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# 2018 Annual Spring Meeting

## Judges' Hot Topics

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*American Bankruptcy Institute; New York*

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*U.S. Bankruptcy Court (D. Ariz.); Phoenix*

**Hon. Robert D. Drain**

*U.S. Bankruptcy Court (S.D.N.Y.); White Plains*

**Hon. Bruce A. Harwood**

*U.S. Bankruptcy Court (D. N.H.); Concord*



# ROCHELLE'S DAILY WIRE

## Judges' Hot Topics

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### **ABI 36<sup>th</sup> Annual Spring Meeting**

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## Contracting Away the Right to File Bankruptcy



*The Fifth Circuit is being asked to decide whether loan structuring can prevent a borrower from filing bankruptcy.*

## **The Validity of a 'Golden Share' to Bar a Filing Goes to the Fifth Circuit**

The Fifth Circuit is being asked to accept a direct appeal and decide whether a creditor can structure a loan agreement to prevent a borrower from filing bankruptcy, sidestepping the principle that public policy prohibits waiving the right to file bankruptcy.

Bankruptcy Judge Edward Ellington of Jackson, Miss., ruled in December that a creditor with a comparatively small claim who is also a minority equity holder can be given the right, wearing its shareholder hat, to preclude the borrower from filing bankruptcy. Consequently, Judge Ellington dismissed the debtor's chapter 11 petition for lack of proper corporate authorization.

The case raises the question of whether a creditor can utilize a so-called golden share to prevent a borrower from filing bankruptcy. On Jan. 17, Judge Ellington certified the case for direct appeal to the Fifth Circuit.

Judge Ellington said that a "blocking provision or golden share is a relatively new provision created by the credit community in an attempt to work around the prohibition against an entity contracting away the right to file bankruptcy."

### **The Golden Share Structure**

The debtor owned a car rental company. To finance an acquisition, the debtor received a \$15 million investment from a diversified financial group. In return, the investor was given 49% of the debtor's preferred equity.

An affiliate of the investor was a creditor with a \$3 million claim. Judge Ellington said that the investor controlled the affiliate-creditor.

The debtor's Delaware certificate of incorporation included a golden share provision prohibiting the company from filing bankruptcy without consent from the investor wearing its hat as a preferred stockholder.

After the debtor filed a chapter 11 petition, the investor, in its status as the holder of the golden share, filed a motion to dismiss, contending the filing was accomplished without proper corporate



authorization. Judge Ellington granted the motion and dismissed the petition in December when the debtor was in the midst of selling the assets.

#### Caselaw on Golden Shares

Judge Ellington said there are six opinions from bankruptcy courts and one from a district court shedding light on the ability of a golden shareholder to block the filing of bankruptcy. All of the cases are new. The first was handed down in 2007. The six others date from 2014 or later. None reached a circuit court.

All of the seven cases, according to Judge Ellington, begin with the “general premise that the waiving or contracting away the right to file for relief under the Bankruptcy Code is contrary to public policy.” All of the cases, he said, hold that a blocking power held by a creditor is “void as a matter of public policy.”

On the other hand, Judge Ellington said it is “clear” from the cases dealing with “golden shares or blocking provisions” that “either provision will be upheld as valid if it is held by an equity holder.”

Applying the caselaw to the facts at hand, Judge Ellington concluded that the blocking position held by the “substantial equity holder” was “valid and enforceable and . . . not contrary to public policy under federal law.”

Judge Ellington conceded that the investor-creditor wears two hats, as a creditor owed \$3 million and an equity holder with a \$15 million investment. Quoting one of the seven cases, the judge said the equity investor had the “unquestioned right” to block a voluntary bankruptcy.

Judge Ellington also concluded that a golden share or blocking provision in articles of incorporation is not invalid under Delaware law.

Should the Fifth Circuit accept the direct appeal, Judge Ellington tasked the appeals court with deciding three issues: (1) Is a blocking provision or golden share, held by either a creditor or equity holder, invalid as a violation of public policy if it prevents a corporation from filing bankruptcy; (2) if the holder is both a creditor and shareholder, is barring bankruptcy invalid as a violation of public policy, and (3) under Delaware law, may a certificate of incorporation contain a blocking provision or golden share, and if permissible, does Delaware law impose fiduciary duties on the holder in exercising its power?

Enforcing the blocking provision may seem reasonable in a case like this where the equity investment was five times larger than the claim as a creditor. But what if the facts were reversed and the claim was five times larger than the equity investment? Where should the Fifth Circuit draw the line on the ratio between debt and equity? Does the creditor’s control invalidate the



exercise of shareholder rights? Should the bankruptcy court make a finding of fact and decide whether the shareholder was using its blocking power to collect the debt or eliminate the bankruptcy court as a platform where other creditors might sue the shareholder-creditor?

