Concurrent Session

"Coast to Coast" Hot Topics and Recent Developments

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Educational Materials

2011

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HOT TOPICS AND RECENT DEVELOPMENTS

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DUTIES OF THE BANKRUPTCY COURT

***United Student Aid Funds, Inc. v. Espinosa,* ___ U.S. ___, 130 S.Ct. 1367, 176 L.Ed.2d 158 (2010).** Debtor filed a Chapter 13 case in 1994 and confirmed a plan which provided he would repay the principal, but not the interest, on his 1988 student loans. Notice was given to his student loan lender who did not object to this proposed treatment. In the absence of any objection, the bankruptcy court confirmed debtor's Chapter 13 plan without making the needed undue hardship finding. In addition, debtor never filed an adversary proceeding seeking to discharge his student loans as required by the Federal Rules of Bankruptcy Procedure. Debtor completed his plan payments and received a discharge in 1997. In 2000, lender began to intercept debtor's tax refunds in order to collect the unpaid interest. Debtor sought injunctive relief from the bankruptcy court arguing confirmation of his Chapter 13 plan and his subsequent discharge precluded the collection of the interest. He further argued the interest obligation was discharged upon his completion of his plan payments. The bankruptcy court granted the injunction and denied lender's attempt to appeal the confirmation of debtor's plan as untimely under Federal Rule of Civil Procedure 60(b). On appeal, the district court reversed finding the Chapter 13 plan violated lender's due process rights because the filing of an adversary proceeding was required to obtain a "hardship" discharge of the loans under 11 U.S.C. § 523(a)(8). The 9th Circuit reversed the district court finding lender received sufficient due process when it received notice of the Chapter 13 plan and its provisions. The Supreme Court considered whether Rule 60(b)(4) authorizes a court to relieve a party from a confirmation order that is final. Although it is clear the bankruptcy court committed legal error when it confirmed a plan that provided for a partial discharge of debtor's student loan obligations without the required

undue hardship determination, lender had ample opportunity to object. Mere legal error does not make a judgment void. Accordingly, the Supreme Court ruled Rule 60(b)(4) does not provide a basis for the relief sought by lender. In its opinion, the 9th Circuit criticized those bankruptcy courts that, in the absence of an objection by a creditor, refused to confirm a debtor's proposed plan when it included a discharge of the debtor's student loans. The Supreme Court found this criticism unwarranted. Bankruptcy courts are tasked with approving plans that conform to the requirements of the Bankruptcy Code. As such, the Supreme Court found it appropriate for bankruptcy courts to deny confirmation when plans do not meet the requirements of the Bankruptcy Code notwithstanding creditors' silence.

PROPERTY OF THE ESTATE

***In re Kasparek*, 426 B.R. 332 (10th Cir. 2010).** Wayne Kasparek (the "Father") purchased 80 acres of land. At the Father's direction, the grantor execute a warranty deed to the Father, Jonathan Kasparek, his son and later the debtor ("Jonathan"), and James Kasparek, his other son, as "joint tenants with the right of survivorship and not as tenants in common." The Father paid the full purchase price of the property, leased the property to a farmer (who paid the Father 100% of the property lease), and paid 100% of the property expenses. The Father testified at trial that the purpose of including the names of his sons on the deed was not to bestow a present interest but to insure, upon the Father's death, the property would vest in his sons without probate proceedings. Upon Jonathan's Chapter 7 bankruptcy filing, trustee sought to sell a 1/3 interest in the property. The Father argued Jonathan and his other son held only their interests in an implied trust for the Father's benefit. After applying Kansas law, the 10th Circuit assumed that an implied trust in the property arose for the benefit of the Father. Pursuant to the Kansas recording statutes, an unrecorded or implied trust in real property is subordinate to a trustee's interest as a bona fide purchaser. A hypothetical purchaser would not have had notice of an implied trust because there is no duty under Kansas law to ask each joint tenant regarding the possibility of an implied trust in real estate. Therefore, the 10th Circuit concluded trustee held Jonathan's 1/3 interest free and clear of any equitable interest held by the Father.

***In re Baldwin*, 593 F.3d 1155 (10th Cir. 2010).** Debtor owned a 99% limited partnership interest in a limited partnership created by her father. Debtor's father was the 1% general partner of the partnership which provided full control. Debtor's father testified the

partnership was created for estate planning purposes, although the partnership agreement stated it was for general business purposes, including holding real estate. When debtor filed bankruptcy, the partnership owned 200 acres of land, including a house constructed on the land. Trustee sought declaratory relief that the estate succeeded to the rights of debtor in the partnership and for judicial dissolution of the partnership based on frustration of purpose. In a second adversary proceeding, trustee sought to enforce a buy/sell offer under the terms of the partnership agreement. The bankruptcy court held trustee succeeded to the rights of debtor under the partnership agreement, which was not appealed. Under Oklahoma partnership law, the 10th Circuit determined judicial dissolution was not warranted because there was no frustration of purpose. Based upon Oklahoma partnership law and the partnership agreement, the 10th Circuit determined trustee gave proper notice of withdrawal and of the buy/sell offer. Therefore, trustee's offer was valid and enforceable.

