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2019

43rd Annual Alexander L. Paskay Seminar
Judicial Merry-Go-Round!

JUDICIAL PARTICIPANTS:	HOT TOPIC:
Hon. Caryl E. Delano (Tpa/Ftm)	Chapter 11 Disclosure Statements: Tips and Tricks
Hon. Shon Hastings (ND)	Adequate Protection: How to Prove Your Case
Hon. Cynthia C. Jackson (Orl)	Tips for Proving Damages for Stay Violations
Hon. Catherine P. McEwen (Tpa)	Mind Your Manners: Discovery Etiquette and the Consequences of Being a Glutton
Hon. Mindy A. Mora (Wpb)	Getting Paid - Practical Tips to Improve Your Fee Application
Hon. John K. Olson (Ftl)	Oral and Written Advocacy
Hon. Charles M. Walker (TN)	Post *Transwest* Analysis: Does 1129(a)(10) Require an Impaired Accepting Class Per Plan or Per Debtor?
Hon. Michael G. Williamson (Tpa)	What's Hearsay and What's Not

Roy S. Kobert, Moderator/Cupid

Feature

By Anupama Yerramalli and Alexander Nicas[1]

"Per Plan" or "Per Debtor"?

Transwest *Reignites the § 1129(a)(10) Debate*

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As a matter of first impression among circuit courts, the U.S. Court of Appeals for the Ninth Circuit recently held in *Transwest* that 11 U.S.C. § 1129(a)(10) should be interpreted on a "per-plan" basis, meaning that only one impaired accepting class at one debtor is required for a multi-debtor joint chapter 11 plan.[2] In adopting the "per-plan" interpretation, the Ninth Circuit dismissed the alternative "per-debtor" interpretation of § 1129(a)(10), which requires an impaired accepting class at every debtor participating in a multi-debtor joint chapter 11 plan.

Transwest resolves, at least in the Ninth Circuit, an issue that has produced conflicting lower court decisions in the Second and Third Circuits, and it reignites a debate as to proper interpretation of § 1129(a)(10).[3] As § 1129(a)(10) has been called the "statutory gatekeeper" to cramdown, the per-plan interpretation alters the balance of power between debtors and creditors in plan negotiations, and it directly affects any chapter 11 case where jointly administered — but not substantively consolidated — debtors seek to cram down a joint plan over creditor objections.[4]

Facts

The *Transwest* debtors' corporate structure consisted of one holding company (the "HoldCo debtor"), two intermediate holding companies (the "MezzCo debtors") and two operating companies (the "OpCo debtors," together with the HoldCo debtor and MezzCo debtors, the "debtors").[5] In 2008, Ashford Hospitality Financing, LP provided financing to the MezzCo debtors, and JPMCC 2007-C1 Grasslawn Lodging LLC provided financing to the OpCo debtors, to finance the purchase of two hotels — one in Hilton Head, S.C., and a second in Tucson, Ariz. The MezzCo debtors' loan was secured by the MezzCo debtors' 100 percent ownership interests in the OpCo debtors, and the OpCo debtors' loan was secured by the two hotels.

In 2010, the debtors filed for chapter 11, and the court approved joint administration of the five bankruptcy cases.[6] Thereafter, the debtors filed a chapter 11 plan predicated upon a third-party investor acquiring the OpCo debtors for $30 million, thereby extinguishing the MezzCo debtors' ownership interest in the OpCo debtors.[7] The chapter 11 plan did not seek to substantively consolidate the debtors.[8]

JPMCC objected to the chapter 11 plan and argued that § 1129(a)(10) applies on a per-debtor, not per-plan, basis.[9] JPMCC's per-debtor interpretation would have blocked confirmation of the chapter 11 plan because (1) JPMCC, after purchasing the MezzCo debtors' loan from Ashford, was the only impaired class of creditors at the MezzCo debtors; and (2) JPMCC voted to reject the chapter 11 plan, meaning that the MezzCo debtors did not have an impaired accepting class to satisfy § 1129(a)(10). The bankruptcy court confirmed the chapter 11 plan over JPMCC's objection, and the district court affirmed.[10]

The Ninth Circuit's Decision

On appeal, a unanimous panel of Ninth Circuit judges held that the plain language of § 1129(a)(10) necessitates the per-plan approach because "once a single impaired class accepts a plan, section 1129(a)(10) is satisfied as to the entire plan."[11] According to the court, this interpretation was persuasive because § 1129(a)(10) "makes no distinction concerning or reference to the creditors of different debtors under 'the plan,' nor does it distinguish between single-debtor and multi-debtor plans."[12] Having determined that "the plan" in § 1129(a)(10) meant the joint chapter 11 plan for all five debtors, it was not the Ninth Circuit's job "to modify the plain language of a statute by interpretation."[13]

The Ninth Circuit also dismissed JPMCC's argument that statutory context supported the per-debtor

1 The authors thank **Adam Rogoff** for his valuable input on this article.

2 *JPMCC 2007-C1 Grasslawn Lodging LLC v. Transwest Resort Props. Inc. (In re Transwest Resort Props. Inc.)*, 881 F.3d 724, No. 16-16221, 2018 WL 615431 (9th Cir. Jan. 25, 2018). *See* 11 U.S.C. § 1129(a)(10) ("If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.").

3 *Compare In re Tribune Co.*, 464 B.R. 126, 180-84 (Bankr. D. Del. 2011) ("*Tribune*") (adopting "per-debtor" interpretation of § 1129(a)(10)), and *In re JER/Jameson Mezz Borrower II LLC*, 461 B.R. 293, 302-03 (Bankr. D. Del. 2011) (same), *with In re Enron Corp.*, 2004 Bankr. LEXIS 2549, at *234-36 (Bankr. S.D.N.Y. July 15, 2004) (adopting "per-plan" interpretation of § 1129(a)(10)), *In re Charter Commc'ns*, 419 B.R. 221, 229-30 (Bankr. S.D.N.Y. 2009) (same), and *In re SGPA Inc.*, 2001 Bankr. LEXIS 2291, at *12-22 (Bankr. M.D. Pa. Sept. 28, 2001) (same).

4 *In re 266 Washington Assocs.*, 141 B.R. 275, 287 (Bankr. E.D.N.Y. 1992).

5 *Transwest*, 2018 WL 615431, at *1.

6 *Id.* at *2.

7 *Id.*

8 *Id.*

9 *Id.* JPMCC also advanced a second chapter 11 plan objection regarding § 1111(b), which is not addressed in this article.

10 *See also* David M. Neff and Eric E. Walker, "*Transwest*: How Many Accepting Impaired Classes Are Required for a Joint Plan Under § 1129(a)(10)?," XXXVI *ABI Journal* 5, 16-17, 60, May 2017, *available at* abi.org/abi-journal.

11 *Transwest*, 2018 WL 615431, at *4.