The validity of a golden share in the hands of someone who is both a shareholder and creditor cries out for a bright-line rule, otherwise the outcome of every case will be uncertain and law could develop in different directions around the country, leading to inconsistent results and forum-shopping.

[The December opinion](#) and the [certification of a direct appeal](#) are both in *In re Franchise Services of North America Inc.*, 17-2361, 2018 BL 16789 (Bankr. S.D. Miss. Dec. 18, 2017 and Jan. 17, 2018).



## What Does It Mean to Reject an Executory Contract?



*First Circuit follows the Fourth Circuit's Lubrizol and rejects the Seventh Circuit's Sunbeam.*

## **Circuit Split Deepens on Rejection of Trademark Licenses**

Pointedly disagreeing with the Seventh Circuit, the First Circuit deepened an existing split by adopting the Fourth Circuit's conclusion in *Lubrizol* and holding that rejection of a trademark license agreement precludes the licensee from continuing to use the license.

The 2/1 opinion from the First Circuit on Jan. 12 reversed the Bankruptcy Appellate Panel, which, to the contrary, had followed Circuit Judge Frank Easterbrook's decision in *Sunbeam Products Inc. v. Chicago American Manufacturing LLC*, 686 F.3d 372 (7th Cir. 2012). In *Sunbeam*, the Seventh Circuit rejected the Fourth Circuit's rationale in *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.*, 756 F.2d 1043 (4th Cir. 1985).

In simple terms, the First Circuit's decision means that the licensee of patents can continue using the technology after rejection as a consequence of Section 363(n), but the same licensee cannot continue using trademark licenses that went along with the technology.

### The Genesis of Section 365(n)

In *Lubrizol*, the Fourth Circuit ruled in 1985 that rejection of an executory contract licensing intellectual property halted the non-bankrupt's right to use patents, trademarks and copyrights. Three years later, Congress responded by adding Section 365(n), which, in conjunction with the definition of "intellectual property" in Section 101(35A), provides that the non-debtor can elect to continue using patents, copyrights and trade secrets despite rejection of a license.

The amendment conspicuously omitted reference to trademarks. The Senate Report said that the amendment did not deal with trademarks because the issue "could not be addressed without more extensive study." According to the report, Congress decided to postpone action "to allow the development of equitable treatment of this situation by bankruptcy courts."

Since then, courts have split into two camps. One group takes a negative inference from the omission of trademarks from Section 365(n) by holding that rejection terminates the right to use a trademark, although the licensee could elect to continue using patents covered by the same agreement.

In *Sunbeam*, the Seventh Circuit split with the Fourth in 2012. Judge Easterbrook acknowledged that Section 365(n) does not preserve the right to use trademarks, but at the same



time does not prescribe the consequences of rejection. Judge Easterbrook instead relied on Section 365(g), which teaches that rejection “constitutes a breach” of contract.

Judge Easterbrook reasoned that a licensor’s breach outside of bankruptcy would not preclude the licensee from continuing to use a trademark. He ruled that rejection converted the debtor’s unfulfilled obligations into damages. He said that “nothing about this process implies that any other rights of the other contracting party have been vaporized.” He added that *Lubrizol* has been “uniformly criticized” by scholars and commentators.

#### The First Circuit Case

Before bankruptcy, the debtor in the case before the First Circuit had granted the licensee a non-exclusive, irrevocable, fully paid, transferrable license to its intellectual property including patents. However, the irrevocable license excluded the debtor’s trademarks.

Separately, the license agreement granted a non-exclusive, non-transferable, limited license to use the debtor’s trademarks.

The day after filing a chapter 11 petition, the debtor filed a motion to reject the trademark and patent licenses as executory contracts under Section 365(a). During the ensuing litigation, the debtor conceded that Section 365(n) allowed the licensee to retain its rights in the intellectual property and patents, but not the trademarks.

Ultimately, the bankruptcy court ruled that Section 365(n) did not preserve the licensee’s rights in the trademarks. The bankruptcy judge believed that the omission of trademarks from the definition of intellectual property in Section 101(35A) meant that Section 365(n) does not protect rights in trademarks.

On the first appeal, the BAP followed *Sunbeam* and reversed the bankruptcy court, calling *Lubrizol* “draconian” and saying that rejection does not “vaporize” trademark rights. To read ABI’s report on the BAP opinion, [click here](#).