***In re Dittmar*, 618 F.3d 1199 (10th Cir. 2010).** Chapter 7 trustees, in separate bankruptcy cases filed by former union employees of commercial aircraft manufacturer, were entitled to turnover of distributions made to pursuant to debtors' stock appreciation rights (SARs). The 10th Circuit held debtors had contingent property interests in the SARs at the time their respective bankruptcy cases were filed. Although debtors' employer made the distributions to debtors post-petition, the employer had agreed to the equity participation agreement under which the SARs were given in pre-petition collective bargaining agreement negotiated with debtors' union. The fact the SARs were contingent on occurrence of certain post-petition events did not make the SARs mere expectancies. Rather, debtors' employer had a pre-petition contractual obligation to make payments if events occurred, making debtors' interests in the SARs sufficiently rooted in the pre-bankruptcy past and properly part of their bankruptcy estates under 11 U.S.C. § 541.

***In re Catholic Diocese of Wilmington, Inc.*, 432 B.R. 135 (Bankr. D. Del. 2010).** The Bankruptcy Court determined assets that non-debtor participants invested in a pooled investment program operated by debtor on behalf of the diocese were held in a resulting trust but that the participants (with one exception) had failed to carry their burden of tracing those funds as required by the lowest intermediate balance test. This ruling was despite the fact the Diocese kept immaculate records of each non-debtor defendant's deposits and withdrawals. Consequently, the Bankruptcy Court found all the funds in the pooled investment program to be

property of the estate and, while subject to the claims of the non-debtor participants, also subject to the claims of other creditors of debtor's estate. The one exception was St. Ann's Church that had an explicit trust agreement with the diocese and had only one deposit into the trust fund. The lowest intermediate balance of the trust never went below the amount of that single deposit.

BANKRUPTCY SALES

***Mountain Highlands, LLC v. Hendricks*, 616 F.3d 1167 (10th Cir. 2010).** Mountain Highlands, LLC ("Mountain") purchased some ski property from Magnolia Mountain Limited Partnership ("Magnolia"), subject to a mortgage from Signature Capital ("Signature"). Before paying Magnolia in full for the ski property, Mountain filed a Chapter 11 case. The proposed reorganization plan, negotiated among and approved by Magnolia and all creditors except Signature, contemplated a real estate exchange agreement whereby Magnolia agreed to accept certain interests in the ski property in satisfaction of the debt owed to it by Mountain, conditioned on bankruptcy court approval of the plan. A few months later, while the plan was still pending before the court, Mountain filed a motion to sell the ski property out of the ordinary course and free and clear of all claims and interests. Magnolia objected to the proposed sale and asked the bankruptcy court to determine whether Magnolia could receive cash from the sale or whether it was bound by the earlier exchange agreement. The bankruptcy court allowed the sale of the ski property to go forward, but then issued an order denying Mountain's reorganization plan because it lacked feasibility; and did not comply with the Bankruptcy Code. Mountain then sued Magnolia for breach of covenant of good faith and fair dealing; interference with prospective economic advantage; and tort. The covenant of good faith and fair dealing "depends on the existence of an underlying contractual relationship." In this case, the exchange agreement was conditioned upon the court's approval of the reorganization plan. Because the bankruptcy court did not approve the plan, the exchange agreement never took effect, and because there was no effective underlying agreement, you cannot have a breach of the covenant of good faith and fair dealing. There was no evidence Magnolia interfered with the negotiations between Mountain and Signature, and there was no evidence the bankruptcy court rejected the reorganization plan because of the objection of Signature. As such, the claims for interference with economic advantage and tort were denied.

