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Recent Developments in Business Bankruptcy Cases and Rules

Moderators

Honorable Kevin J. Carey
United States Bankruptcy Judge
District of Delaware

Honorable Kevin R. Huennekens
United States Bankruptcy Judge
Eastern District of Virginia

Panelists and Drafters

Marguerite Lee DeVoll
Watt Tieder Hoffar & Fitzgerald, L.L.P.
1765 Greensboro Station Place, Suite 1000
McLean, Virginia 22102
mdevoll@watttieder.com

Stephen E. Leach
Hirschler Fleischer
8270 Greensboro Drive
Suite 700
Tysons, Virginia 22102
sleach@hf-law.com

Marissa K. Lilja
Tydings & Rosenberg
One East Pratt Street, Suite 901
Baltimore, Maryland 21202
mlilja@tydingslaw.com

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Advances by a bank to cover a debtor's account overdrafts are unsecured loans to the debtor under the UCC and may be recovered as preferential transfers under section 547(c)(2) if made during the preference period.

A transfer occurs for purposes of section 547 when the issuing bank issues a stop-payment on a cashier's check after the cashier's check has been delivered to the payee.

Section 544(b) does not limit trustees to asserting avoidance claims only under state fraudulent transfer law. Rather, it permits a trustee to stand in the shoes of a creditor and assert claims under all applicable law to void a transfer. Thus, standing in the shoes of the IRS, a trustee can assert claims under the FDCPA and IRC, which have longer look-back periods.

Bankruptcy courts must examine the transfer that is the subject of a clawback action – and not its component parts – for the safe harbor under section 546(e) to apply. Simply because an intermediary "transfer" was made by or to (or for the benefit of) a financial institution does not mean that the final transferee is protected by section 546(e).

Bankruptcy court finds that potential recovery in a fraudulent transfer action is not limited to the amount of unpaid claims under confirmed plan; the litigation can proceed for the benefit of parties who received equity interests in the reorganized debtor notwithstanding that their allowed claims under the plan have been paid due to the post-confirmation appreciation in value of the estate.

CASE COMMENCEMENT AND ELIGIBILITY

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<u>U.S. Bank, N.A. v. Vill. At Lakeridge, LLC</u>, – U.S. – (Mar. 5, 2018)

A clear-error standard of review is appropriate when the issue on appeal contains a mixed question of law and fact, and the resolution rests upon an interpretation of the facts presented to the bankruptcy court, as was the case in determining whether a creditor was a non-statutory insider for the purposes of the cramdown provisions under section 1129.

The debtor is a corporate entity with a single owner. On the petition date, a bank and the debtor's owner were the debtor's primary creditors. The debtor proposed a plan that impaired the claims of both the bank and the owner. The bank rejected the plan and the debtor sought to confirm the plan over the bank's rejection using the cramdown provisions of section 1129(b).

Section 1129(a)(10) provides that if a class of claims is impaired under a plan, at least one class of impaired claims must accept the plan, determined without including the acceptance of the plan by any insider. Statutory insiders are defined by section 101(31) of the Code, but that section is not all inclusive and the courts have identified various non-statutory insiders, typically based on whether a person's transactions with the debtor have been made at arm's length.

Because the only other impaired creditor was the owner, who was a statutory insider whose acceptance of the plan would not satisfy section 1129(a)(10), the owner sought to transfer its claim to a non-insider. A board member of the owner offered the claim to an individual for a reduced price. That purchaser consented to the debtor's proposed reorganization. The bank objected and alleged that the purchaser was a non-statutory insider because the purchaser was romantically involved with the selling board member. The bankruptcy court evaluated all of the evidence provided and determined that, although the parties admitted to a romantic relationship, there was sufficient evidence that the negotiations were conducted at arm's length. Accordingly, the bankruptcy court found that the purchaser was not an insider for the purposes of section 1129(a)(10).

The Ninth Circuit affirmed the bankruptcy court by a divided vote. The Ninth Circuit determined that the bankruptcy court finding was entitled to clear-error review because it was based on a factual finding that the sale of the claim was conducted at arm's length.

The bank appealed to the Supreme Court, arguing that the Ninth Circuit should have employed a *de novo* review. The Supreme Court held that the Ninth Circuit was correct in reviewing the bankruptcy court's decision for clear error based on the "mixed question" of law and fact presented to the court. The standard of review for a mixed question depends on "whether answering it entails primarily legal or factual work" and as a result either a *de novo* or clear-error review may be justified. The analysis provided by the Supreme Court relied on the assumption that the Ninth Circuit employed the correct legal test to identify non-statutory insiders. The Supreme Court found the analysis to be based in fact and best determined by the bankruptcy court. Accordingly, review by clear error was appropriate for the factual findings of the bankruptcy court.

In a concurring opinion, Justice Kennedy asserted that the lower courts may continue to elaborate on the actual legal standard that determines whether a person is a non-statutory insider under the Code, considering the relevance and meaning of an "arms-length transaction" in that context. In a second concurring opinion, Justice Sotomayor, joined by Justices Kennedy, Thomas, and Gorsuch, noted that the Court's opinion does not address whether the Ninth Circuit's underlying legal test was correct and that the standard of review is "deeply intertwined with the test being applied." Both concurring opinions hint that their authors did not agree with the test used by the lower courts, but the question of whether the purchaser was actually a non-statutory insider was not at issue before the court.