12 *Id.*

13 *Id.*

continued on page 84

"Per Plan" or "Per Debtor"? Transwest *Reignites the § 1129(a)(10) Debate*

from page 30

interpretation, thus disagreeing with *Tribune*.[14] In *Tribune*, the bankruptcy court held, in part, that § 1129(a)(10) should be interpreted as "per debtor" because § 102(7) provides that the "singular includes the plural" throughout title 11, and other subsections of § 1129(a) support a per-debtor interpretation.[15] Regarding § 102(7), the Ninth Circuit stated that applying it to the text of § 1129(a)(10) revises the statute to read "at least one class of claims that is impaired under the plans has accepted the plans," which the court found to be consistent with the per-plan approach.[16]

As for other subsections of § 1129(a), the Ninth Circuit noted that, for example, § 1129(a)(3) (the good-faith requirement) does not need to be interpreted as "per debtor" because nothing in the plain text of the statute indicates that it applies in this manner.[17] Finally, the panel dismissed JPMCC's objection that the chapter 11 plan substantively consolidated the debtors because this issue was not properly before the court on appeal and, to the extent that the per-plan approach would result in a "parade of horribles" for lenders, such "policy considerations [are] best left for Congress to resolve."[18]

In her concurrence, Circuit Judge Michelle Friedland noted that the "better reading" of § 1129(a)(10) is that it applies on a per-plan basis, despite the statutory language being "somewhat ambiguous."[19] Judge Friedland instead focused on JPMCC's substantive consolidation argument and she agreed that the chapter 11 plan treated the debtors as a single entity, meaning that JPMCC's claims were satisfied from the debtors' substantively consolidated pool of assets.[20] This "*de facto*" substantive consolidation, rather than the court's per-plan interpretation of § 1129(a)(10), was the root of JPMCC's objection, because absent consensus, "there should have been an evaluation of whether substantive consolidation was appropriate before it (effectively) occurred."[21] To allay the creditor's concerns, Judge Friedland proposed that a court assess, on a case-by-case basis, whether the requirements of substantive consolidation have been met "if a creditor believes that a reorganization improperly intermingles different estates."[22]

Section 1129(a)(10)'s Legislative History

Although the Ninth Circuit held that "the plain language of section 1129(a)(10) indicates that Congress intended a 'per-plan' approach," the legislative history is not so clear.[23] The 1978 version of § 1129(a)(10) required that "at least one [non-insider] class of claims has accepted the plan."[24] Commentators and courts agree that the accepting-class requirement was intended to address *In re Pine Gate*, a pre-Bankruptcy Code single-asset real estate case in which the plan was crammed down on the debtor's sole secured creditor by providing that creditor with a payment in cash equal to the fair market value of the real property.[25]

> **A benefit to evaluating § 1129(a)(10) in the context of good faith is that it counters plan-related manipulation inherent in adopting one golden rule and furthers the reorganization goal of chapter 11. Such manipulation was at the core of the recommendation to remove § 1129(a)(10) from the Bankruptcy Code by the ABI Commission....**

After § 1129(a)(10) was enacted, confusion arose as to whether an unimpaired class deemed to have accepted a plan satisfied the accepting-class requirement.[26] "Impaired" was added to the statute in 1984 in order to address this issue, and a congressional report indicated that this change was intended to ensure that a class of creditors affected by the plan voted in its favor.[27]

Not all commentators agree with this conclusion. The final report published by the ABI Commission to Study the Reform of Chapter 11 concluded that "[a]though some courts and commentators suggest that section 1129(a)(10) was intended to ensure that a plan had some creditor support, neither the legislative history nor the Bankruptcy Code indicate such a purpose."[28]

Conclusion and Implications

Transwest will likely reignite the debate as to the proper interpretation of § 1129(a)(10), one that has been dormant for more than five years.[29] Should a circuit split continue, debtors

14 *Id.* at *5.
15 *Id.*
16 *Id.*
17 *Id.*
18 *Id.*
19 *Id.* at *6.
20 *Id.*
21 *Id.* at *6-7.
22 *Id.* at *8.
23 *Id.* at *5.
24 *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

25 *See In re Pine Gate Assocs. Ltd.*, No. B75-4345A, 1976 WL 359641, at *17 (N.D. Ga. Oct. 20, 1976); *National Bankruptcy Review Commission Final Report, Bankruptcy: The Next 20 Years*, Oct. 20, 1997, at 584, n.1474 (stating that § 1129(a)(10) was enacted as a last-minute reaction to *Pine Gate*); *In re Duval Manor Assocs.*, 191 B.R. 622, 628 (Bankr. E.D. Pa. 1996) (stating that § 1129(a)(10) "was designed to ameliorate a perceived harshness inherent in the cramdown provisions" after *Pine Gate*). After *Pine Gate*, multiple courts construed its holding to allow for "maximum cramdown," meaning confirmation of a debtor's plan over the objection of the debtor's only creditor, once that creditor received the fair-market value of the property. *See* Bruce A. Markell, "Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification," 11 *Emory Bankr. D. J.* 1, 38 (1994-95) (discussing "maximum cramdown"); *In re Hobson Pike Assocs. Ltd.*, No. B76-2124A, 1977 WL 182364, at *7 (N.D. Ga. Sept. 20, 1977); *In re Marietta Cobb Apartment Co.*, No. 76-B-1523, 1977 WL 182365, at *4 (Bankr. S.D.N.Y. Sept. 9, 1977).
26 *In re Barrington Oaks Gen. P'ship*, 15 B.R. 952, 967 (Bankr. D. Utah 1981) (discussing contradictory inferences between §§ 1126(f) (deemed acceptance by unimpaired class), 1129(a)(8) (class either accepts plan or is unimpaired) and 1129(a)(10) (accepting class is required), and whether deemed acceptance by an unimpaired class satisfies § 1129(a)(10)).
27 *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984); *In re Bloomingdale Partners*, 170 B.R. 984, 994 n.15 (Bankr. N.D. Ill. 1994) (citing 1983 Senate report that stated, "Paragraph (10) makes clear the intent of section 1129(a)(10) that one 'real' class of creditors must vote for the plan of reorganization").
28 *See ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations* at p. 258, *available at* commission.abi.org/full-report.
29 *See supra* n.3.

might selectively choose to file in certain jurisdictions, and the prevailing interpretation of § 1129(a)(10) will directly affect how a reorganization plan is formulated.