With regard to trademarks, Circuit Judge William J. Kayatta, Jr. reversed the BAP in a 2/1 opinion, holding that the right to use trademarks did not survive rejection.

Judge Kayatta said that *Sunbeam* “largely rests on the unstated premise that it is possible to free a debtor from any continuing performance obligations under a trademark license even while preserving the licensee’s right to use the trademark.” That premise, he said, is wrong because “effective licensing of a trademark” requires the licensor to continue monitoring and exercising control over the quality of the goods sold under the mark.



*Sunbeam* is wrong, in Judge Kayatta’s view, because it “entirely ignores the residual enforcement burden it would impose on the debtor just as the Code otherwise allows the debtor to free itself from executory burdens” and “invites further degradation of the debtor’s fresh start options.”

Judge Kayatta therefore favored “the categorical approach of leaving trademark licenses unprotected from court-approved rejection, unless and until Congress should decide otherwise.”

#### The Dissent

Circuit Judge Juan R. Torruella dissented with regard to trademarks. Like *Sunbeam*, he would have held that rights in a trademark “did not vaporize” as a result of rejection.

Judge Torruella based his dissent in large part on the legislative history surrounding the adoption of Sections 363(n) and 101(35A). He saw Congress as allowing courts to use their equitable powers to protect trademark licensees.

Rather than eviscerating the licensee’s trademark rights, Judge Torruella said he instead would “be guided by the terms of the [license agreement], and non-bankruptcy law, to determine the appropriate equitable remedy of the functional breach of contract.”

#### Distribution Rights

The litigation in bankruptcy court also involved the debtor’s license of distribution rights. Affirmed by the BAP, the bankruptcy court had ruled that rejection cut off distribution rights too.

On appeal in the circuit, the licensee mounted several creative arguments aimed at showing that distribution rights were an adjunct to the patents and technology and therefore should survive.

Judges Kayatta and Torruella agreed that rejection cut off distribution rights.

#### The Next Steps

If the licensee does not throw in the towel, the next step will be a petition for rehearing *en banc* or a petition for *certiorari*. The circuit split pits not only the First Circuit against the Seventh. In his concurrence in *In re Exide Technologies*, 607 F.3d 957, 964 (3d Cir. 2010), Third Circuit Judge Thomas L. Ambro reached the same result as the Seventh Circuit on much the same reasoning.

[The opinion is](#) *Mission Product Holdings Inc. v. Old Cold LLC (In re Old Cold LLC)*, 879 F.3d 376 (1st Cir. Jan. 12, 2018).



## Is a Release the Equivalent of a Final Judgment?



*Delaware bankruptcy judge disagrees with district court on final adjudicatory power to include third-party releases in confirmation orders.*

## **Bankruptcy Court Finds Constitutional Power to Grant Releases in Confirmation Orders**

On remand from the district court in *Millennium Lab Holdings*, Bankruptcy Judge Laurie Selber Silverstein of Delaware decided that a bankruptcy court has constitutional power to enter a final order granting non-consensual, third-party releases of non-bankruptcy claims as part of a chapter 11 confirmation order.

Written with a passion suggesting it may be the most important decision of her career, Judge Silverstein's 69-page opinion on Oct. 3 concludes that the limitations on the constitutional power of a bankruptcy court under *Stern v. Marshall* are altogether inapplicable to granting third-party releases because a confirmation order exclusively implicates questions of federal bankruptcy law and raises no issues under state or common law.

Ordering remand in March, District Judge Leonard P. Stark of Delaware implied, without explicitly holding, that a bankruptcy court should only make proposed findings and conclusions when granting third-party releases as part of a chapter 11 confirmation order. Sending the case back to Judge Silverstein, he told her to consider the question of constitutional power and also decide whether the appellant had waived *Stern* objections.

In her Oct. 3 opinion, Judge Silverstein persuasively ruled that the appellant had waived *Stern* objections by never raising the issue during the confirmation process. If there is another appeal, Judge Stark and even the Third Circuit could uphold confirmation just on the issue of waiver and never reach the broader *Stern* questions given the principle that courts should not make constitutional rulings when a case can be decided on another ground.

Consequently, *Millennium Lab Holdings* may leave the constitutional issue undecided at the appellate level. Until the question is starkly raised and decided, parties will proceed at their peril if they consummate plans with releases based only on the bankruptcy court's confirmation order.

### The Facts

The chapter 11 debtor, Millennium Lab Holdings II LLC, obtained a \$1.825 billion senior secured credit facility and used \$1.3 billion of the proceeds before bankruptcy to pay a special dividend to shareholders.



