuit where an insurance policy is insufficient to pay all tort claims the debtor incurred in an accident. Under *Martinez v. OGA Charters, L.L.C. (In re OGA Charters, L.L.C.)*, 901 F.3d 599 (5th Cir. 2018), the insurance proceeds become property of the estate. The same reasoning applies to permit preference avoidance and recovery here, even though the policy proceeds were paid out prepetition. *Law Office of Rogelio Solis PLLC v. Curtis*, \_\_\_ F. 4th \_\_\_, 2023 U.S. App. LEXIS 26621 (5th Cir. Oct. 6, 2023).
- 12.1.b **Avoiding power claims are property of the estate.** The trustee auctioned avoiding power claims. Section 363(b) permits the trustee to sell property of the estate. Property of the estate includes all interests of the debtor in property as of the petition date and any property acquired by the estate after the petition date. Property includes inchoate or contingent interests. Debtors have the right to file a bankruptcy petition, and the debtor in possession or the trustee may file avoidance actions to recover property that the debtor transferred prepetition. Therefore, the debtor has an inchoate interest in the avoidance actions before bankruptcy, which are thus property of the estate under section 541(a)(1). Alternatively, the actions are acquired by the estate after the petition and are property of the estate under section 541(a)(7). In either event, the trustee may sell the avoidance actions. *Pitman Farms v. ARKK Food Co., LLC (In re Simply Essentials, LLC)*, 78 F. 4th 1006 (8th Cir. 2023).
- 12.1.c **Deepening insolvency is a viable damages theory.** The trustee sued former directors for breach of fiduciary duty, claiming that for self-dealing reasons, they prolonged the life of a hopelessly insolvent corporation that had no prospect for survival. The trustee proposed to introduce an expert report on damages that showed the decline in the corporation's value over the period from when the corporation could no longer survive until it ceased operations. Although the Delaware courts have rejected deepening insolvency as a theory of liability, they have not rejected it as a theory of damages. Rather, Delaware decisions suggest they would approve it. If a corporation may recover loss of value caused by breach of fiduciary duty, then one measure of that loss is its deepening insolvency or increasingly negative net worth caused by the breach. Accordingly, the courts admits the expert's testimony. *Kane v. PaCap Aviation Fin., LLC*, 652 B.R. 184 (D. Haw. 2023).

### 12.2 Turnover

### 12.3 Sales

- 12.3.a **Fifth Circuit approves break-up fee as administrative expense.** The debtor in possession obtained court approval to contract with a stalking horse bidder and commit to a break-up fee and expense reimbursement, subject to negative notice and any objections. The DIP reached a stalking horse agreement hours before the auction and so did not have time to provide notice. An overbidder won the auction, and the stalking horse sought payment of the fees. Section 503(b) allows administrative expenses that are actual costs and expenses of preserving the estate. Section 363(b) authorizes use of estate assets outside the ordinary course of business, including for sale expenses. Under Fifth Circuit precedent, section 503(b) is typically backward looking (post-hoc authorization), and section 363(b), which is less stringent, relying on the “business judgment standard,” is typically forward looking (advance authorization). An allowable administrative expense requires a postpetition agreement and actual necessary costs of preserving the estate. It does not require advance court approval. Here, the fee provided actual benefit to the estate, preventing a naked auction and resulting in an overbid. The fee also meets the business judgment standard under section 363(b). *Official Comm. Of Unsecured Creditors v. Bouchard Transp. Co., Inc. (In re Bouchard Transp. Co., Inc.)*, 74 F. 4th 743 (5th Cir. 2023).
- 12.3.b **Purchaser required to bargain with debtor’s union, despite free-and-clear order, based on post-sale conduct.** The debtor had a collective bargaining agreement with its employees. The purchaser bought the debtor’s assets at a section 363 sale free and clear of all interests and obligations, including successorship. After the sale, the debtor in possession rejected the CBA. The purchaser hired nearly all the debtor’s former employees. The union demanded collective bargaining with the purchaser, who declined, based on the sale order. Under federal labor law, a purchaser becomes obligated to bargain with the prior union if the purchaser hires a majority of the seller’s employees. Here, the purchaser did so. That was a post-sale act that was not affected by the sale order. Therefore, the purchaser is required to recognize the union and bargain. *United Steel, Paper and Forestry, Rubber, etc. Union v. Braeburn Alloy Steel LLC (In re CCX, Inc.)*, 2023 U.S. Dist. LEXIS 165086 (D. Del. Sept. 18, 2023).

## 13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

### 13.1 Trustees

### 13.2 Attorneys

- 13.2.a **Sections 326 to 330 preempt any state law action to recover professional fees.** The debtor in possession retained special counsel to pursue litigation. The court ordered the appointment of a chapter 11 trustee. The trustee determined not to pursue the litigation. The plan appointed a liquidating trustee to address claims. Special counsel filed a fee application for work for the debtor in possession and for the chapter 11 trustee. Under *Lamie v. U.S. Trustee*, 540 U.S. 526 (2004), special counsel was no longer entitled to fees for work for the estate performed after the appointment of the chapter 11 trustee. The liquidating trustee objected to the fee application on that ground and on other grounds. Counsel filed an adversary proceeding against the liquidating trustee and his counsel for state law claims of abuse of process, fraud, conspiracy, promissory estoppel, and breach of contract, seeking recovery of any fees that were disallowed plus punitive damages. Conflict preemption exists where a state law actually conflicts with a federal requirement or impedes the execution of a federal law. A conflict deprives the court of subject matter jurisdiction. Here, sections 326 through 330 provide a full procedure for employment of professionals and allowance of their fees. Allowing a professional to bring a separate state law action for fees would directly conflict with the Bankruptcy Code provisions and create an obstacle to the federal plan. Therefore, the court lacks subject matter jurisdiction to hear the action and grants the trustee’s motion to dismiss. *RKF Glob., PLLC v. Nuti Hart LLP (In re Sunergy Cal. LLC)*, 651 B.R. 781 (Bankr. E.D. Cal. 2023).

13.3 Committees

13.4 Other Professionals

13.5 United States Trustee

14. TAXES

15. CHAPTER 15—CROSS-BORDER INSOLVENCIES