Although it is common for a joint plan to be filed for a multi-debtor enterprise in chapter 11, debtors should conduct an impaired-accepting-class analysis of each debtor, and thought should be given to including language stating that the plan is a separate plan for each debtor. If any debtor does not have an impaired accepting class, the per-debtor interpretation could require conversion to chapter 7 for those debtors who fail to satisfy § 1129(a)(10), while others pursue reorganization under chapter 11. The per-plan approach counters this result and affords flexibility to achieve a reorganization of the entire enterprise. Creditors aggrieved by the per-plan interpretation will likely focus on whether the joint plan (1) violates notions of corporate separateness (*i.e.*, each corporate entity is a distinct debtor that files a separate bankruptcy petition and has its own bankruptcy estate); (2) is a *de facto* or "deemed" substantive consolidation for plan-voting and distribution purposes;[30] and (3) is fair and equitable and does not unfairly discriminate.[31]

The concurrence's suggestion that courts pursue a case-by-case analysis might present an alternative approach. Although not suggested by Judge Friedland, a court could conduct a § 1129(a)(3) good-faith analysis to review a debtor's plan and its formulation, an inquiry that is supported by analogous precedent in a similar context. In *Village at Camp Bowie I LP*, the Fifth Circuit held that the artificial impairment of claims to create an impaired accepting class in order to satisfy § 1129(a)(10), while not prohibited by the text of this section, must be evaluated through the good-faith lens of § 1129(a)(3).[32] Adopting this reasoning, a court could focus on how a plan is formulated and whether application of either the per-plan or per-debtor approach unduly prejudices debtors or creditors.

A benefit to evaluating § 1129(a)(10) in the context of good faith is that it counters plan-related manipulation inherent in adopting one golden rule and furthers the reorganization goal of chapter 11.[33] Such manipulation was at the core of the recommendation to remove § 1129(a)(10) from the Bankruptcy Code by the ABI Commission to Study the Reform of Chapter 11, a concern that should be addressed by Congress if courts fail to find a workable, practical solution.[34] abi

30 William H. Widen, "Corporate Form and Substantive Consolidation," 75 *Geo. Wash. L. Rev.* 237, 254 (2007) (stating that in "'deemed' substantive consolidation, distinct legal entities are not combined. Instead, votes on a plan, plan distribution, or both are computed 'as if' legal entities had been combined"). Although not cited in *Transwest*, the Third Circuit has held that for purposes of calculating quarterly U.S. Trustee fees under 11 U.S.C. § 1129(a)(12), such fees should be assessed for each debtor, absent substantive consolidation. *See In re Genesis Health Ventures Inc.*, 402 F.3d 416, 424 (3d Cir. 2005).

31 *See* 11 U.S.C. § 1129(b).

32 *W. Real Estate Equities LLC v. Vill. at Camp Bowie I LP (In re Vill. at Camp Bowie I LP)*, 710 F.3d 239, 247-48 (5th Cir. 2013).

33 *See, e.g., Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'shp*, 526 U.S. 434, 453 (1999) (stating that policies underlying chapter 11 are preserving going concerns and maximizing property available to satisfy creditors).

34 *See ABI Commission Final Report*, n.28 at p. 260 ("The Commissioners debated the utility of section 1129(a)(10), focusing on whether the provision protected creditor interests or simply allowed creditors to hold up the confirmation process. For example, the Commissioners discussed cases with a limited number of impaired creditor classes and a lender or other large creditor who purchases a sufficient number of claims in each class to control the plan vote. By voting against the plan in each of these classes, that single creditor can block a cramdown because there will be no accepting impaired class of creditors for purposes of section 1129(a)(10).").

Feature

By Kyu Paek[1]

Aggressive Creditors Beware

Egregious Stay Violations Might Merit Substantial Damages

Kyu Paek
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Two recent cases — *In re Lansaw*[2] and *Sundquist v. Bank of America*[3] — illustrate the broad scope of damages available to debtors under § 362(k)(1) of the Bankruptcy Code when parties commit egregious violations of the automatic stay. This provision provides that "an individual injured by any willful violation of [the automatic stay] shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." In both cases, the courts included emotional distress damages as part of the "actual damages" calculation based primarily on the debtors' credible testimony. Moreover, the facts surrounding the stay violations in both cases warranted the awarding of punitive damages, and in the case of *Bank of America*, the court ordered the stay-violating mortgage lender to pay $45 million.

Lansaw

Garth and Deborah Lansaw operated a daycare business and leased commercial space from Frank Zokaites. The parties' relationship soured over the course of the lease term, and the Lansaws decided to lease different premises with another landlord. When Zokaites learned of the new lease, he served the Lansaws with a notice to seize their personal property to secure the payment of unpaid rent. The debtors filed for bankruptcy, triggering the automatic stay, and their bankruptcy counsel notified Zokaites' attorney of the filing.[4]

With knowledge of the bankruptcy, Zokaites willfully violated the automatic stay on three occasions. First, he forcefully entered the daycare to take pictures of personal property, went into Mrs. Lansaw's office, and backed her against the wall asking three times, "Do you want to hit me?" She testified that Zokaites got so close to her that she could feel his breath.[5]

A few days later, Zokaites visited the daycare on a weekend and proceeded to padlock and chain the doors. Mrs. Lansaw's mother, who had come to clean the facilities, called the police. Later that day, the debtors were told by their attorney that Zokaites had proposed an "interim standstill agreement" under which he would agree to unchain the daycare door if Mrs. Lansaw's mother would stipulate that she had not been assaulted by Zokaites, and if the Lansaws reaffirmed their lease and ceased removing personal property from the premises. The Lansaws rejected these terms. In the evening, the Lansaws returned to the daycare, removed the chains themselves and decided to sleep there in case Zokaites came back to rechain the door. Sure enough, Zokaites returned, removed Mrs. Lansaw's keys that were hanging in the keyhole inside the premises, and locked the door from the outside.[6] Lastly, Zokaites called the Lansaws' new landlord on multiple occasions to frustrate the new lease, and even threatened to sue the new landlord if the new lease was not terminated.[7]

The Lansaws commenced an adversary proceeding against Zokaites to enjoin further stay violations and recover damages. In particular, they testified about the emotional distress they suffered. Mrs. Lansaw testified about nightmares, the "sheer fear" she experienced when seeing someone who resembled Zokaites, loss of trust in others and depression; Mr. Lansaw testified that he suffered similar effects as his wife. The bankruptcy court found their testimony credible and awarded them $7,500 for emotional distress, $2,600 for legal fees and $40,000 in punitive damages. The district court affirmed.[8]

On appeal to the Third Circuit, Zokaites argued that (1) emotional distress should not be part of the "actual damages" computation under § 362(k)(1), (2) the Lansaws should be required to provide medical evidence to prove any emotional distress and (3) the punitive damages award was improper. The Third Circuit rejected each of these arguments.