Indebted to Medicare and Medicaid for \$250 million that it could not pay, Millennium filed a chapter 11 petition along with a prepackaged plan calling for the shareholders to contribute \$325 million in return for releases of any claims that could be made by the lenders. The plan did not allow the lenders to opt out of the releases.

Before confirmation, a lender holding more than \$100 million of the senior secured debt filed suit in district court in Delaware against the shareholders and company executives who would receive releases under the plan. The suit alleged fraud and RICO violations arising from misrepresentations inducing the lenders to enter into the credit agreement.

Over objection, Judge Silverstein confirmed the plan and approved the third-party releases. The dissenting lender appealed.

Having consummated the plan, Millennium filed a motion to dismiss the appeal on the ground of equitable mootness, because the plan had been consummated in the absence of a stay pending appeal.

#### District Judge Stark's Remand

Arguably for the first time, the objecting lender contended on appeal that the bankruptcy court lacked constitutional power to enter a final order granting third-party releases. Although the bankruptcy court had clearly found "related to" jurisdiction to impose the releases, District Judge Stark concluded that the bankruptcy court had not been called on to decide whether it had power under *Stern* to enter a final order including the releases.

To most readers, Judge Stark's decision in March implied, without holding, that granting the releases was beyond the bankruptcy court's constitutional power. Among other things, Judge Stark said that the objecting lender was entitled to an Article III adjudication because the releases were "tantamount to resolution of those claims on the merits against" the lender.

Rather than rule on a constitutional issue that had not been developed in the lower court, Judge Stark remanded the case for Judge Silverstein to decide whether she had final adjudicatory authority, either as a matter of constitutional law or as a consequence of the lender's waiver. If there were no power to make a final order, Judge Stark said that Judge Silverstein could submit proposed findings and conclusions or strike the releases from the confirmation order.

To read ABI's discussion of Judge Stark's opinion, [click here](#).

#### Granting Releases Is a 'Core' Bankruptcy Power

Ruling after remand, Judge Silverstein didn't keep the reader in suspense. On the second page of her opinion, she said there is constitutional power to grant releases in a confirmation order. To



rule otherwise, she said, would go “far beyond the holding of any court” and “dramatically change the division of labor between the bankruptcy and district courts.”

Judge Silverstein found circuit court support for her conclusion. She cited post-*Marathon Pipeline* but pre-*Stern* decisions from the Seventh and District of Columbia Circuits finding constitutional power to grant third-party releases in a confirmation order.

Post-*Stern*, Judge Silverstein found support from two Third Circuit opinions for the proposition that a bankruptcy court can issue a final order on a core issue that has preclusive effect on a third party’s lawsuit: *In re Lazy Days’ RV Center Inc.*, 724 F.3d 418 (3d Cir. 2013), and *In re Linear Electric Co.*, 852 F.3d 313 (3d Cir. March 20, 2017). She emphasized a statement in *Lazy Days’* that *Stern* is “plainly inapposite” where the debtor sought relief “based on a federal bankruptcy law provision with no common law analogue.”

More recently, Judge Silverstein cited bankruptcy court decisions from Boston and White Plains, N.Y., finding constitutional power to grant third-party releases in confirmation orders.

Adopting even the broadest interpretation of *Stern*, Judge Silverstein said that confirming a plan with releases “does not rule on the merits of the state law claims being released.” Therefore, she said, “*Stern* is inapplicable as confirmation of a plan is not a state law claim of any type.”

To the contrary, Judge Silverstein said, a bankruptcy court has final adjudicatory power because the court “is applying a federal standard” to ensure that the releases “comply with applicable provisions of the Bankruptcy Code.”

In short, there is no contravention of *Stern* because the bankruptcy court is making a determination on confirmation based entirely on federal bankruptcy law, where there is statutory core power under 28 U.S.C. § 157(b)(2)(L). The fact that confirmation bars a creditor’s state law claims against a third party is merely incidental.

Indeed, the incidental effect on third-party claims is the gist of the issue. Judge Silverstein pointed out the consequences of making *Stern* applicable to plans with third-party releases.

If there were no final adjudicatory power in the confirmation context, Judge Silverstein said that bankruptcy courts could no longer make Section 363 sale orders insulating buyers from successor liability. Similarly, bankruptcy courts would lack power, she said, to order substantive consolidation, bar annual shareholders’ meetings, recharacterize debt as equity, or subordinate claims.

On the question of the waiver of *Stern* objections under *Wellness International*, Judge Silverstein thoroughly analyzed the record to conclude that the objecting lender never raised the constitutional question during or even after the confirmation process.