AVOIDING POWERS/LITIGATION

Assured Guar. Corp. v. Fin. Oversight and Mgmt. Bd. (In re Fin. Oversight & Mgmt. Bd. For P.R.), 872 F.2d 57 (1st Cir. 2017)

A creditors committee has the right to intervene in an adversary proceeding under Rule 7024 and section 1109(b), subject to restrictions imposed by the court.

The committee of unsecured creditors (the "committee") moved to intervene in an adversary proceeding arising within Puerto Rico's debt adjustment case under the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"). PROMESA was enacted to address the financial crisis in Puerto Rico and created a financial oversight board. Among other things, PROMESA empowered the board to commence quasi-bankruptcy proceedings to restructure Puerto Rico's debt. This procedure incorporated large portions of the Code. After the quasi-bankruptcy proceedings were filed, companies that insure Puerto Rican bonds filed an adversary proceeding seeking a declaratory judgment that the plan approved by the board violated PROMESA and the US Constitution and an injunction prohibiting the board from implementing the plan. The committee was appointed pursuant to section 1103(c) and sought to intervene in the adversary proceeding under Rule 7024.

Rule 7024 provides that "the court must permit anyone to intervene who…is given an unconditional right to intervene by federal statute." Fed. R. Civ. P. 24(a)(1). The committee asserted an unconditional right to intervene under section 1109(b), which states that any "party in interest" including a creditors' committee, "may raise and appear and be heard on any issue in a case under this chapter."

The district court found that it was bound by a previous holding of the First Circuit and determined that the committee did not have the right to intervene under Rule 7024. With this opinion, the First Circuit sought to clarify its prior decision and set new precedent. The First Circuit held that section 1109(b) provides the right to intervene in an adversary proceeding under Fed. R. Civ. P. 24(a)(1). In analyzing section 1109(b), the First Circuit found that "case" was a term of art referring to litigation commenced in the bankruptcy court, but that "proceeding" refers only to a particular dispute or matter arising within a case. Accordingly, the court found that an adversary proceeding is part of the "case" and that an unsecured creditors' committee is entitled to intervene under section 1109(b) and Rule 24(a)(1). The First Circuit declined to determine the scope of the committee's participation in the adversary proceeding, and noted that intervention of right may be subject to conditions set by the courts.

Bakst v. Bank Leumi, USA (In re D.I.T., Inc.), 575 B.R. 534 (Bankr. S.D. Fla. 2017)

Bankruptcy trustee has a right to a jury trial in a fraudulent transfer action, notwithstanding debtor's waiver of right to a jury in its prepetition loan agreement. The defendant bank did not file a proof of claim so that the action was not part of the claims resolution process.

Chapter 7 trustee sued a prepetition lender to the debtor to recover an alleged fraudulent transfer under section 548. The trustee demanded a jury trial. The debtor had waived the right to a jury trial in the prepetition loan documents with the lender. Because the debtor had paid the lender in full, the lender had not filed a proof of claim.

The lender sought to strike the trustee's jury demand on three grounds: (a) the trustee was bound by the debtor's jury trial waiver in the loan documents; (b) a trustee is not entitled to a jury trial in a fraudulent transfer or other avoidance action under the Code; and (c) the trustee's suit was integral to the claims resolution process and thus equitable in nature so that there was no right to jury trial.

The bankruptcy court made short work of the first argument, finding that the debtor's prepetition waiver of a jury trial did not apply to the trustee's claims which arose under section 548 of the Code and were distinct from prepetition claims the debtor might have had against the lender (as to which waivers did remain enforceable). Similarly, the trustee would not be subject to a prepetition agreement to arbitrate disputes, or to the *in pari delicto* defense, if the trustee sought relief under a cause of action created by the Code itself as distinct from a claim under state law.

The court also rejected the argument that the trustee was not entitled to a jury trial in an avoidance action. In *Katchen v. Landy*, 382 U.S. 323 (1966), the Supreme Court ruled that if a creditor has not filed a proof of claim, a preference action against the creditor is not part of the claims' allowance process and the creditor retains its right to a jury trial. Conversely, in *Langenkamp v. Culp*, 498 U.S. 42 (1990), the Supreme Court found that when a creditor who was subject to a preference action filed a proof of claim, the preference action became part of the claims allowance process, which is equitable in nature, and thus the creditor had no right to jury trial. Here the lender had not filed a proof of claim, and thus the trustee's suit was not part of the claims allowance process. Further, under *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989) and *Stern v. Marshall*, 564 U.S. 462 (2011) fraudulent transfer actions are actions at law and in an action at law either party may demand a jury.

A defendant in an avoidance action that pays the claim will then have a claim against the estate under section 502(h). The lender argued that such a potential future claim might impact the universe of claims and in that way become part of the claims allowance process, implicating the court's equitable powers. Calling this argument a "quivering house of cards" the bankruptcy court said that if a possible future claim under section 502(h) was sufficient to turn an avoidance action into part of the claims allowance process, every avoidance action would fall under the court's equitable powers, negating the analyses in *Katchen* and *Langenkamp.* Accordingly, the trustee is entitled to a jury in his action against the lender.

Henry v. Official Comm. of Unsecured Creditors of Walldesign, Inc. (In re Walldesign, Inc.), 872 F.3d 954 (9th Cir. 2017)

Parties receiving fraudulent transfers are initial transferees not entitled to the safe harbor protection of section 550(b)(1) when the party directing the transfers did not have legal ownership over the funds.