First, on the gating issue of whether emotional distress should be included in the "actual damages" calculus, the Third Circuit observed that courts have taken three different approaches: (1) rejecting inclusion;[9] (2) expressing skepticism about its availability without outright rejection;[10] and (3) allowing inclusion.[11] The Third Circuit sided with the "growing number of circuits" allowing emotional distress[12] and acknowledged that the legislative history behind enactment of the automatic stay contemplated a "breathing spell" from

1 The views expressed in this article of those of the author alone and do not reflect the views of the U.S. Bankruptcy Court for the Southern District of New York.
2 853 F.3d 657 (3d Cir. 2017).
3 566 B.R. 563 (Bankr. E.D. Cal. 2017).
4 *Lansaw*, 853 F.3d at 661.
5 *Id.*
6 *Id.* at 661-62.
7 *Id.* at 662.
8 *Id.* at 663.
9 *See, e.g., United States v. Harchar*, 331 B.R. 720, 732 (N.D. Ohio 2005).
10 *See, e.g., Aiello v. Providian Fin. Corp.*, 239 F.3d 876, 880 (7th Cir. 2001).
11 *See, e.g., In re Dawson*, 390 F.3d 1139, 1148 (9th Cir. 2004).
12 *Lansaw*, 853 F.3d at 667.

creditors and a moratorium on "all collection efforts, *all harassment*, and all foreclosure actions."[13] Agreeing with the Ninth Circuit's decision in *In re Dawson*, the *Lansaw* court opined that Congress was concerned about the emotional and psychological toll as well as the financial loss from willful stay violations.[14]

Next, the *Lansaw* court held that when stay violations are patently egregious, corroborating medical evidence is not necessary and a court may rely solely on a debtor's testimony in awarding emotional distress damages. Given the finding that Zokaites' actions rose to that patently egregious level, the $7,500 award for emotional distress was proper.[15]

Last, the Third Circuit affirmed the award of punitive damages. The court noted that one of the purposes for awarding punitive damages is to deter future misconduct; in determining that Zokaites was not sufficiently deterred, the Third Circuit cited his trial testimony in which he downplayed the severity of his actions. Further, the court opined that the $40,000 punitive damage award comported with due-process considerations and was not excessive.[16]

Bank of America

Erik and Renee Sundquist purchased a home in Lincoln, Calif., borrowing $587,250 from Bank of America at a 6 percent interest rate. They sought a loan modification but were told that Bank of America would not consider a modification unless and until the Sundquists defaulted on their mortgage. Against their better judgment and in reliance on Bank of America's instructions, the Sundquists ceased making mortgage payments with the intention to cure the default alongside the modification.

However, Bank of America failed to deal with the couple in good faith and commenced a multi-year campaign of rejecting more than 20 of the Sundquists' loan-modification applications, citing myriad fabricated clerical deficiencies (thus permitting them to keep making additional applications) on the one hand, and on the other hand scheduling the foreclosure of the home.[17] Facing imminent foreclosure, the Sundquists filed a chapter 13 petition on June 14, 2010, intending to file a plan to cure the Bank of America default and proceed with the loan modification.

With knowledge of the bankruptcy filing, Bank of America nonetheless committed multiple willful violations of the automatic stay. First, Bank of America proceeded with the scheduled foreclosure auction at which it credit bid the outstanding mortgage amount to purchase the house. Once purchased, Bank of America recorded the deed with the county recorder, then immediately commenced eviction proceedings and served an eviction notice on the Sundquists. Bank of America also caused its agents to enter into the Sundquists' gated community on multiple occasions under false pretenses to lurk about the home, follow the debtors, knock on windows and doors, ring the doorbell and otherwise terrorize the family. Once evicted, the debtors were forced to lease another home.

Eventually, Bank of America realized that it had foreclosed in violation of the stay, so it began the process of reversing the foreclosure. However, it did so without notifying the debtors and secretly unrecorded the foreclosure sale on Dec. 30, 2010. Despite the rescission, Bank of America nonetheless continued to send agents to the house to remove personal property, including major appliances.

Meanwhile, having no reason to believe that title to the property would be restored in their favor, the Sundquists dismissed their chapter 13 petition on Sept. 20, 2010, thus terminating the automatic stay.[18] Just when the couple thought their ordeal with Bank of America was over, Bank of America began sending mortgage statements along with notices of default. In April 2011, the Sundquists contacted Bank of America and found out for the first time that Bank of America had rescinded the foreclosure.

When the Sundquists returned to the house, they found that Bank of America had removed major appliances, window coverings and carpet. Moreover, Bank of America had failed to maintain the lawn and shrubbery, resulting in a $20,000 fine from the homeowners' association (HOA).[19]

The Sundquists sued Bank of America for violations of the automatic stay, and Hon. **Christopher M. Klein** issued a lengthy opinion containing detailed factual findings. The court was highly critical of the tactics utilized by Bank of America in dangling the false specter of a loan modification, and observed that Bank of America never intended to "kill a goose that keeps laying 6 percent golden eggs."[20] Judge Klein further chided Bank of America for its multiple willful stay violations and rejected Bank of America's excuse that the violations were due to the bank's computer systems: "A business organization that elects to use computers to control acts that are in the line of fire of the automatic stay is no less exposed to the damages for 'willful' stay violations than entities that rely on real people to direct action."[21]

Next, Judge Klein outlined the appropriate damages that should be awarded under § 362(k)(1). First, the court awarded economic damages, including $73,200 in rent for alternative housing, $10,000 in moving expenses and $87,882 in legal fees. As part of the "economic damages" component, the court also considered lost income. Specifically, the stress induced by Bank of America's stay violations prevented Mrs. Sundquist from accepting a promotion at work. Calculating what her income would have been with the promotion, the court awarded her lost-income damages of $401,511. Similarly, Mr. Sundquist, who worked as a consultant for HOAs, lost income because HOAs in the Sacramento market blackballed him for Bank of America's failure to pay HOA fees when it "owned" the property. The court determined that his lost income was $91,351.[22]

The court continued with economic damages, awarding $24,000 in appliances removed by Bank of America, $26,637

13 *Id.* at 666-68 (emphasis in original; quotations and citations omitted).
14 *Id.* at 667.
15 *Id.* at 668-70.
16 *Id.* at 670-71.
17 For additional commentary on questionable mortgage lender practices, including falsely promising loan modifications on the condition of mortgage nonpayment, *see* David Dayen, *Chain of Title* (2016).
18 *See* 11 U.S.C. § 362(c)(2)(B).
19 *See Bank of America*, 566 B.R. at 572-81.
20 *Id.* at 591. Likewise, Judge Klein explained that Bank of America did not have to worry about losing value in a foreclosure because "the collateral is in a premium location in a gated community and is likely to be sufficient to cover the full debt indefinitely." *Id.* Hence, Bank of America was in a no-lose situation: If the couple eventually cured their default, the bank would receive the interest payments; if they did not and the bank was forced to foreclose, Bank of America would obtain a valuable piece of real property.
21 *Id.* at 591-93.
22 *Id.* at 593-601.

continued on page 64

Egregious Stay Violations Might Merit Substantial Damages

from page 39

in HOA fees and penalties, $20,000 for bad-faith post-petition loan-modification denials and $40,000 in medical bills (Mrs. Sundquist's bills comprised of stress-related injuries and Mr. Sundquist's bills comprised a back injury incurred when moving out of the house during the eviction).[23]

Like the *Lansaw* court, the *Bank of America* court awarded emotional distress as part of "actual damages" under § 362(k)(1). Notably, Judge Klein took into consideration the lengthy, arduous loan-modification charade that Bank of America put the Sundquists through prior to the bankruptcy. According to the court, that process had a debilitating effect on Mrs. Sundquist and turned her into the "eggshell plaintiff" that law students learn about in tort class. Thus, by the time Bank of America improperly evicted her in violation of the stay, she had suffered profound emotional distress, so the court awarded her $200,000. Bank of America's stay violations deeply affected Mr. Sundquist as well, even driving him to attempt suicide, and the court awarded him $100,000 for emotional distress. The court noted that a fuller record would have netted greater emotional distress for both Mr. and Mrs. Sundquist.[24]