***In re Reliant Energy Channelview LP*, 594 F.3d 200 (3rd Cir. 2010).** Debtors sought to sell their largest asset, a power plant in Texas. Debtors contacted 115 potential purchasers which ultimately resulted in 12 bids. In part because its bid was not contingent on getting financing, Kelson's bid of $468 million was selected. Debtors and Kelson entered into an asset purchase agreement. As part of the asset purchase agreement, Debtors agreed to seek bankruptcy court approval of the sale and to seek an order approving certain bid protections and procedures for Kelson's benefit should the bankruptcy court require an auction. Specifically, a competing bid had to exceed Kelson's offer by $5 million and, if Kelson was not the successful purchaser, it would receive a break-up fee of $15 million plus reimbursement of expenses up to $2 million. Both the sale motion and the bid procedure motion drew objections. The bankruptcy court ordered an auction, approved the $5 million overbid requirement, approved the $2 million expense reimbursement but refused to approve the $15 million break-up fee. After an auction, the bankruptcy court approved the sale to a competing bidder, Fortistar, and Kelson appealed. The district court affirmed the bankruptcy court's ruling and Kelson again appealed. In analyzing whether the bankruptcy court abused its discretion when it denied Kelson a break-up fee, the 3rd Circuit looked to 11 U.S.C. § 503(b) as the sole basis for the award of such fees. 11 U.S.C. § 503(b) permits payment of post-petition administrative expenses *only* for the "actual, necessary costs and expenses of preserving the estate." Finding no compelling reason to treat break-up fees differently, the 3rd Circuit held such fees must be reviewed under the same standard as any other administrative claim, i.e., an administrative claimant must demonstrate the break-up fee was necessary to preserve the value of the estate. If the claimant would bid without such a fee, then the fee was not necessary to preserve the value to the estate. Here, Kelson made its bid without the assurance of a break-up fee. Under these circumstances, the court held the break-up fee was not required to induce the first bid. The question then became whether the break-up fee was needed to preserve Kelson's bid. Because the bankruptcy court believed the break-up fee would deter other bidders, it ruled the detriment to the estate outweighed the benefit. The 3rd Circuit held the bankruptcy court did not abuse its discretion. Kelson also argued that, given creditor support, the bankruptcy court should have approved the fee. Anticipating the Supreme Court's *Espinosa* ruling, the 3rd Circuit held the bankruptcy court was not bound by the unanimity among creditors but by the provisions of 11 U.S.C. § 503(b).

LEASES AND EXECUTORY CONTRACTS

***In re C.W. Mining Co.*, 422 B.R. 746 (10th Cir. BAP 2010), *appeal docketed*, No. 10-4054 (10th Cir. March 4, 2010).** Debtor's non-residential lease of coal mine did not automatically terminate pursuant to lease terms pre-petition or during involuntary gap period and was property of the estate and therefore assumable by Chapter 7 trustee pursuant to 11 U.S.C. § 365. 11 U.S.C. § 541(b)(2)'s exclusion from the estate of any non-residential lease that has "terminated at the expiration of the stated term of such lease during the case" applies to leases which terminate automatically, without further action of the landlord. Because debtor had existing contractual cure rights at the time involuntary petition was filed, termination of the lease by landlord was not complete and lease, along with cure rights, became property of the estate. 11 U.S.C. § 365(c)(1) did not prevent trustee from assuming lease because applicable non-bankruptcy law did not make lease unassignable.

***In re Exide Technologies*, 607 F.3d 957 (3rd Cir. 2010).** Eleven years prior to its bankruptcy filing debtor Exide sold substantially all of its industrial battery business to EnerSys for approximately $135 million. To memorialize the transaction, the parties entered into 23 agreements. Four of these – the Trademark and Trade Name License Agreement, the Asset Purchase Agreement, the Administrative Services Agreement, and a letter agreement – were at issue. Nine years later, Exide decided to re-enter the industrial battery market and wanted to market all of its products under the Exide name, however, EnerSys refused to terminate the Trademark and Trade Name License Agreement. After filing bankruptcy, Exide sought to regain the use of its trademark and trade name by rejecting the agreement as an executory contract. The bankruptcy court granted Exide's motion and the district court upheld the bankruptcy court's order. EnerSys appealed arguing both lower courts erred when they held the contract was executory in nature. While undefined by Congress, the 3rd Circuit (like the 10th Circuit) defines an executory contract as a contract under which the obligation of both the debtor and the other party are so far underperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. The time for making this determination is the petition date. Reviewing the circumstances, the 3rd Circuit ruled ExerSys had substantially performed by paying the full $135 million purchase price, assuming Exide's liabilities under numerous contracts and accounts receivable and operating under the agreements for over ten years. Under the facts before the appellate court there were no material obligations

remaining for ExerSys to perform. Accordingly, the contracts were not executory contracts subject to assumption or rejection. In a concurring opinion, Judge Ambro also addressed the district court's determination that rejection of the Trademark and Trade Name Agreement would have terminated ExerSys' use of the trademark and trade name. In his analysis, he opined that 11 U.S.C. § 365(n)(1) should be applicable to trademarks.