Her original ruling on confirmation did not deal with final adjudicatory power because any reference to *Stern* was so oblique that neither the court nor the parties understood that a constitutional issue was afoot. Citing the *Wellness International* prohibition of sandbagging, Judge Silverstein said that the lender could not lie in the weeds and raise constitutional infirmities for the first time on appeal.

On the ground of waiver alone, Judge Silverstein found that she was entitled to enter a final order.

[The opinion is](#) *In re Millennium Lab Holdings II LLC*, 15-12284, 575 B.R. 252 (Bankr. D. Del. Oct. 3, 2017).



## Erosion of the Fundamental Principles of Bankruptcy Law



*Circuits are split on whether inaction is an 'act' that violates the automatic stay.*

## **Tenth Circuit Direct Appeal to Decide Whether the Automatic Stay Is Really Automatic**

The Tenth Circuit has just granted a direct appeal involving a deepening split where a minority of two circuits held that the automatic stay is not automatic.

In *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017), the Tenth Circuit held that passively holding an asset of the estate, in the face of a demand for turnover, does not violate the automatic stay in Section 362(a)(3) as an act to “exercise control over property of the estate.” *Cowen* was important, because it means that debtors in chapters 7, 11, 12 and 13 cannot recover their repossessed vehicles in six states without mounting a turnover action. It also means that businesses in chapter 11 cannot immediately resume operations if property was repossessed before filing.

In substance, the Tenth Circuit held that the automatic stay is not really automatic. Latching onto the words “any act” in Section 362(a)(3), the appeals court held that inaction is not an act and thus cannot violate the automatic stay.

The Tenth Circuit in *Cowen* sided with the D.C. Circuit. The Second, Seventh, Eighth, Ninth and Eleventh Circuits hold the opposite, having ruled that a lender or owner must turn over repossessed property immediately or face a contempt citation.

The case being directly appealed to the Tenth Circuit is *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-5006, 2017 BL 235622 (Bankr. D. Kan. July 7, 2017), decided in July by Bankruptcy Judge Robert E. Nugent of Wichita, Kan. Forced to rule contrary to two prior decisions of his own, Judge Nugent reluctantly held that the automatic stay did not prevent a statutory worker’s compensation lien from attaching automatically after bankruptcy to a recovery in a lawsuit. In other words, the lien attached to after-acquired property despite the policy evident in Section 552(a).

The chapter 13 trustee in *Garcia* appealed and obtained a certification of direct appeal from the district court without opposition. On Nov. 20, the Tenth Circuit granted a direct appeal.

The trustee’s petition for direct appeal said that *Cowen* “deepened an existing split in the Circuit Courts” and “has been criticized by a bankruptcy court and commentators.” The trustee cited the American Bankruptcy Institute among those who criticized *Cowen*.



The trustee in *Garcia* may mount a frontal assault on *Cowen*, but the upcoming three-judge panel in the Tenth Circuit might attempt to narrow *Cowen*. To the extent that the three judges rely on *Cowen*, they nonetheless will have laid the groundwork for an *en banc* rehearing to set aside *Cowen* entirely.

Preferably, the Tenth Circuit should address *Cowen en banc*, because attempting to narrow *Cowen* will result in increased complexity and a lack of predictability in how the Tenth Circuit might rule under slightly different circumstances.

To read ABI's discussion of *Cowen* and *Garcia*, [click here](#) and [here](#).

The direct appeal is *Davis v. Tyson Prepared Foods Inc. (In re Garcia)*, 17-611 (10th Cir.).



*Tenth Circuit joins the minority by holding that passive retention of collateral is no stay violation.*

## **Circuit Split Widens on Stay Violation for Failure to Turn Over Repossessed Collateral**

The Tenth Circuit widened an existing split among the courts of appeals by ruling that passively holding an asset of the estate, in the face of a demand for turnover, does not violate the automatic stay in Section 362(a)(3) as an act to “exercise control over property of the estate.”

The Tenth Circuit allied itself with the District of Columbia Circuit. The Seventh, Second, Ninth and Eighth Circuits are arrayed on the other side and hold that retention of estate property after demand for turnover does violate the automatic stay.

Taking the minority position, the Feb. 27 opinion authored by Circuit Judge Monroe G. McKay was based on the plain meaning of the statute, not on “policy considerations.”

Before bankruptcy, a lender repossessed the debtor’s truck. After filing a chapter 13 petition, the debtor requested the return of the truck. The creditor refused, claiming he had sold the truck before the bankruptcy filing.