Finally, the court found that Bank of America's willful stay violations merited the award of punitive damages. In considering the appropriate award, Judge Klein found that Bank of America acted with "knowing and reckless disregard" of the law, and also mentioned Bank of America's "long rap sheet of fines and penalties in cases relating to its mortgage business." Given Bank of America's vast profitability, a conventional punitive-damages multiplier "would be laughed off in [Bank of America's] boardroom ... payable out of the petty cash account." Accordingly, the court ordered Bank of America to pay $45 million in punitive damages, but to prevent a disproportionate windfall to the Sundquists, the court allocated much of the award to California public law schools ($20 million) and nonprofit consumer law groups ($20 million).[25]

Conclusion

These cases show the consequences that parties might face for willfully violating the stay. While the circumstances surrounding each case were distinct — an overzealous landlord in *Lansaw* and a seemingly automated stay-violating lender in *Bank of America* — both drew the ire of the court. The courts awarded emotional-distress damages, and the *Lansaw* court did so based solely on the debtors' credible testimony without corroborating medical evidence.

The damages awarded in *Bank of America* merit additional comment. In this case, the court explained that damages arising from automatic stay violations continue to accrue even after the stay is no longer in place.[26] As previously mentioned, the stay ceased to protect the Sundquists after they dismissed their case within a few months of filing, yet damages continued to accumulate until restitution. In other words, Bank of America's liability for items such as lost income would have been much smaller had they compensated the couple sooner. In addition, the *Bank of America* court also considered Bank of America's pre-stay campaign of offering false loan modifications in awarding larger damages, notably for emotional distress.

Finally, these cases show that courts are willing to award sizeable punitive damages when violations are patently egregious. Larger entities with automated processes should be especially cautious when dealing with individuals in bankruptcy because a court may order the payment of high punitive damages as a means to deter future stay violations. abi

23 *Id.* at 601-05.
24 *Id.* at 605-609. The court added that in the event of a retrial, evidence supporting emotional distress would likely "be considerably more robust." *Id.* at 608 n.101, and 609 n.104.
25 *Id.* at 609-19.
26 *Id.* at 586.

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April 12, 2017

Willful Stay Violation Can Justify Damages for Emotional Distress, Third Circuit Says

> For an 'egregious' stay violation, medical evidence of emotional distress is not required.

The Third Circuit joined a growing number of courts that allow damages for emotional distress resulting from a willful violation of the automatic stay under Section 362(k)(1).

In his April 10 opinion, Circuit Judge Michael J. Melloy did not need to decide whether "financial injury is a necessary predicate to recovery for emotional distress" because the debtors incurred $2,600 in attorneys' fees as a result of the stay violation. Judge Melloy was sitting by designation from the Eighth Circuit.

The 'Egregious' Stay Violation

The individual debtors' landlord had locked them out of the premises, where they operated a daycare business. He also physically threatened the wife and threatened to sue the debtors' new landlord unless he terminated their lease and they renewed a lease with him.

According to Bankruptcy Judge Thomas P. Agresti of Erie, Pa., the stay violation was the "most egregious" he had seen during his tenure on the bench. He said the debtors' testimony about having nightmares and becoming depressed was "compelling."

In addition to $2,600 in attorneys' fees, Judge Agresti awarded $7,500 for emotional distress and $40,000 in punitive damages against the debtors' landlord. Judge Agresti was upheld in district court and again in the Third Circuit, where the appeals court said the stay violations were "patently egregious."

Emotional Distress Damages Are 'Actual'

The landlord contended in the Third Circuit that damages for emotional distress are not "actual damages" and are thus not permitted under Section 362(k)(1). That section provides that "an individual injured by any willful violation of [the automatic stay] shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages."

Judge Melloy said that the Third Circuit had not yet decided whether "actual damages" includes damages for emotional distress. He said that the First, Ninth and Eleventh Circuits permit emotional distress damages for willful stay violations.

The Seventh Circuit, he said, was "skeptical" about emotional distress damages but "might" permit an award "where the plaintiff is already seeking damages for financial injury." A district court in Ohio ruled in 2005 that emotional distress damages do not qualify as "actual damages."

Although Section 362(k)(1) is "indisputably ambiguous," Judge Melloy concluded that "Congress intended the automatic stay to protect both financial and non-financial interests." He therefore joined "the growing number of circuits" by concluding that "actual damages" includes damages resulting from emotional distress.

Judge Melloy did not decide "whether financial injury is a necessary predicate" to damages for emotional distress because the debtors incurred $2,600 in attorneys' fees.

Since debtors will invariably incur some attorneys' fees after a stay violation, the Third Circuit opinion seems to mean that emotional distress damages will be available, at least where the stay violation was egregious.

The Sufficiency of the Evidence

The landlord contended that the debtors had not proven that the stay violation caused the debtors' emotional distress because they introduced neither medical documentation nor expert medical testimony.

Judge Melloy declined to "adopt a bright-line rule requiring" corroborating medical evidence, "at least where a stay violation is patently egregious." In those circumstances, he said that "a claimant's credible testimony alone can be sufficient to support an award of emotional-distress damages."

Likewise, the debtors were not required to show causation with "absolute precision" when the stay violation was "so egregious that a reasonable person could be expected to suffer some emotional harm."

Since the bankruptcy court awarded "a comparatively modest $7,500" for emotional distress, Judge Melloy said the damages were not unduly speculative."

Punitive Damages

Judge Melloy said that the $40,000 punitive damage award "comports with due process," given that the "repeated stay violations" were "sufficiently reprehensible."

Since actual damages were about $10,000, the 4-1 ratio between punitive and actual damages was "in line with awards previously deemed acceptable by the Supreme Court" and was not so excessive as to be unconstitutional.

Opinion Link

View Opinion

Case Details

Judge Name	Michael J. Melloy
Case Citation	Zokaites v. Lansaw (In re Lansaw), 16-1867 (3d Cir. April 10, 2017)
Case Name	In re Lansaw
Case Type	Consumer
Court	3rd Circuit
Bankruptcy Tags	Automatic Stay Bankruptcy Litigation Ethics Consumer Bankruptcy

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An insightful writer known for his authoritative take on legal developments affecting bankruptcy practice, Bill Rochelle published for Bloomberg every day from 2007 through 2015.

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July 11, 2018

Seventh Circuit Opens a Can of Worms on Bankruptcy Sales and Adequate Protection

> Do free and clear sales confer interests that are entitled to adequate protection?

In a highly theoretical opinion, the Seventh Circuit said that an out-of-the-money creditor in a free and clear bankruptcy sale *might* be entitled to some sale proceeds, thus reducing the recovery by the senior lender even if the lender is not being paid in full.