Pre-petition, the debtor's sole shareholder, director, and president (the "president"), oversaw the debtor's day-to-day business operations and finances. The debtor maintained a disclosed primary bank account. The president secretly opened an additional account in the name of the debtor, but listed his personal address on the account and added his wife as a signatory. The president deposited rebates from the debtor's suppliers into the secondary account without reporting them as income to the debtor. The president funneled nearly $8 million into this account over 10 years and paid his personal expenses and expenses for other businesses out of the account. The committee of unsecured creditors sued the president and parties who received funds from the account as alleged transferees of fraudulent transfers.

Under section 550(b)(1) of the Code, a fraudulent transfer may be recovered from "(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any [subsequent] transferee of such initial transfer", subject to the safe harbor provision of section 550(b)(1). The safe harbor provision protects subsequent transferees who accept payments for value, in good faith, and without knowledge of their voidability. The bankruptcy court granted summary judgment for recipients of funds from the account on the grounds that they were subsequent transferees entitled to the safe harbor provision of section 550(b)(1). On appeal, the district court reversed.. The district court applied the "dominion test" finding that creditors who received the misappropriated funds from the secret account were initial transferees under section 550(a)(1) and were therefore not entitled to section 550(b)(1)'s safe harbor provision.

The Ninth Circuit affirmed the district court, holding that the president was not the initial transferee under section 550(a)(1) when he transferred misappropriated corporate funds because he did not have legal control over the funds in a personal capacity. Accordingly, funds could be recovered from both the president and the recipients of the transfers. The president was "strictly liable as the party for whose benefit the transfers were made" while recipients of the funds were "strictly liable as initial transferees because they received funds directly from a corporate debtor." The Ninth Circuit arrived at this holding despite evidence of the president's use of the funds, because they found those actions did not change the account's legal ownership so that the president never had legal dominion or control of the funds.

The Ninth Circuit applied the "dominion test" to determine which parties were initial transferees. The dominion test considers an initial transferee to be someone who has "the right to put the money to one's own purposes." The key to the test is whether the individual "has legal title to the funds". The Ninth Circuit adopted the majority approach to the "dominion test" and determined that the principal of a debtor who misappropriates funds, but never transfers the funds to a personal bank account, does not have legal ownership and is not an initial transferee, but rather merely a party for whose benefit the transfer is made. Because the transfers here were made directly from the debtor's account, they were one step transactions by which money was directed from the debtor to the initial transferees for the benefit of the president. Therefore, both the president and the transferees from the account are strictly liable for repayment of fraudulent transfers.

A dissent argued that the result was not equitable and that a "control test" rather than the "dominion test" should be applied to determine if parties are initial transferees under section 550(a)(1).

Indian Harbor Ins. Co. v. Zucker, 860 F.3d 373 (6th Cir. 2017)

Deepening the split in authority, the Sixth Circuit holds that a liquidation trustee is subject to the "insured-versus-insured" exception in the debtor's liability insurance policy when attempting to bring suit against the debtor's officers.

After filing for bankruptcy, the debtor created a liquidation trust to pursue legal claims on behalf of the estate. As part of that plan, the debtor and the creditors stipulated that the debtor's officers had no liability for conduct after the bankruptcy filing and limited pre-petition liability to any amounts recoverable from the debtor's insurance policy. The selected trustee sued the debtor's officers, claiming they breached their fiduciary duties to the debtor. Many liability insurance contracts contain insured-versus-insured policy exclusions, which limit the available coverage to claims brought by outsiders of the company. The debtor's insurance company filed suit, seeking a declaratory judgment that the trustee's lawsuit fell within the "insured-versus-insured" exception in the debtor's liability policy. The trustee argued that the bankruptcy filing established the debtor-in-possession as a separate entity, and that the trustee was therefore not bringing suit on behalf of the same "company" that was subject to the insurance policy exception.

The Sixth Circuit found that the lawsuit was barred by the "insured-versus-insured" provision of the insurance policy. Just as the exception would exclude any lawsuit brought by the debtor against its officers, the trust "stands in [the debtor's] shoes and possesses the same rights subject to the same defenses." Although the bankruptcy estate is created upon filing, the debtor-in-possession or trustee must bring the lawsuit, and any lawsuit is "by" the debtor and fits within the liability exclusion because the debtor as debtor-in-possession remains "the Company" that entered into the insurance contract.

A dissent asserted that an assignee, such as the liquidating trustee in this case, should be afforded the same right to be exempt from the insured-versus-insured exclusions as court-appointed trustees. The dissent noted that there is a split among "federal courts on the issue of whether a lawsuit against a corporation's former directors and officers brought by a debtor in possession, trustee, creditors' committee, or post-confirmation liquidating trustee triggers the 'insured vs. insured' exclusion in a directors and officers liability policy."

<u>In re Agriprocessors, Inc.</u>, 859 F.3d 599 (8th Cir. 2017)

Advances by a bank to cover a debtor's account overdrafts are unsecured loans to the debtor under the UCC and may be recovered as preferential transfers under section 547(c)(2) if made during the preference period.