A month later, the debtor moved to hold the creditor in contempt for willful violation of the automatic stay. The bankruptcy court granted the motion and directed the creditor to turn the truck over immediately, coupled with a warning that failure to do so could result in imposition of monetary damages for willful violation of the stay under Section 362(k)(1).

When the creditor did not comply, the debtor initiated an adversary proceeding. At trial, the creditor contended there was no stay violation because the debtor’s ownership interest was terminated by the sale before bankruptcy.

The bankruptcy judge ruled that documents showing a sale of the truck were “likely forged.” The judge also said that the creditor “gave perjured testimony.” Even if the testimony were correct, the bankruptcy judge held that the debtor’s ownership had not been terminated properly under Colorado law.

The bankruptcy judge concluded that the creditor violated Section 362(a)(3) and imposed actual and punitive damages under Section 362(k)(1). On appeal, the district court set aside the calculation of damages but otherwise upheld the bankruptcy court.



The creditor came out on top in the Tenth Circuit in terms of statutory interpretation, but it might not escape sanctions.

Judge McKay described the “majority rule” as saying that “the act of passively holding onto an asset constitutes “exercising control” over it, and such action violates Section 362(a)(3),” quoting the Seventh Circuit in *Thompson v. General Motors Acceptance Corp.*, 566 F.3d 699, 703 (7th Cir. 2009). He described the majority as “driven more” by “practical” and “policy considerations” than by “faithful adherence to the text.”

Concluding that the language of the statute is “plain,” Judge McKay aligned the Tenth Circuit with the D.C. Circuit’s *U.S. v. Inslaw*, 932 F.2d 1467 (D.C. Cir. 1991).

Observing that the statute bars “any act to exercise control over property,” Judge McKay said that “act” means “to ‘take action’ or ‘do something.’” Because the stay enjoins “doing something,” he said, “It does not cover ‘the act of passively holding onto an asset.’”

Significantly also, Judge McKay said that Section 362(a)(3) does not “impose an affirmative obligation to turnover property.”

Judge McKay conceded that the majority’s “best argument” is for reading Section 362(a)(3) in tandem with Section 542, which provides that someone in “control” of estate property “shall deliver” it to the trustee. Arguably, Section 542 provides a right to return, while Section 362 imposes a sanction for failure to do so.

Judge McKay said that the majority’s “policy argument” in combining the two sections “is simply not supported by the statute’s text or its legislative history,” in part because there is “no textual link between Section 542 and Section 362.”

The opinion adopted “the minority rule: only affirmative acts to gain possession of, or to exercise control over, property of the estate violate Section 362(a)(3).”

Judge McKay said that his statutory interpretation may not absolve the creditor of liability for damages. On remand, he instructed the bankruptcy court to employ Sections 362(a)(3) and 105(a), which give power to “sanction conduct abusive of the judicial process.”

He said that the bankruptcy court’s finding that the creditor likely forged documents and gave perjured testimony “would qualify as post-petition acts to exercise control over the debtor’s property in violation of the automatic stay.”

The Tenth Circuit does not seem to undercut the notion that the debtor retains the right to recover possession of repossessed property if title has not transferred. The opinion could be



interpreted to mean that a creditor need not heed a demand for turnover but may await entry of a turnover order.

Consequently, debtors who lose possession of their cars before filing may now be obliged in the Tenth Circuit to initiate legal proceedings to recover possession. In other circuits, bankruptcy has the virtue of enabling debtors to recover repossessed autos immediately because lenders know they face contempt sanctions if they do not cooperate.

The opinion has a beneficial feature: It removes the need for courts to explain why a bank's "administrative freeze" does not violate the automatic stay.

The opinion includes a holding favorable to debtors. In the case at hand, the bankruptcy court dismissed the chapter 13 petition because loss of the truck bereft the debtor of ability to generate regular income.

Judge McKay held that jurisdiction to impose damages under Section 362(k) continues after dismissal because a "court must have the power to compensate victims of violations of the automatic stay and punish violators, even after the conclusion of the underlying bankruptcy case," citing [\*Johnson v. Smith \(In re Johnson\)\*](#), 575 F.3d 1079, 1083 (10th Cir. 2009).

[The opinion is](#) *WD Equipment v. Cowen (In re Cowen)*, 849 F.3d 943 (10th Cir. Feb. 27, 2017).



## To Circumvent *Baker Botts*, It Matters Where You File



***Baker Botts v. ASARCO doesn't prohibit retention agreements allowing fees for defense of fees, judge holds.***

## **Retention Agreements Allowing Defense Fees Ok in New Mexico, but Not in Delaware**

A company planning a contentious reorganization should consider filing chapter 11 in Albuquerque, N.M., because a judge there will permit retention agreements allowing compensation for successful defense of professionals' fee applications.