How's that possible? The Chicago-based appeals court *theorized* that the ability to sell free and clear *might* create an interest in property for which a subordinate creditor *could* be entitled to an adequate protection payment.

Before you panic and conclude that everything you know about bankruptcy sales is about to change, keep in mind that the Seventh Circuit based its July 9 opinion on an assumption that may prove to be wrong when the question arises again.

The Underwater Sales

The circuit court decided two consolidated appeals, both involving an Illinois bulk sale law designed to aid the state in collecting taxes. If state taxes are not paid, the bulk purchaser of a business becomes liable for the taxes under state law.

In parallel bankruptcies, the debtors owed $1.4 million and $600,000, respectively, in state taxes. In sales free and clear of liens and claims under Section 363(f), the properties fetched $5.2 million and $2 million, respectively. However, banks held first liens on the properties for $14 million and $4 million, respectively.

In other words, the first lien lenders would recover only a fraction of their secured claims even if they received all sale proceeds.

The state opposed distribution of the sale proceeds to the senior lenders, contending the state was entitled to be paid in full because the bulk sale law permits collection of the tax debts from purchasers. More cogently, the state argued that its successor liability claims under the bulk sale law amounted to an "interest" in property that was entitled to adequate protection under Section 363(e).

Because the senior lenders were underwater, the bankruptcy judges in Chicago both ruled that the state was entitled to no recovery from the sales.

On appeal, two different district judges remanded for the bankruptcy judges to develop the record by making two findings: (1) what the state would have recovered if the property had not been sold free and clear, and (2) how the state could be compensated for its "interest" given that the lenders had senior liens.

On remand, both bankruptcy judges again denied the state any recovery, ruling that the state's realizable interest was effectively zero. The appeals court allowed direct appeals on both cases.

The Circuit Opinion, Based on an Assumption

Circuit Judge Ilana K. Rovner authored a 29-page opinion upholding the results in the bankruptcy courts, albeit on different grounds that some in the bankruptcy community may find unsettling.

Judge Rovner explained that the Illinois bulk sale law does not affect lien priorities. Indeed, the law does not apply in foreclosure, where the state cannot assert a successor liability claim against a purchaser.

In bankruptcy, however, the state contends that the ability to hold purchasers personally liable has "real value" that is entitled to adequate protection. More specifically, the state claims that a purchaser will pay a higher price because a bankruptcy sale relieves the purchaser of liability for state taxes. Developing the theory further, the state postulates

that the purchaser would pay more to avoid the expense and loss of value to the business that would result from foreclosure, where the tax liability would disappear.

Judge Rovner therefore framed the question as whether the state was entitled to adequate protection when the properties were sold free and clear in bankruptcy court.

Significantly, Judge Rovner's entire opinion rests on a critical assumption. Without deciding, she assumed that the state's ability to impose successor liability was an "interest" in the debtor's property that would invoke the concept of adequate protection under Sections 363(e) and 361(1). She made the assumption because the bankruptcy courts had made the same assumption, and the issue was litigated or decided below.

Judge Rovner's own opinion contains language undercutting the assumption. She said that a buyer's inclination to pay a premium for a sale free and clear "is attributable to [the state law] rather than any asset of the estate." If that is true, a sale free and clear would be cutting off a state law right against a purchaser, not an interest in estate property deserving of adequate protection.

Judge Rovner said she was "dubious of the notion" that the state could have recovered all outstanding taxes. She also recognized that allowing the state to recover even a portion of the taxes "would, in a real sense, permit [the state] to jump the queue of creditors and grant [the state] monetary protection for its interest at the expense of other creditors."

Judge Rovner therefore analyzed several hypotheticals to decide what the state "realistically could have recovered from the purchaser." Even if a purchaser might pay more, the bank, she said, "surely would not be indifferent" if the state were to receive some of the proceeds when the secured lender was not being paid in full. The lender could foreclose, she said, to cut off the tax claims.

Nevertheless, "foreclosure comes with significant costs and can ultimately reduce the net recovery of a bank," Judge Rovner said.

In a settlement to avoid foreclosure, a bank might accept somewhat less if the state were to take less than full payment. Judge Rovner said that compromises between the bank and the state "are more than an abstract possibility." On the other hand, she quoted one of the district judges who said that an interest otherwise entitled to adequate protection "may be worth nothing, in practical terms, in which case the interest holder is entitled to no compensation pursuant to Section[s] 363(e) and 361(1)."

Focusing adequate protection "is where the wheels come off the wagon of [the state's] argument," Judge Rovner said, because "Section 361(1) directs us to consider how much the value of [the state's] interest decreased as a result of the bankruptcy court's free and clear orders." In that regard, she said, "we are still faced with the problem of valuation."

Regardless of whether the trustee or the state bore the burden of proof, she said there was "no evidence as to what [the state] likely would have collected from the purchaser but for the bankruptcy court's Section 363(f) free-and-clear order." In the absence of evidence about how much the state's interest was diminished, Judge Rovner held that the "bankruptcy courts therefore did not err in valuing [the state's] interest at zero for purposes of its right to adequate protection."

What Does the Opinion Mean?

Judge Rovner's opinion has set the stage for the next case where the state and the trustee will present expert witnesses about the incremental value in a bankruptcy sale as opposed to foreclosure.

It has always been this writer's belief that a bankruptcy sale is more valuable than foreclosure for several reasons. Nonetheless, would the state be entitled to the incremental value, rather than the lender who is not being paid in full?

A lender's ability to liquidate collateral in bankruptcy court could be viewed as a right held by a secured creditor, not value inherent in the collateral itself to which adequate protection rights might attach. Likewise, the bulk sale laws could be seen as creating only a claim against a purchaser, not an interest in the bankrupt seller's property warranting adequate protection.

In a different context, the Ninth Circuit said in *Pinnacle Restaurant at Big Sky LLC v. CH SP Acquisitions LLC (In re Spanish Peaks Holdings II LLC)*, 862 F.3d 1148 (9th Cir. July 13, 2017), that a bankruptcy sale can be the rough equivalent of mortgage foreclosure, in which case the state's tax claims would be extinguished altogether. To read ABI's discussion of *Spanish Peaks*, click here.

In any event, courts in the Seventh Circuit are now taxed with deciding whether the Illinois bulk sale law creates an interest in property entitled to adequate protection. It is by no means clear, however, that the outcome will affect only Illinois.

Most states have laws that confer rights on creditors to pursue claims against purchasers who do not follow procedures required by bulk sale laws. It is also not evident why the issue is confined to bulk sale laws, because subordinate secured creditors could argue that sales free and clear of their liens enhance the purchase price.