The debtor's bank traditionally provided overdraft protection[2] whenever the debtor's account had a negative balance. Because the debtor had two accounts, the bank consistently "netted" the two accounts to determine if there was an overdraft, and an overdraft only occurred when the net amount was negative. One of the accounts was consistently below $0, but the other account usually covered the balance. The net balance would occasionally be negative and the bank would advance overdraft payments on behalf of the debtor. During the preference period, the debtor wired funds to cover both intraday and true overdrafts, and ultimately transferred all of its funds from one account to the other account to cover the negative balance of the second account. The trustee sought to recover the overdraft-covering deposits and the full balance transfer from the bank as avoidable transfers.

A trustee may avoid a debtor's transfer of property as a preference under section 547(b), subject to a transferee's defenses under section 547(c). Under section 550(a), the trustee may recover avoidable preferential transfers from "(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transfer."

The Sixth Circuit held that the debtor's deposits to repay the true overdrafts were recoverable by the trustee, but that intraday overdraft deposits and the full balance transfer were not recoverable. The Sixth Circuit found that bank's deposits to cover the true overdrafts were unsecured loans to the customer under applicable Iowa law. Therefore, as to the debtor's deposits made to repay true overdrafts, the bank was an initial transferee under section 550 because it received payment on a debt to the bank and exercised dominion and control over the transferred funds. Conversely, the trustee could not recover deposits made by the debtor to cover intraday overdrafts, because the bank was a "mere conduit" when it received these funds and therefore not a transferee under section 550(a). The Sixth Circuit affirmed the bankruptcy court's determination that under the "netting" agreement for the accounts, the transfer of the balance from one account to cover the negative balance of the other account was not a debt at all, and therefore there was no avoidable transfer under section 547(b)(2). The Sixth Circuit rejected the bank's assertion of multiple section 547(c) defenses. Most notably, the Sixth Circuit held that

[2] At issue in this case were both intraday and true overdrafts. Intraday overdrafts occurred when the balance became negative at any point in the day, but could be remedied based on later transactions in the day. A true overdraft occurs at midnight after the account balance is negative.

overdraft debts were not incurred in the ordinary course of business with the bank because there was a significant increase in the number of overdrafts during the preference period.

<u>In re Essex Construction, LLC</u>, No. 16-24661-TJC, 2017 WL 3278832 (Bankr. D. Md. Aug. 1, 2017) (Catliota, J.)

A transfer occurs for purposes of section 547 when the issuing bank issues a stop-payment on a cashier's check after the cashier's check has been delivered to the payee.

In this chapter 11 case, despite several orders prohibiting and restricting the debtor's use of cash collateral, the debtor obtained a cashier's check from a bank and delivered it to the payee. The payee deposited the check into its bank account, but before the check was honored by the issuing bank, the debtor convinced that bank to stop-payment on the check. The payee's bank retained physical possession of the check. Following the disclosure of these transactions, the debtor consented to appointment of a chapter 11 trustee.

The trustee negotiated a settlement with the payee, the debtor, and the issuing bank, for the return of the cashier's check to the debtor and a release of the payee's claims against the issuing bank for the stop-payment. When the trustee sought court approval of the settlement under section 549, the debtor's lenders objected. The lenders argued that section 549 did not apply as no transfer occurred because the debtor convinced the issuing bank to stop-payment before the cashier's check was honored and the funds were never outside the debtor's control. The trustee, on the other hand, argued that three transfers occurred: (1) the first transfer occurred when the debtor obtained the cashier's check from the issuing bank; (2) the second occurred when the debtor delivered the cashier's check to the payee; and (3) the third transfer occurred when the issuing bank stopped payment on the check and retained the funds.

The bankruptcy court found that the first transaction – the purchase of the cashier's check by the debtor – was not a transfer under the Code and the Fourth Circuit decisions in *Bowers v. Atlanta Motor Speedway (Bowers I)*, 99 F.3d 151 (4th Cir. 1996) and *Bowers v. Kuse Enters. (Bowers II)*, 1998 WL 957455 (4th Cir. Sept. 22, 1998) because the issuing bank was acting as a mere conduit of the debtor and did not have control over the funds.

As to the second transaction – the delivery of the cashier's check – the court found that while a transfer of a cashier's check occurs upon delivery of the check, when the debtor successfully convinced the issuing bank to stop-payment, the debtor had only effectuated a conditional transfer when it delivered the cashier's check to the payee. As such, while this constituted a transfer under section 101(54), it did not constitute a transfer under section 549.

As to the third transaction – the issuing bank's stop-payment – the court found this to be a transfer under section 549. In so holding, the court found that when the issuing bank "placed itself in the center of a dispute between its customer and the payee" and made an independent determination, the issuing bank ceased being a mere conduit. As such, the issuing bank then had legal dominion and control over the funds because the issuing bank's own liability as to its decision to stop-payment on the cashier's check needed to be resolved as part of any disposition of funds.

In short, whether a transfer occurs for purposes of section 549 comes down to when the debtor relinquishes full legal dominion and control over its property interests such that another party can exercise legal dominion and control over the property.

Hillen v. City of Many Trees, LLC (In re CVAH, Inc.), 570 B.R. 816 (Bankr. D. Id. 2017) and Gordon v. Rogich (In re Alpha Protective Servs., Inc.), 570 B.R. 888 (Bankr. M.D. Ga. 2017)

Section 544(b) does not limit trustees to asserting avoidance claims only under state fraudulent transfer law. Rather, it permits a trustee to stand in the shoes of a creditor and assert claims under all applicable law to void a transfer. Thus, standing in the shoes of the IRS, a trustee can assert claims under the FDCPA and IRC, which have longer look-back periods.