VALUATION ISSUES

***Schwab v. Reilly,* ___ U.S. ___, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010).** Debtor filed for protection pursuant to Chapter 7. On Schedule B – Personal Property, debtor listed cooking and other kitchen equipment to which she assigned a value of $10,718. On Schedule C – Exemptions, relying on two different exemptions, she sought to exempt $10,718 worth of equipment from her estate. Trustee did not object to these exemptions. Subsequent to the deadline for objecting to debtor's exemptions, an appraisal demonstrated the equipment's total market value could be as much as $17,200. Based on this appraisal, trustee filed a motion to sell the equipment, pay debtor $10,718 out of the sale and distribute the net proceeds to her creditors. Debtor objected to trustee's motion on the grounds her schedules put trustee and creditors on notice she intended to simply exempt the actual equipment from her estate. Because trustee failed to object to her claimed exemptions, he was precluded from selling the assets at this late date. Alternatively, debtor sought to dismiss her case. The bankruptcy court denied both trustee's motion to sell the property and debtor's conditional motion to dismiss. Both the district court and the 3rd Circuit affirmed the bankruptcy court's ruling. 11 U.S.C. § 522(l) provides that: "[t]he debtor shall file a list of property that the debtor claims as exempt under [11 U.S.C. § 522(b)]. . . . Unless a party in interest objects, the property claimed as exempt on such list is exempt." 11 U.S.C. § 522(b) permits a debtor to exempt property listed in either 11 U.S.C. § 522(d) or the applicable state exemptions. Virtually all of the property listed in 11 U.S.C. § 522(d) is the debtor's "interest" in the type of property up to a certain dollar value. Similarly, state exemption statutes exempt a debtor's interest in property up to a certain dollar amount; with few exceptions, they do not exempt the actual asset. Debtor argued the phrase "property claimed as exempt" refers to all information set forth on Schedule C, including her estimated valuation of the property. By contrast, trustee argued, because the Bankruptcy Code defines such property as an interest, not to exceed a certain dollar amount, in a particular asset, not the interest itself, the

value of the property claimed exempt should be judged on the dollar value a debtor assigned the *interest*, not on the value a debtor assigned the *asset*. In a 6-3 decision, the Supreme Court agreed with trustee. The flaw in debtor's argument, according to the Supreme Court, is that under her interpretation, a trustee would have been required to object to exemptions which were within the statutory value limits. This would be absurd. Because the actual exemptions look to a debtor's interest in certain property as opposed to the property itself, a debtor may only exempt his or her interest. In ruling for debtor, the 3rd Circuit relied on the Supreme Court's holding in *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992). In *Taylor*, the debtor provided the value of the claimed exemption as "unknown." The issue before the Supreme Court in *Taylor* involved a debtor's claimed exemption which was objectionable on its face. By contrast, in *Schwab*, the claimed exemptions were within the statutory limits and, therefore, not objectionable on their face. Accordingly, the Supreme Court held the 3rd Circuit's reliance on the holding in *Taylor* was misplaced.

***In re Good*, 428 B.R. 235 (E.D. Tex. 2010).** This bankruptcy decision provides a good reminder of the need for consistency. In its schedules, in contesting lender's motion for relief from stay, and throughout a hotly contested confirmation battle, debtor asserted secured lender was oversecured. Then during the claims objection phase of the case, debtor objected to secured lender's claim asserting lender was undersecured. Because confirmation of the plan required the bankruptcy court to determine both the value of secured lender's collateral and whether secured lender was oversecured, judicial estoppel precluded debtor from relitigating the issue.

VOLUNTARY AND INVOLUNTARY CASES

***In re DB Capital Holdings, LLC*, 2010 WL 4925811 (10th Cir. B.A.P. Dec. 6, 2010).** In a recent unpublished opinion, the 10th Circuit BAP affirmed the bankruptcy court's order dismissing a Chapter 11 filing for lack of corporate authority. Debtor was a Colorado LLC managed by a manager. The manager of the LLC filed a petition for relief after secured lender commenced an action for a receivership of debtor's real estate project. The 10th Circuit BAP applied Colorado law to determine whether the manager was authorized to file the Chapter 11 petition. An amendment to the operating agreement of the LLC barred the manager from filing a petition for relief or consenting to an involuntary petition, although the original operating agreement had permitted a filing. The manager of the LLC argued for the invalidation of the

amendment as contrary to public policy because the amendment had been made at the request of the primary secured lender. Both the bankruptcy court and the BAP refused to invalidate the provision. Even without the amendment, both courts determined the operating agreement did not give the manager the ability to file for relief because filing a Chapter 11 was a "radical departure" from the ordinary operation of the business. Although a debtor could carry on business in a Chapter 11, it is not "ordinary" business.