An oil field contractor with about \$5.5 million in assets and liabilities filed a chapter 11 petition and sought authority to retain counsel under an engagement agreement that included compensation for successful defense of the attorneys' fee applications. The U.S. Trustee and the creditors' committee objected to the fee-defense provision, citing [\*Baker Botts LLP v. Asarco LLC\*](#), 135 S. Ct. 2158, 192 L. Ed. 2d 208, 83 U.S.L.W. 4428 (2015), and [\*In re Boomerang Tube Inc.\*](#), 548 B.R. 69 (Bankr. D. Del. 2016).

In his Sept. 20 opinion, Bankruptcy Judge David T. Thuma analyzed whether *ASARCO*, which disallowed defense fees under Section 330(a)(1), also precludes the inclusion of a fee-defense provision in a retention agreement under Section 328(a). He concluded, "*ASARCO* does not hold that a fee defense provision can never be a 'reasonable term' under Section 328(a)."

*ASARCO* involved a case where the bankruptcy court awarded debtor's counsel \$5.2 million for successfully defending its fees. The lawyers' retention was under Section 327, and the allowance of fees was governed entirely by Section 330, because the attorneys had no agreement with the debtor for payment of defense fees that might bring the case under the umbrella of Section 328.

Judge Thuma parsed *ASARCO*, a 6/3 decision, and found that Justice Clarence Thomas disallowed defense fees because the "services" benefitted only the lawyers, not the estate.

Next, Judge Thuma analyzed *Boomerang*, where Delaware Bankruptcy Judge Mary F. Walrath refused to approve a retention application requiring the debtor to compensate committee professionals for successfully defending their fees. She barred the use of Section 328 as a vehicle for paying defense costs because it, like Section 330(a), was not a "specific and explicit statute" overriding the American Rule against fee-shifting. Section 328 permits the court to approve retentions "on any reasonable terms and conditions of employment."

The *Boomerang* committee contended that the engagement agreement fell under the so-called contract exception to the American Rule, allowing parties by contract to agree that the losing side



pays everyone's lawyers. The argument was flawed, Judge Walrath said, because the debtor was not a party to the retention agreement. Even if the contract exception applied, Judge Walrath said she could not approve it because fee-defense costs would not entail any services for the committee, only benefit the lawyers themselves.

Judge Thuma disagreed with *Boomerang*. If the terms of employment have been approved by the court under Section 328(a), he said that the "professional's compensation is governed by those terms and conditions, rather than the general [reasonable compensation] language of Section 330(a)(1)(A)."

Judge Thuma noted that *ASARCO* did not involve a fee-defense provision in a retention agreement approved under Section 328(a). He then analyzed whether defense costs can be a "reasonable" term of employment.

Reasonable employment terms are not only those that benefit the client. Retention agreements, he said, will contain many provisions that benefit the lawyers as well. Even provisions that benefit lawyers also provide indirect benefit for the client because "the client obtains the services of needed, able professionals," Judge Thuma said.

Pre-*ASARCO*, Judge Thuma said that the experience in his district in paying successful defense costs had "been good for the most part," because "objections to fee applications have been limited to *bona fide* disputes, and the fee defense costs have been reasonable."

Unless *ASARCO* requires it, Judge Thuma said there "is no need to change the system," which "has worked pretty well." He did not read *ASARCO* "as mandating a change, if a properly drafted employment term is timely presented to the court and approved under Section 328(a)."

Judge Thuma ended his opinion by laying down criteria under which he would approve defense costs. Among other things, the debtor must approve them, committee counsel must be similarly protected, and fees will not be allowed for an unsuccessful defense.

[The opinion is](#) *In re Hungry Horse LLC*, 574 B.R. 740 (Bankr. D.N.M. Sept. 20, 2017).



## Where Does Tolerance for Marijuana Emanate? Ninth Circuit, of Course.



*Debtor must violate criminal law to justify dismissal, concurring opinion says.*

## **Ninth Circuit BAP Backs Away from Automatic Dismissal of 'Marijuana' Cases**

Now that about half the states have some form of legal marijuana sales, Bankruptcy Appellate Panel Judge Maureen A. Tighe of Woodland Hills, Calif., wrote a concurring opinion saying that the court should not reflexively dismiss a bankruptcy just because there is marijuana on the premises.