The chapter 7 trustee brought an avoidance action under section 544 relying on the Federal Debt Collection Procedures Act ("FDCPA") and the Internal Revenue Code ("IRC") as "applicable law." The statute of limitations under the FDCPA is 6 years. In contrast, the trustee standing in the shoes of the IRS, may be immune from state law statutes of limitations under sovereign immunity. The defendant argued that the FDCPA and the IRC are not "applicable law" under section 544(b)(1) and thus the trustee could not take advantage of the extended look-back period under the IRC.

Applying principles of statutory construction, the bankruptcy court found that "applicable law" as used in section 544(b)(1) contains no limiting language except that there be a "triggering" creditor into whose shoes the trustee must step. Further, the language of section 544(b)(1) does not limit which of the debtor's actual creditors the trustee may rely upon, except that the creditor must hold an unsecured claim allowable under section 502, or not allowable only under section 502(e). The bankruptcy court also noted that the purpose of section 544(b)(1), when applied in conjunction with the recovery provisions of section 550, is to restore the estate to its financial condition prior to the occurrence of an avoidable transfer. Thus, allowing a trustee to utilize all "applicable law" furthers the trustee's ability to accomplish this purpose. The bankruptcy court found that nothing in the FDCPA or the IRC limited or prohibited a trustee from relying on their provisions. Consequently, the trustee could rely on the FDCPA and IRC to bring avoidance actions, including the longer look-back periods.

The bankruptcy court in *Gordon* reached the same conclusion regarding a trustee's claim under section 544(b) based upon the FDCPA and identifying the IRS as the unsecured creditor with the standing to assert the claim.

Merit Mgmt. Group, LP v. FTI Consulting, Inc., -- U.S. --, 138 S. Ct. 883 (2018)

Bankruptcy courts must examine the transfer that is the subject of a clawback action – and not its component parts – for the safe harbor under section 546(e) to apply. Simply because an intermediary "transfer" was made by or to (or for the benefit of) a financial institution does not mean that the final transferee is protected by section 546(e).

A trustee of a litigation trust created under a confirmed chapter 11 plan sued to avoid the debtor's allegedly fraudulent transfers to the partial owner of the debtor's competitor, made as part of the debtor's purchase of the competitor's stock. The Supreme Court was asked to resolve a circuit split and determine the applicability of the "safe harbor" provision of section 546(e) where one of the intermediary transfers was "made by or to (or for the benefit of) a … financial institution."

The Supreme Court first noted that the initial question presented – whether the safe harbor applies because the transfer was "made by or to (or for the benefit of) a … financial institution" – put the "cart before the horse." Rather, the first step in the analysis must be to identify the relevant transfer at issue. Appellant argued that the Supreme Court must consider all the component parts of the transfer, not just the overarching transfer. The appellee, on the other hand, argued that the only relevant transfer was the overarching transfer between the debtor and appellant.

The Supreme Court held that the critical transfer was the overarching transfer, not the intermediary transfers. In reaching this conclusion, the Supreme Court looked to the text of section 546(e) and the specific context in which its language is used. Specifically, section 546(e) itself included a limitation on its application – it does not apply to actual fraudulent transfers under section 548(a)(1) – thus indicating that it applies to the overarching transfer. Further, section 546(e) uses the phrase "may not avoid" rather than "comprise of." Consequently, the Supreme Court determined that the statutory language and the context in which it is used support a finding that the transfer the trustee sought to avoid is the relevant transfer for consideration under section 546(e).

The Supreme Court rejected appellant's argument that the clauses "or for the benefit of" and "securities clearing agencies" were intended to protect the overarching transfer if a component of the overarching transfer was made to a protected intermediary financial institution or security clearing agency. The Supreme Court focused on the transfer that the trustee sought to avoid, and not its component parts, in determining the terms "or for the benefit of" and "securities clearing agencies" do not extend the safe harbor provision to the final transferee if such transferee is not otherwise a protected entity.

Thus, the relevant transfer for purposes of section 546(e) was the transfer the trustee sought to avoid – not the component parts that make-up that transfer.

PHA Litigation Trust v. Water St. Healthcare Partners, L.P., (In re Physiotherapy Holdings, Inc.), 2017 WL 5054308 (Bankr. D. Del. Nov. 1, 2017)

Bankruptcy court finds that potential recovery in a fraudulent transfer action is not limited to the amount of unpaid claims under confirmed plan; the litigation can proceed for the benefit of parties who received equity interests in the reorganized debtor notwithstanding that their allowed claims under the plan have been paid due to the post-confirmation appreciation in value of the estate.

The debtor failed shortly after a leveraged buyout and filed a chapter 11 petition. The debtor asserted that the sellers provided fraudulent financial information to induce the LBO. Under the debtor's plan, unsecured noteholders (who had provided the bulk of the LBO financing) received equity in the reorganized debtor, which the bankruptcy court found had a value of 40 percent of their allowed claims. The plan also created a litigation trust to pursue fraudulent transfer claims against the sellers. Under the trust, the noteholders and the purchasing shareholder under the LBO were each entitled to 50 percent of any recovery by the trust.