***In re Southern California Sunbelt Developers, Inc.,* 608 F.3d 456 (9th Cir. 2010).** Thirteen entities filed involuntary petitions against two alleged debtors. The thirteen petitioning creditors were controlled by two individuals. After the petitions were dismissed, alleged debtors filed motions against petitioning creditors for costs, attorney's fees and punitive damages under 11 U.S.C. § 303(i). After a month long evidentiary hearing, the bankruptcy court awarded costs and fees in the amount of $745,000 which included the fees and costs associated with alleged debtors' prosecution of the 11 U.S.C. § 303(i) motions. In addition, the bankruptcy court awarded alleged debtors $130,000 in punitive damages. Finally, pursuant to its inherent power, the bankruptcy court held the two controlling individuals jointly and severally liable for all of alleged debtors' attorney's fees and costs. Petitioning creditors and the individuals appealed raising three issues. First, they asserted the bankruptcy court erred by awarding attorney's fees and costs to litigate the 11 U.S.C. § 303(i) motions. In affirming the bankruptcy court's ruling, the 9th Circuit distinguished between sanction statutes and fee-shifting statutes. Sanction statutes or rules, like Fed.R.Bankr.P. 9011, shift the cost only for a discrete portion of the litigation, rather than the cost of the litigation as a whole. The ultimate outcome of the proceeding is irrelevant. Conversely, fee-shifting statutes are dependent upon the outcome of the proceeding and are only triggered if a particular party prevails. Moreover, if triggered, fees and costs for the entire proceeding are awarded, not for a discrete portion. Finding, 11 U.S.C. § 303(i) to be a fee shifting provision, the 9th Circuit held it was appropriate for the bankruptcy court to award alleged debtors' attorney's fees and costs to prosecute the motions. To have held otherwise would have diluted the fee shifting. Appellants' second challenge was focused on the punitive damage award. They argued punitive damages could not be awarded in the absence of actual damages. Relying on the specific language of 11 U.S.C. § 303(i), the 9th Circuit upheld the bankruptcy court's award. Finally, the individuals contended it was improper to make them responsible for alleged debtors' attorney's fees and costs associated with the prosecution of the

11 U.S.C. § 303(i) motions. Because the individuals' liability was based on the bankruptcy court's inherent sanction powers, the 9th Circuit agreed and held the sanctions should be limited to the damages associated with the wrongful act, i.e., the filing of the involuntary petition.

APPOINTMENT OF EXAMINERS

***In re Erickson Retirement Communities LLC*, 425 B.R. 309 (Bankr. N.D. Tex. 2010).** Mezzanine lenders, who were out of the money, filed motion for appointment of examiner under 11 U.S.C. § 1104. The Bankruptcy Court denied motion on two grounds. First, mezzanine lenders were found to have contracted away the right to bring an examiner motion under 11 U.S.C. § 1104. The mezzanine lenders argued they could not contract away their rights under the Bankruptcy Code. Pursuant to the terms of the subordination agreement, the mezzanine lenders "agreed not to '*exercise any rights or remedies or take any action or proceeding to collect or enforce any of the Subordination Obligations'* without 'the prior written consent of the Agent' under the senior secured lenders had been 'fully satisfied.'" *Id*. at 313 (emphasis in original). 11 U.S.C. § 510(a) supports the enforcement of a subordination agreement and the Bankruptcy Court found the parties were sophisticated and well-represented by counsel. Therefore, that agreement would be recognized and enforced. Second, the Bankruptcy Court held, even if the mezzanine lender had the right to bring such a motion, the Court would greatly limit an examiner's authority. The case was well on its way to conclusion and the Bankruptcy Court did not see any value in appointing an examiner, especially considering the multitude of professionals who were then employed by the estate.

PROFESSIONALS

***In re Universal Building Products*, 2010 WL 4642046 (Bankr. D. Del. Nov. 4, 2010)**. Committee counsel was disqualified after an objection to its employment from debtor and the U.S. Trustee. Prior to the formation of the committee, Arent Fox LLP and Elliot Greenlease & Siedzikowski, P.C. (jointly, "Committee Counsel") used a third party, Dr. Haishan Liu, to solicit proxies from Chinese creditors likely to be placed on the committee. Dr. Liu then used those proxies to support hiring Committee Counsel. Neither Committee Counsel nor Dr. Liu had any prior relationship with the creditors Dr. Liu contacted. E-mail traffic between the parties showed they were working together to secure Committee Counsel's employment by the committee. Once

achieved, Committee Counsel recommended hiring Dr. Liu as a translator for the Chinese creditors on the committee. The Bankruptcy Court held this action violated Delaware's Rules of Professional Responsibility (identical to the Model Rules of Professional Conduct), specifically Rule 7.3 which provides attorneys may not cold-call prospective clients unless that person is a lawyer or has a prior relationship with that attorney. "What the Court finds improper in this case is that once [Committee Counsel] learned that Dr. Liu did not represent any creditor on the list, they actively encouraged and assisted him in his efforts to solicit creditors to get their proxies to attend the formation meeting and vote for counsel." *Id*. at 17. The Bankruptcy Court disagreed with debtor's argument that the Committee Counsel was not disinterested because of their prior representation of the creditors for whom Dr. Liu held proxies. "Prior representation, even if adverse to the interests of the committee or unsecured creditors, does not disqualify committee counsel." *Id*. at 26. *See* 11 U.S.C. § 1103(b). Finally, the Bankruptcy Court found Committee Counsel's failure to disclose the full extent of their relationship with Dr. Lui also disqualified them to represent the committee. The fact Committee Counsel supplemented their disclosures was insufficient considering they only did so after the debtor and U.S. Trustee objected to their employment.