The debtor was a blind, 92-year-old woman living in an assisted living facility. She owned a small shopping center where one of the tenants was a marijuana dispensary operating legally under state law but not federal law. She filed a chapter 13 petition to halt foreclosure and sell the property.

*Sua sponte*, the bankruptcy judge dismissed the case because the debtor had received post-petition rent from the dispensary. The unanimous Ninth Circuit Bankruptcy Appellate Panel reversed and remanded on Feb. 5, because the bankruptcy judge had not made adequate findings of fact and stated legal conclusions indicating the grounds for dismissal.

Judge Tighe's concurring opinion is noteworthy. Before dismissing, she explained that the bankruptcy court must find that the debtor is violating the federal Controlled Substances Act. She noted that the debtor's plan "did not necessarily require rental income" from the dispensary.

Rather, the plan called for selling the shopping center and using the proceeds to pay creditors in full. In the meantime, the debtor intended to reject the lease and evict the dispensary.

Judge Tighe focused on 21 U.S.C. § 856(a)(2), which prohibits someone from knowingly and intentionally allowing property to be used for the distribution of drugs. The criminal statute also requires a showing that the primary or principal use of the property is for the distribution of drugs.

Judge Tighe explained why the debtor had not necessarily violated criminal law.

To violate the law, she said, there must be evidence that the debtor herself knew that the tenant operated a dispensary or that she intentionally allowed that use.

The debtor's son was her attorney-in-fact and managed the shopping center. Judge Tighe said the record did not show when the debtor became aware of the illegal activities. In addition, she said, her son's knowledge could not be imputed to the debtor.



In sum, Judge Tighe said that “the presence of marijuana near the case should not cause mandatory dismissal.” Her opinion suggests that a debtor might escape dismissal by refusing to accept rent from a marijuana business after filing and move to reject a lease. A problem could arise if the marijuana operator exercises the right under Section 365(h) to remain in possession after rejection.

Judge Tighe was sitting on the BAP by designation.

[The opinion is](#) *Olson v. Van Meter (In re Olson)*, 17-1168 (B.A.P. 9th Cir. Feb. 5, 2018).



## Do Chapter 13 Debtors' Rights Include Section 108?



*Courts split on whether Section 108(a)  
extension of statutes of limitations applies  
to chapter 13 debtors.*

## **Section 108(a) Time Extension Held Not Applicable to Chapter 13 Debtors**

On an issue where bankruptcy courts are divided, Bankruptcy Judge Bruce A. Harwood ruled that the two-year extension of the statute of limitations does not apply to an adversary proceeding initiated by a chapter 13 debtor.

Nine months after a couple filed their chapter 13 petition, they sued a bank for allegedly overcharging them and generally botching the servicing of their modified mortgage. The bank responded with a motion to dismiss, contending that the debtors' various claims under state and federal law were barred by statutes of limitations.

In his February 7 opinion, Judge Harwood said that the complaint would be timely if the two-year expansion of the statutes of limitations under Section 108(a) applied to the chapter 13 debtors' claims.

If a statute of limitations would expire after filing, Section 108(a) says that "the trustee may commence such action only before the later of (1) [the date when the statute would expire on its own or] . . . (2) two years after the order for relief."

The courts are split, Judge Harwood said. He cited decisions from Texas, Virginia and Louisiana for holding that Section 108(a) only applies to a chapter 13 trustee. He cited courts from California, Washington, D.C., and Pennsylvania as allowing chapter 13 debtors to benefit from the two-year extension.

Judge Harwood concluded that "the better reasoned decisions are those that hold that Section 108(a) cannot be used by chapter 13 debtors to toll the time period for commencing an action."

"By its very terms," he said, Section 108(a) "applies to actions that may be commenced by 'a trustee,' not to actions commenced by a 'debtor.'"

Although the debtors otherwise might have stated some claims that would survive dismissal, Judge Harwood was required to dismiss the adversary proceeding because "chapter 13 debtors are not entitled to the protections of Section 108(a)."

In similar cases where the statute of limitations is a problem, debtors should consider persuading the chapter 13 trustee to join the suit as an additional plaintiff or stipulate that the debtor



may sue in the trustee's name, with recoveries earmarked for the chapter 13 estate. If the trustee declines, a chapter 13 debtor could take a page out of the chapter 11 playbook by filing a motion for permission to sue in the trustee's name, just like chapter 11 creditors' committees obtain permission to sue directors and officers when the debtor obviously will not. We do not warrant whether any of these alternative procedures will prevail.

[The opinion is](#) *Hatton v. TD Bank NA (In re Hatton)*, 17-1053 (Bankr. D. N.H. Feb. 7, 2018).