After the litigation trust sued the sellers, the reorganized debtor was sold for much more than the value of the noteholders' equity interests under the plan, but arguably for less than the value of the claims the noteholders had exchanged for equity. The sellers/defendants argued that recovery under the fraudulent transfer claims were capped at the amount of unpaid claims under the plan and the noteholders had received more than that amount as a result of the sale of the reorganized debtor. The trust argued that it was entitled to recover the full amount received by sellers under the LBO regardless of the amount of unpaid claims under the plan. The parties asked the court to rule on this issue to facilitate mediation.

The court found that the trust's claims were not capped by the amount of unpaid claims under the plan. Sections 544(b) and 548 allow a trustee to avoid a fraudulent transfer and section 550 allows recovery from a transferee "for the benefit of the estate." The court observed that while the answer was not clear cut other courts have found that there is no cap on recovery of fraudulent transfers (section 548(a) provides for "avoidance" of such a transfer, not a part thereof). Those cases have also found that the "for the benefit of the estate" language in section 550 does not limit recovery to the amount of creditor claims because the estate comprises interests beyond just those of creditors, such as the interests of equity holders. The court further found that if the claims were capped, sellers/defendants would be able to keep most of the money they had fraudulently received (thereby benefiting from post-plan appreciation of the debtor, as to which they had played no part).

The court also looked to *Moore v. Bay*, 284 U.S. 4 (1931) where the Supreme Court held that a trustee could avoid a fraudulent transfer in its entirety, for the benefit of the estate, and that recovery was not limited to the amount of the triggering claim. The estate comprises more than the interests of creditors. Further, the noteholders, who took equity under the plan, will not receive a windfall: they took the risk of future depreciation of their equity and thus should be entitled to any future appreciation. Likewise, a decline in the value of their equity interests would not have affected the amount of a litigation recovery, and neither should an increase in value. Accordingly, the trust's recoverable amount is not limited to the amount of unpaid claims under the plan.

CASE COMMENCEMENT AND ELIGIBILITY

Citizens & Northern Bank v. Monroe Heights Develop. Corp., Inc. (In re Monroe Heights Develop. Corp., Inc.), 2017 WL 3701857 (Bankr. W.D. Pa. Aug. 22, 2017)

Bankruptcy court dismisses chapter 11 petition filed on its behalf by its controlling shareholder where state court appointed a receiver with the powers of the debtor's board of directors (including the power to file a petition for the debtor).

The debtor owned three hotels which served as collateral for a bank loan. After the loan went into default, the bank sought appointment of a receiver for the debtor. A state court entered a receivership order giving the receiver the powers of the debtor's board of directors. Six days after appointment of the receiver, the debtor's 90 percent shareholder filed a bankruptcy petition on behalf of the debtor. The bank moved to dismiss the petition, arguing that under the receivership order the receiver had stepped into the shoes of the debtor's board of directors and that under state law only the board could authorize a bankruptcy filing. The shareholder responded that the receivership order impermissibly interfered with the debtor's right to file for bankruptcy.

The bankruptcy court agreed with the bank that state law controls who can file a bankruptcy petition for a corporate debtor and that applicable state law generally vests that power in the board of directors, and not a shareholder. The court expressed concern that the shareholder was asking it to second-guess a state court judgment in violation of the *Rooker-Feldman* doctrine (which denies federal courts authority to review state court judgments). If the shareholder believed the receivership order had inappropriately given the receiver the powers of the board, his recourse should have been to the state court of appeals.

Looking to *In re Corp. & Leisure Events Prods., Inc.*, 351 B.R. 724 (Bankr. D. Az. 2006), the shareholder argued that the receivership order did not merely change the identity of the party authorized to file bankruptcy on behalf of the debtor, but effectively blocked the debtor from access to the bankruptcy court. The *Leisure* court ruled that appointment of a receiver at the request of a creditor does not divest the parties originally authorized to file a petition for a debtor from doing so (on the theory that the receiver would favor the interests of the creditor).

The bank, in turn, looked to *Sino Clean Energy, Inc. by and through Baowen Ren v. Seiden*, 565 B.R. 677 (D. Nev. 2017), where shareholders of a debtor had obtained appointment of a receiver who had dismissed the board and appointed a new board. Months later, the former board filed a bankruptcy petition for the debtor. The *Sino* court dismissed the petition, finding that the receiver had been properly appointed under state law, there was no evidence that the new board or the receiver could not file for bankruptcy on behalf of the corporation, and there was no evidence the receiver was biased and would not act fairly toward all constituencies.

Here, the bankruptcy court adopted the *Sino* court approach: in the absence of a showing that the state court proceeding resulted in an improper impediment to a corporate debtor's access to bankruptcy court, due, for instance, to the receiver's favoritism toward a particular creditor or constituency, then there is no reason not to defer to the action of the state court. Accordingly, the bankruptcy court dismissed the petition.

CLAIMS AND PRIORTIES

In re SRC Liquidation, LLC, 573 B.R. 537 (Bankr. D. Del. 2017)

Goods delivered by a vendor directly to the debtor's customers do not qualify as goods received by the debtor under section 503(b)(9).