PLAN CONFIRMATION ISSUES

In re G-1 Holdings Inc., 420 B.R. 216 (D.N.J. 2009). Among other issues (not discussed here – it is a 60 page opinion), at confirmation, IRS objected to the interest rate on its priority tax claim and that the application of the new value exception to the absolute priority rule was improper. The Court (both the district court and bankruptcy court sitting jointly) was faced with determining the appropriate rate from among three options, eventually deciding to follow the formula approach of *Till v. SCS Credit*. The rate proposed by debtor and approved by the Court was LIBOR plus one percent. IRS was unable to carry its burden of proof of a higher risk adjustment to the base rate. The case demonstrates the difficulty of the *Till* formula approach, and the need for expert witnesses, which is more acute due to the lack of an efficient market to determine a rate. The second notable issue in G-1 was the application of the new value exception to the absolute priority rule. IRS contended the sponsor of the plan was receiving an equity interest on account of its prior ownership which violated the absolute priority rule, in particular the market test required by *LaSalle*. The Court turned the rule on its head by deciding

that the plan sponsor's contributions were "substantial and necessary for the successful reorganization" and that "without these contributions" debtors could not reorganize. Thus, the Court concluded the cash contributions were reasonably equivalent. As to lack of marketing as required by *LaSalle*, the Court determined the asbestos committee held a veto power and voted in favor of the plan. "Thus, the policy behind the absolute priority rule of preventing the debtor from using its exclusivity to prevent creditors from bargaining for a fair and equitable outcome is adhered to here where creditors with co-equal bargaining power stand as joint plan proponents."

***Grede v. Bank of New York Mellon*, 598 F.3d 899 (7th Cir. 2010).** Grede, despite having a wholly inappropriate name for his profession, was the liquidating trustee for Sentinal Management Group, Inc. ("Trustee"). He brought suit against Bank of New York Mellon ("Bank") based on claims that were not part of the bankruptcy estate but had been assigned to Trustee by investors under the terms of the confirmed plan. Bank challenged Trustee's authority to do so as collusive and as being without standing. (Bank styled it as a challenge to standing; however, Judge Easterbrook reminds the reader that "standing" refers to injury, causation and redressability, not authority to bring a suit. *Id*. at 900.) First, the 7th Circuit dismissed the argument that the action was collusive because the assignees could have brought the action in federal court on their own. Collusion could only be found if the claims could only have been brought in state court and assignment would allow them to be brought in federal court. Bank then argued Trustee would be wasting trust assets by bringing third-party complaints. While the Bankruptcy Code would not permit such suits, the confirmed plan governs the Trustee's activity, not the Code. "A liquidation trust is no different in this respect from a reorganized debtor. No one believes that the powers and duties of the managers at United Airlines, which emerged from bankruptcy when the court approved its plan of reorganization in 2006, depend today on the terms of the Code." *Id*. at 902. Thus, the 7th Circuit allowed Trustee to proceed on behalf of the third-party claimants.

EQUITABLE MOOTNESS

***Bank of New York Trust Company, N.A. as Indenture Trustee, et al., v. Official Unsecured Creditors' Committee, et al. (In re Pacific Lumber Co.),* 584 F.3d 299 (5th Cir. 2009)**. In a direct appeal to the 5th Circuit, the indenture trustee for secured note holders challenged confirmation of a joint plan proposed by Marathon, a secured lender, and MRC, a

competitor of the debtors. Because plan consummation was not stayed pending appeal, the 5th Circuit first addressed equitable mootness on each issue. Mootness did not bar the review of (i) the treatment of secured claims, (ii) calculation of administrative priority claims, or (iii) the plan's non-debtor release clauses. However, equitable mootness did bar the review of the treatment of impaired and unsecured classes. The standard for determining whether equitable mootness applies is "(1) whether a stay was obtained, (2) whether the plan has been 'substantially consummate,' and (3) whether the relief requested would affect either the rights of the parties not before the court or the success of the plan." *Id*. at 240.

***Sutton v. Weinman (In re Centrix),* 2010 WL 3490245 (Sep. 8, 2010).** A liquidating Chapter 11 plan was confirmed in consolidated cases from which an appeal was timely filed but no stay obtained. Trustee moved to dismiss the appeal based on equitable mootness due to substantial consummation of the plan. The district court dismissed the appeal and an appeal was filed with the 10th Circuit. While the appeal was pending, the 10th Circuit released its decision in *Search Market Direct, Inc. v Jubber (In re Paige)*, 584 F.3d 1327 (10th Cir. 2009). In the *Search Market* case, the 10th Circuit adopted the equitable mootness doctrine and indicated the factors to be considered. Upon remand to the district court to consider the *Search Market* factors, the district court again dismissed the appeal and a new appeal was pursued. The 10th Circuit established in *Search Market* that the standard of review for equitable mootness is an abuse of discretion and reaffirmed that standard in *Centrix*. In *Search Market*, the 10th Circuit established six factors circuit quoted in *Centrix*. "It seems that under the doctrine of equitable mootness a court should decline to hear an appeal of a bankruptcy court's decision where the answers to the following six questions indicate that reaching the merits would be unfair or impracticable: (1) Has the appellant sought and/or obtained a stay pending appeal? (2) Has the appealed plan been substantially consummated? (3) Will the rights of innocent third parties be adversely affected by reversal of the confirmed plan? (4) Will the public-policy need for reliance on the confirmed bankruptcy plan—and the need for creditors generally to be able to rely on bankruptcy court decisions—be undermined by reversal of the plan? (5) If appellant's challenge were upheld, what would be the likely impact upon a successful reorganization of the debtor? And (6) based upon a quick look at the merits of appellant's challenge to the plan, is appellant's challenge legally meritorious or equitably compelling? 584 F.3d at 1339. We cautioned that '[t]hese six factors are not necessarily conclusive, nor will each factor always merit equal