Opinion Link

View Opinion

[+] Feedback

Case Details

Judge Name	Ilana K. Rovner
Case Citation	Illinois Department of Revenue v. Hanmi Bank, 17-1575 (7th Cir. July 9, 2018)
Case Name	Illinois Department of Revenue v. Hanmi Bank
Case Type	Business
Court	7th Circuit
Bankruptcy Tags	Asset Sales Practice and Procedure Valuation Business Reorganization Finance and Banking

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News at 11

By Richard L. Costella and Kristen M. Siracusa[1]

Fees Incurred in Defending Fee Applications Post-*Baker Botts*

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The U.S. Supreme Court's decision in *Baker Botts LLP v. ASARCO*[2] prompted much debate among the bankruptcy bench and bar when it held that estate professionals are not entitled to fees for defending fee applications under § 330(a)(1) of the Bankruptcy Code. In so holding, the Court found that "Congress did not expressly depart from the American Rule[3] to permit compensation for fee-defense litigation by professionals hired to assist trustees in bankruptcy proceedings."[4] In the aftermath of *Baker Botts*, several bankruptcy courts (particularly in the District of Delaware) have rejected contractual walk-arounds to the decision.[5]

In *In re 29 Brooklyn Avenue LLC*,[6] the U.S. Bankruptcy Court for the Eastern District of New York distinguished the *Baker Botts* decision and held that § 503(b)(4) of the Bankruptcy Code allows for attorney's fees incurred in defending a receiver's application for compensation under § 503(b)(3)(E).

29 Brooklyn Avenue: Background

Prior to the debtor filing for chapter 11 relief on Jan. 18, 2012, a secured creditor of the debtor initiated foreclosure proceedings with respect to the debtor's real property located at 29 Brooklyn Ave., Brooklyn, N.Y.[7] A receiver had been appointed in the foreclosure proceeding and had managed/operated the property since October 2010.[8] The debtor's proposed chapter 11 plan did not provide for payment of the receiver's outstanding commissions or expenses, and the receiver filed an objection to the plan based on this omission.[9] After the debtor agreed to escrow funds sufficient to pay the receiver's claim, the receiver withdrew his objection and the plan was confirmed on Feb. 14, 2013.[10]

The confirmed plan provided for payment of all administrative expenses and allowed claims.[11] Following the sale of the property and payment of sale expenses and secured claims, the debtor retained $1,367,454. Unsecured claims in the case totaled less than $70,000.[12] The receiver filed a proof of claim in the amount of $80,757.22, which represented the prepetition paid and unpaid expenses of the property, the receiver's commission and his legal fees incurred up to the petition date.[13] The debtor objected to the proof of claim, and the parties engaged in extensive discovery. Following an eight-day trial, the receiver's claim was allowed in the amount of $72,449.35.[14]

Following entry of the order awarding fees, the receiver filed a motion seeking an allowance of the attorneys' fees that he incurred during the course of the bankruptcy case in the amount of $355,953.25.[15] The bankruptcy court determined that the vast majority of the fees were related to the defense of the proof of claim (which was substantially allowed) and the defense of the debtor's application to surcharge the receiver (which was denied except for $225.49).[16]

29 Brooklyn Avenue: Bankruptcy Court's Decision

Upon the commencement of a bankruptcy case, a receiver[17] must cease all administration activities and must not make any disbursements from the property of the debtor except in such circumstances when it would be necessary to preserve the property.[18] The receiver must then "(1) turn over all property of the debtor in the custodian's control to the trustee (or debtor in possession), and (2) file an accounting of any property of the debtor that came into the possession, custody, or control of the custodian."[19] The Bankruptcy Code provides that custodians (receiv-

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2 135 S. Ct. 2158 (2015).
3 The American Rule provides that each side must pay its own attorney's fees unless a statute or contract provides otherwise. *Id.* at 2164.
4 *Id.*
5 *See, e.g., In re Boomerang Tube Inc.*, 548 B.R. 69 (Bankr. D. Del. 2016) (holding that provision in engagement letter for counsel to committee of unsecured creditors that required estate to indemnify them for expenses incurred in any successful defense of their fees ran afoul of *Baker Botts*). *Boomerang Tube* was adopted by Judge **Brendan Linehan Shannon** by letter entered in *In re New Gulf Res. LLC, et al.*, Case No. 15-12566 (Bankr. D. Del. Feb. 1, 2016), and by Judge **Christopher S. Sontchi** by letter entered in *Samson Res. Corp., et al.*, Case No. 15-11934 (Bankr. D. Del. Feb. 8, 2016).
6 548 B.R. 642 (Bankr. E.D.N.Y. 2016).
7 *Id.* at 643.
8 *Id.*
9 *Id.* at 644.
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 *Id.* The receiver was surcharged $225.49 for a total amount awarded of $72,223.86. *See In re 29 Brooklyn Ave. LLC*, 535 B.R. 36 (Bankr. E.D.N.Y. 2015).
15 *Id.*
16 *Id.*
17 A receiver is defined as a "custodian" under the Bankruptcy Code. 11 U.S.C. § 101(11).
18 *29 Brooklyn Ave.*, 548 B.R. at 645.
19 *Id.* (citing 11 U.S.C. § 543(b)).

ers) may be awarded their expenses and compensation under § 503(b)(3)(E); the Code also allows compensation for the custodian's attorney. Specifically, § 503(b)(4) grants an administrative expense for "reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under subparagraph (A), (B), (C), (D), or (E) of paragraph (3) of this subsection."[20]

The bankruptcy court determined that § 503(b)(4) is "unquestionably a fee-shifting statute"[21] and that the fees requested by counsel to the receiver might be allowed if they fall within the ambit of § 503(b)(4). It was undisputed that the receiver's counsel was entitled to fees for services that were directly related to the process of turning over property of the estate in the receiver's control, as well as for providing the required accounting, as the plain language of § 503(b)(4) provides for compensation for services rendered by an attorney of an entity with an allowed expense under § 503(b)(3)(E).[22] In light of the *Baker Botts* decision, however, the parties disputed whether § 503(b)(4) allowed for the attorneys' fees that were incurred in defending the receiver's application for compensation under § 503(b)(3)(E).

Distinguishing *Baker Botts*

The bankruptcy court commenced its analysis by distinguishing the Supreme Court's decision in *Baker Botts*. In that case, Baker Botts successfully prosecuted fraudulent-transfer claims against ASARCO's parent company and recovered a significant judgment for the debtor.[23] Baker Botts, who was retained pursuant to § 327(a) of the Bankruptcy Code, sought compensation under § 330(a) for its services to the estate and ASARCO objected to the application.[24] The bankruptcy court awarded Baker Botts its fees, including an additional $5 million for the time spent defending the objection to its fee application. The district court affirmed, but the Fifth Circuit Court of Appeals reversed the award.