Pre-petition, the debtor purchased goods from a vendor who would either deliver its products directly to the debtor or directly to the debtor's customers, "at the debtor's direction and utilizing the debtor's account with United Parcel Service." Both the debtor and the vendor agreed that the goods delivered directly to the debtor in the 20 days prior to the petition date qualified as goods received by the debtor under section 503(b)(9), but the parties disagreed as to the status of the goods shipped directly to the debtor's customers.

The bankruptcy court held that delivery of goods directly to a customer, even at the direction of the debtor and using the debtor's accounts to pay for shipping, did not constitute constructive receipt by the debtor under the Uniform Commercial Code. Accordingly, the creditor's request for administrative priority for goods shipped directly to customers was denied under section 503(b)(9). This decision was issued just days after the decision by the Third Circuit in In re World Imps., Ltd., and the finding that "receipt" requires physical possession by the debtor or its agent was consistent with that opinion.

Even prior to the Third Circuit's guidance in In re World Imps., Ltd., the Delaware bankruptcy court was faced with a substantially similar issue in In re ADI Liquidation, Inc., 572 B.R. 543 (Bankr. D. Del. 2017) and similarly held that shipments made directly to the debtor's customers pursuant to an arrangement between the parties did not qualify as goods "received" by the debtor under section 503(b)(9).

In re World Imps., Ltd., 862 F.3d 338 (3rd Cir. 2017)

Goods are "received" under Section 503(b)(9) when the debtor or its agent takes physical possession of the goods, not when goods are delivered to a common carrier.

Section 503(b)(9) provides that a creditor may have a priority administrative expense claim for the value of goods "received by the debtor within 20 days before" a bankruptcy petition is filed. Prior to the petition date, two creditors sold goods to the debtor in the ordinary course of business. The goods were shipped via common carrier from China to the United States "free on board" at the port of origin, so that the risk of loss passed to the debtor upon transfer at the port. The goods were shipped more than 20 days before the petition date, but were physically received by the debtor fewer than 20 days before the petition. The creditors moved for allowance of administrative expense claims under section 503(b)(9).

The creditors asserted that the goods were "received" when they were physically accepted by the debtor. The debtor argued that the goods were "received" upon shipment in China. The Code does not define "received" in section 503(b)(9). The bankruptcy court, relying upon the Convention on Contracts for the International Sale of Goods, held that the goods were "constructively received" at the port because the risk of loss transferred at that point. Accordingly, the bankruptcy court found for the debtor because the goods were therefore received more than 20 days prior to the petition date and thus were not subject to section 503(b)(9) treatment. The district court affirmed.

The Third Circuit reversed, finding that "based on the ordinary meaning of 'received,' the legislative context of the Bankruptcy Code, and the persuasive decisions finding that Congress meant to use the Uniform Commercial Code definitions for this particular amendment to the Bankruptcy Code, the goods were 'received' when the debtor or its agent takes physical possession of them." This definition is consistent with the interpretation of "received" under section 546(c). The Third Circuit further clarified that common carriers are not agents and therefore "constructive receipt" cannot include delivery to a common carrier. Accordingly, the transfer of risk of loss is not the same as receipt for the purpose of analyzing section 503(b)(9) claims.

EXECUTORY CONTRACTS AND LEASES

In re Cho, -- B.R. --, 2018 WL 1309591 (Bankr. D. Md. March 13, 2018) (Harner, J.)

An oral settlement agreement with the debtor that has unperformed, material promises under state law constitutes an executory contract subject to rejection under section 365.

Chapter 11 debtors filed a motion to reject under section 365(a), as an executory contract, a prepetition settlement agreement reached in Maryland state court between the debtors and the former owners of the business. The debtors had refused to sign the written settlement agreement, but orally agreed to and acknowledged its terms under oath in state court. The debtors argued that they were not bound by the agreement because they did not sign it or, alternatively, the agreement was an executory contract subject to rejection. Former owners of the business objected, asserting that agreement was enforceable and was not an executory contract subject to rejection.

The bankruptcy court held that under Maryland law, a parties' oral settlement agreement was a valid and enforceable contract. The court then considered the executory nature of the agreement, noting that because the Code does not define an "executory contract," courts use one of two tests to determine whether a contract is executory for purposes of section 365: the Countryman test and the Functional test. Applying the Countryman test – as adopted by the Fourth Circuit in *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th

Cir. 1985) – the court examined whether there were material unperformed promises by both parties to the agreement.

After concluding that both parties had unperformed obligations under the settlement agreement, the court examined whether the parties' non-disparagement obligations were sufficient material, affirmative obligations to render the settlement agreement to be executory. The court surveyed several cases – some finding that obligations to refrain from taking a certain action are affirmative, material obligations and others finding that such obligations are restrictive covenants that are passive and not affirmative in nature. In agreeing with the analysis *In re WorldCom, Inc.*, 343 B.R. 486 (Bankr. S.D.N.Y. 2006), the court found that the latter approach places form over substance and that the non-disparagement obligations were material to the agreement. Consequently, the court found that settlement agreement in issue was an executory contract subject to rejection under section 365.

The court's decision is a useful reminder of the essential elements and considerations for determining what is an executory contract under section 365, particularly, in the Fourth Circuit.

PLANS/CONFIRMATION ISSUES

In re Millennium Lab Holdings II, LLC, 575 B.R. 252 (Bankr. D. Del. 2017)

Bankruptcy court finds that it has Constitutional authority to confirm a plan of reorganization that includes non-consensual releases of non-debtor fraud and RICO claims against other non-debtors. Confirmation of such a plan is not an adjudication of such claims that would be barred by Article III of the Constitution.