weight.' *Id*." Upon a review of each factor, the 10th Circuit determined the district court did not abuse its discretion in dismissing the appeal as equitably moot.

AVOIDANCE ACTIONS

***In re TOUSA Inc.*, 422 B.R. 783 (S.D. Fla. 2009).** TOUSA, Inc. was a large homebuilder based in Florida. In June, 2005, it entered into a joint venture with Falcone/Richie LLC. The joint venture was funded by $675 million in loans which TOUSA guaranteed. When the housing market in Florida collapsed, the joint venture defaulted on its loan obligations and the lenders filed suit against TOUSA on its guaranty. The suit was settled a few months later. To fund the settlement, TOUSA and certain of its subsidiaries (which were not guarantors) took on $500 million of new debt secured by blanket liens on all of the subsidiaries' assets. Six months later TOUSA and its subsidiaries filed bankruptcy. During the course of TOUSA's bankruptcy case, the unsecured creditors' committee filed suit against the parties to the settlement agreement seeking to set aside their liens and recover monies paid to the defendants on the grounds that the transfers were fraudulent transfers. In ruling in favor of the unsecured creditors' committee, the Bankruptcy Court found that TOUSA and its subsidiaries were insolvent both before and after the transaction and found the lenders knew or should have know of the precarious financial status of TOUSA and its subsidiaries. The court further found the subsidiaries did not receive reasonably equivalent value in exchange for the liens granted. Accordingly, the Bankruptcy Court ruled the transfers were fraudulent and recoverable.

***Stanley v. U.S. Bank N.A.; National Union fire Insurance v. U.S. Bank N.A. (In re TransTexas Gas Corp.)*, 597 F.3d 298 (5th Cir. 2010).** The 5th Circuit addressed the appeals of two adversary proceedings in this opinion. The first, Stanley, was an appeal from the bankruptcy court's ruling that a severance payment to Stanley, the former CEO was recoverable as a fraudulent transfer or a preferential transfer. TransTexas filed its first bankruptcy case in 1999. As part of its plan of reorganization, TransTexas entered an employment agreement with Stanley under which he would be paid $3 million if he was terminated without cause and $1.5 million if he was terminated with cause. In 2002, the reorganized company was struggling. Despite allegations Stanley was defrauding the company, the board agreed to a Separation Agreement under which Stanley was paid $2.27 million. Debtor's board agreed to the Separation Agreement as a means of getting Stanley to go away quietly before TransTexas filed a second Chapter 11

petition. The 5th Circuit upheld the bankruptcy court's ruling that debtor did not receive reasonably equivalent value in exchange for Stanley's severance payments. "Going away quietly" did not constitute "value" for the estate. The second issue presented to the 5th Circuit was whether the D&O insurance purchased by the debtors covered Stanley's defense costs and the judgment. The bankruptcy court found that this did not constitute a "loss" under the policy as interpreted under Texas law. The policy stated that a "Loss … shall not include … matter which may be deemed uninsurable under the law pursuant to which this policy shall be construed." *Id.* at 309. "Payments fraudulent as to creditors that must therefore be repaid due to bankruptcy court order is a disgorgement of ill-gotten gains and a restitutionary payment." *Id.* at 310.

***In re Moore*, 608 F.3d 253 (5th Cir. 2010).** Prior to his bankruptcy filing, his major creditor, The Cadle Company ("Cadle"), filed suit against debtor, his wife, and two of his business entities asserting debtor had used the business entities to shield his personal assets from creditors. Specifically, Cadle asserted a claim for reverse veil-piercing against the two business entities, fraudulent transfer against debtor's wife and one of the entities, and sought the imposition of a constructive trust against the assets of debtor's wife and the two entities. Before the matter could be resolved, debtor filed a Chapter 7 case. Under his 11 U.S.C. § 544(b) powers, trustee took over the litigation. Because funds were scarce, Cadle continued to fund the litigation. After advancing $60,000 with no resolution, Cadle offered to purchase the claims from the estate and Cadle and trustee entered into negotiations. After the bankruptcy court ruled on the parties' motions for summary judgment, trustee entered into settlement negotiations with defendants. Eventually, trustee entered into a proposed settlement of $37,000. Cadle objected to the proposed settlement and offered to pay $50,000 for the claims. Because the bankruptcy court concluded as a matter of law that trustee could not sell the claims, it approved the proposed settlement. The district court affirmed and Cadle appealed. As a general matter, a trustee may sell causes of action belonging to the estate. Here, Cadle sought to purchase three different types of claims: reverse veil-piercing claims; state law fraudulent transfer claims; and constructive trust recovery claims. Under 5th Circuit precedent, both traditional as well as reverse veil-piercing claims were previously held to be property of the bankruptcy estate. Relying on these prior cases, the 5th Circuit reversed the bankruptcy and district courts and held such claims could be sold to Cadle. The question then became whether trustee could sell the 11 U.S.C. § 544(b) avoidance claims. Recognizing a split amongst the circuits on the question of whether a trustee