Section 330(a) of the Bankruptcy Code permits "reasonable compensation for actual, necessary services rendered."[25] In affirming the Fifth Circuit, the Supreme Court in *Baker Botts* held that "reasonable compensation for services rendered" requires "loyal and disinterested service in the interest of a client."[26] The Court further determined that treating fee-defense litigation as a service to the estate would allow compensation for unsuccessful efforts to defend a fee application,[27] which it found to be "an unnatural interpretation of the term 'services rendered'" and "a particularly unusual deviation from the America Rule" that was completely unsupported by the language of the statute.[28] As noted by the *29 Brooklyn Avenue* court, the outcome in *Baker Botts* hinged on the interpretation of the word "services" in § 330(a).[29] The Supreme Court determined that "actual, necessary services rendered" under § 330(a) did not include litigating against a client.[30] In *29 Brooklyn Avenue*, the court found that the legal services were provided to the receiver and defending the receiver's fee application was "labor performed for" and "disinterested service" to the receiver.[31]

> **It is clear that in the post-*Baker Botts* bankruptcy world, parties will continue to creatively attempt to utilize the decision to either object to or defend applications seeking fees for defending fees.**

Moreover, the fee-shifting statutes at issue in the two cases were different. In *29 Brooklyn Avenue*, § 503(b)(4), and not § 330(a), was at issue. Section 503(b)(4) only allows compensation for the attorney of an entity whose expense is allowable in the case under § 503(b)(3)(A)-(E).[32] The bankruptcy court reasoned that this removes the risk that an attorney might receive a fee award for unsuccessfully defending a fee application, which was an underlying concern of the Supreme Court in *Baker Botts*.[33]

In addition, § 503(b)(4) is an explicit fee-shifting statute that specifically provides for attorneys' fees for the "prevailing party." In *29 Brooklyn Avenue*, the receiver engaged in extensive litigation with the debtor over his compensation, and ultimately, the receiver prevailed. Therefore, the bankruptcy court determined that under § 503(b)(4), the receiver's counsel was entitled to reasonable compensation for services rendered to the receiver in the case, and that the holding of *Baker Botts* would not require a different result.[34]

Fees Incurred in Defending Fees under § 503(b)(4)

The bankruptcy court in *29 Brooklyn Avenue* followed the framework set forth by the Ninth Circuit Court of Appeals in *In re Wind N' Wave*[35] and *In re Smith*[36] for evaluating a request for attorneys' fees under § 503(b)(4) that were incurred defending an application for compensation under § 503(b)(3). Under the rulings in those cases, fees incurred to defend a fee application can be awarded where

20 11 U.S.C. § 503(b)(4).
21 *29 Brooklyn Ave.*, 548 B.R. at 646.
22 *Id.*
23 *Id.* (citing *Baker Botts*, 135 S. Ct. at 2163).
24 *Id.*
25 11 U.S.C. § 330(a)(1).
26 *Baker Botts*, 135 S. Ct. at 2165-67.
27 *Id.* at 2166.
28 *Id.*
29 *Id.* The Supreme Court rejected numerous arguments made by parties in favor of allowing compensation for fee-defense litigation. Arguments were made that fee-defense litigation (1) was part of the services rendered to the estate because the estate benefits from obtaining a judicial determination of the amount of compensation owed to a professional, and (2) was compensable because it is inextricably tied to the preparation of a fee application, which is compensable under the Bankruptcy Code. *Baker Botts*, 135 S. Ct. at 2166-67.
30 *29 Brooklyn Ave.*, 548 B.R. at 647 (citing *Baker Botts*, 135 S. Ct. at 2165).
31 *Id.*
32 *See* 11 U.S.C. § 503(b)(4).
33 *29 Brooklyn Ave.*, 548 B.R. at 647 (citing *Baker Botts*, 135 S. Ct. at 2166).
34 *Id.* at 648. The *29 Brooklyn Avenue* court also acknowledged that the confirmed chapter 11 plan in the case paid all creditors 100 percent of their claims and that the only unpaid claim at the time of the litigation was the receiver's claim. *Id.* The debtor was a single-member LLC, thus any reduction in the receiver's claim would only benefit the sole equityholder. *Id.* The court indicated that, in essence, the receiver was not litigating with the debtor, but with the sole equityholder, and that the estate and creditors would not be prejudiced by an award of attorneys' fees in the case. *Id.*
35 509 F.3d 938 (9th Cir. 2007).
36 317 F.3d 918, 928 (9th Cir. 2002). The bankruptcy court noted that to the extent *Wind N' Wave* and *Smith* stand for the proposition that fees may be awarded to counsel for a debtor or trustee for defending a fee application against objections interposed by a representative of the bankruptcy estate, they have been overruled by *Baker Botts*. *29 Brooklyn Ave.*, 548 B.R. at 649 ("In light of [*Baker Botts*], fees incurred by debtor's counsel in defending a fee application against objections by the bankruptcy estate would not be allowable under the standard laid out in *Wind N' Wave* or *Smith* because such fees are not compensable under § 330(a)(1).")

continued on page 52

News at 11: Fees Incurred in Defending Fee Applications Post-Baker Botts

from page 31

the case "exemplifies a set of circumstances where litigation was necessary."[37] Such services are "necessary" where (1) the prosecution or defense of the fee application was successful, (2) when the objections to the fee application were meritless, (3) when the litigation is not pursued simply to increase legal fees and (4) when the incurred expenses are unavoidable.[38]

Evaluating the circumstances of the litigation in *29 Brooklyn Avenue*, the court determined that the litigation was "necessary."[39] First, the receiver prevailed in his application for compensation under § 503(b)(3)(E). The court next acknowledged that it had previously determined that the debtor's efforts to disallow the receiver's claim based on allegations of mismanagement were "misplaced" and that the debtor "misunderst[ood] the legal standard."[40] The court found that there was nothing in the record to indicate that the receiver pursued the litigation to incur and increase fees for his counsel.[41] Further, the court held that the litigation was driven by the objections (the vast majority of which were overruled) raised by the debtor. Finally, the court ruled that the incurred legal fees were unavoidable as the litigation was the only way the receiver could receive his compensation.[42]

The bankruptcy court noted that the receiver did not choose to be a part of the bankruptcy case, and that once the case had been filed, the receiver did all that he was required to do under the Bankruptcy Code. Further, the court noted that it was the debtor "that chose to embark on a multi-year effort to disallow an approximately $80,000.00 claim," and it was this litigation strategy that resulted in the fees incurred by receiver's counsel.[43] "[T]his case exemplifies a set of circumstances where the fees incurred by the Receiver's counsel were necessary."[44]

Conclusion

It is clear that in the post-*Baker Botts* bankruptcy world, parties will continue to creatively attempt to utilize the decision to either object to or defend applications seeking fees for defending fees. Given the different fee-shifting statute at issue in *29 Brooklyn Avenue*, it is clear that *Baker Botts* was distinguishable. However, it is equally clear that this is not the last we will hear of the *Baker Botts* decision, and it remains to be seen how courts across the nation will deal with proposed creative solutions to recover fees associated with defending fee applications. abi

37 *29 Brooklyn Ave.*, 548 B.R. at 648 (quoting *Wind N' Wave*, 509 F.3d at 943 (quoting *In re Smith*, 317 F.3d at 928) (internal quotations omitted)).
38 *29 Brooklyn Ave.*, 548 B.R. at 648.
39 *Id.* at 649.
40 *Id.* (quoting *29 Brooklyn Ave.*, 535 B.R. at 59).
41 *Id.*
42 *Id.*
43 *Id.*
44 *Id.*