may generally sell avoidance actions, the 5th Circuit focused on the narrow issue of whether a trustee could sell causes of actions which he or she inherited from creditors under 11 U.S.C. § 544(b). Because the claims existed outside of bankruptcy, the 5th Circuit reversed the lower courts' ruling that the 11 U.S.C. § 544(b) claims could not be sold. Finally, as to the constructive trust claim, the 5th Circuit held that it was a remedy intertwined with the alter ego and fraudulent transfer claims and could likewise be sold.

***In re Trout,* 609 F.3d 1106 (10th Cir. 2010).** *Trout* involves two appeals consolidated because the same issue was presented. In each case, debtors purchased a vehicle with a loan, but lenders failed to perfect their liens within 30 days of debtors receiving possession. Trustee filed adversaries seeking to: (1) avoid the liens pursuant to 11 U.S.C. § 547(b); (2) recover the value of the avoided liens as of the pre-petition date under 11 U.S.C. § 550(a); and (3) preserve the liens for the benefit of the estate under 11 U.S.C. § 552. On summary judgment, lenders did not contest trustee's ability to avoid the liens and preserve them for the benefit of the estate; rather lenders challenged trustee's right to an additional monetary award. The bankruptcy court held, because the preservation of the lien returned the estate to the position it would have been but for the transfer, there was no need for trustee to recover any property or its value. The 10th Circuit BAP affirmed the bankruptcy court on a slightly different ground. The BAP agreed with the bankruptcy court that the recovery under 11 U.S.C. § 550 was not mandatory but permissive, however, it disagreed with the bankruptcy court's ruling that: (a) the relief under 11 U.S.C. §§ 550 and 551 were mutually exclusive; and (b) the relief under 11 U.S.C. § 550 was completely unavailable in the case of non-possessory lien interests. Rather, the BAP held that there might be circumstances in which 11 U.S.C. § 551 would not put an estate in the position it would have been and some recovery under 11 U.S.C. § 550 would be appropriate. Affirming the BAP, the 10th Circuit pointed to the mandatory language 11 U.S.C. § 551 preserving the lien for the benefit of the estate but the permissive language of 11 U.S.C. § 550 which allows a court to award a monetary recovery. In arguing for a monetary recovery, trustee pointed to the depreciation of the value of the collateral. The 10th Circuit, however, pointed out trustee could always have sold the cars and held the funds pending a resolution of the adversary proceeding.

BANKRUPTCY AND TRIBAL SOVERIEGN IMMUNITY

Tribal Troubles – Without Bankruptcy Relief, ABI Journal, Vol. xxix, No. 10, December/January 2010. Indian tribes are unique in the governmental hierarchy of the United States. 11 U.S.C. § 109 limits those entities entitled to seek relief under the Bankruptcy Code. Federally recognized Indian tribes do not appear to be eligible to file for relief. This is because a federally-recognized Indian tribe does not qualify as a "debtor" eligible for relief under the Bankruptcy Code. 11 U.S.C. § 109 is the exclusive authority on who may be a debtor to obtain relief in bankruptcy. Only a "municipality" or a "person" (each as defined) is eligible to be a debtor under 11 U.S.C. § 109. Indian tribes are not specifically identified in any of the bankruptcy definitions. Accordingly, Indian tribes are sovereign domestic governments ineligible to file petitions for relief under the Bankruptcy Code.

***Breakthrough Management Group, Inc. v. Chukchansi Gold Casino and Resort*, ___ F.3d ___, 2010 WL 5263143 (10th Cir. Dec. 27, 2010).** Management training firm asserted federal infringement and RICO claims against an Indian tribe, the tribe's economic development authority, a casino operated by the tribe for its financial benefit, and various individuals. The district court granted the tribe's motion to dismiss based on sovereign immunity but denied dismissal based on sovereign immunity for the entities related to the tribe. The 10th Circuit reviewed the decision applying six factors (at least for this case because "there is no need to define the *precise* boundaries of the appropriate test …") to determine whether the tribally related entities were entitled to sovereign immunity. The 10th Circuit determined that as subordinate economic entities sovereign immunity applied and remanded to the district court to determine if that sovereign immunity had been waived.