The chapter 11 debtor's plan provided for the release of common law fraud and RICO claims asserted by non-debtor third parties ("Claimants") against non-debtor equity holders who were making a substantial ($325MM) contribution to the plan. The contribution was essential to the reorganization. The bankruptcy court confirmed the plan and Claimants appealed. The district court remanded the case, directing the bankruptcy court to consider if it had constitutional adjudicatory authority to approve the nonconsensual release of Claimants' common law fraud and RICO claims against the equity holders.

Claimants argued, among other things, that *Stern v. Marshall*, 564 U.S. 462 (2011), precluded the bankruptcy court from entering a final order confirming the plan because Claimants' claims against the equity holders did not stem from the bankruptcy itself, nor did they need to be resolved in the claims' allowance process.

The bankruptcy court disagreed. While a bankruptcy court lacks constitutional authority to issue final orders adjudicating state law claims under the court's related to jurisdiction, it may nonetheless enter final orders in core proceedings, including confirmation of a plan which impacts state law claims. Here, the operative proceeding for purposes of a constitutional analysis is confirmation of a plan which is an enumerated core proceeding under 11 U.S.C. § 157(b).

Looking to *Stern,* confirmation of a plan is not a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim, nor is it a claim of any type.

Confirmation of a plan, for which there is no state law equivalent, requires the application of federal standards under sections 1129(a) & (b). It is widely recognized that nonconsensual third-party releases are permissible in a plan if they meet certain standards of fairness and necessity to the reorganization. Article III of the Constitution does not preclude a bankruptcy court from entering a final order in a core matter, such as confirmation of a plan, even though the plan impacts or even precludes a state law action between two non-debtors as to which the bankruptcy court has only related to jurisdiction or even no jurisdiction. Here, the bankruptcy court's decision to confirm the plan with the releases was based on standards fixed by the Code for confirmation and was thus not an improper adjudication of Claimants' common law claims. Accordingly, the court finds that it had constitutional authority to confirm the plan with the releases.

Nota Bene: In *In re Midway Gold US, Inc.*, 575 B.R. 475 (Bankr. D. Colo. 2017), decided three days after *Millennium Lab*, the court denied confirmation of a plan providing for non-consensual releases of non-debtor claims against other non-debtors, finding that it lacked even related to jurisdiction over such claims and notwithstanding that the released parties were making contributions essential to the success of the plan. Even such essential contributions did not create related to jurisdiction over the claims being released. The court noted that it had not been provided with evidence of potential claims for contribution or indemnification by the released parties against the estate which could change its jurisdictional ruling. The decision did not include a *Stern* analysis.

<u>In re SunEdison, Inc.</u>, 576 B.R. 453 (Bankr. S.D.N.Y. 2017)

A plan may not grant third-party releases of claims of non-voting creditors when the plan and disclosure statement do not create a "duty to speak".

The debtors' joint plan contained a broad third-party release in favor of numerous non-debtors. The releasing parties, as defined by the plan, included both parties who vote in favor of the plan and "all Holders of Claims entitled to vote for or against the Plan that do not vote to reject the plan." No one objected to the release, but the court *sua sponte* raised the issue of whether the release should be approved and reserved the issue after confirming the rest of the plan.

Here, the bankruptcy court noted that to determine whether a creditor consents to a third-party release, courts apply general contract principals, including that consent may be express or illustrated by conduct. Courts agree that an affirmative vote to accept a plan constitutes consent to any third-party release contained therein. Alternatively, "absent a duty to speak, silence does not constitute consent" and a party cannot grant consent by not voting. There are exceptions to this general contract rule and acceptance by silence is valid when (1) it is supported by the parties' conduct; (2) the silent party accepts the benefits of the offer despite opportunity to reject them and understands the offeror expects compensations; and (3) the offeror has given the offeree reason to understand that silence will constitute acceptance and by staying silent the party intends to accept the offer. The third exception is intrinsically linked to a desire to mislead by remaining silent, and only with the intention to mislead is silence considered affirmative consent.

The court determined that the debtors "failed to demonstrate that the Non-Voting Releasors impliedly consented to the Release" and that the court could not otherwise approve the release. The court held that the non-voting parties did not provide consent to the third-party releases in the plan because there was no affirmative duty for them to speak and therefore remaining silent did not constitute consent. The warning in the disclosure statement and on the ballots, regarding the effect of not voting on the plan, was not sufficient to establish a duty to speak because (1) there was no intention of the non-voting creditors to mislead the debtors by their silence as required by the exception; and (2) the silence did not affirmatively signify consent to the release. The court further held that it did not otherwise have subject matter jurisdiction to approve the release of the non-voting creditors' claims and could not approve the release in its presented form.

JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Properties Inc., 881 F.3d 724 (9th Cir. 2018)

Ninth Circuit finds, as a matter of first impression among the courts of appeal, that section 1129(a)(10) is satisfied on a "per plan" rather than a "per debtor" basis in connection with confirmation of a joint plan. A plan need not include a due-on-sale provision when a creditor makes the section 1111(b) election as to its under-secured claim.

Five related entities (a holding company, two mezzanine debt borrowers, and two operating companies) filed separate chapter 11 cases which were jointly administered, but not substantively consolidated. The holding company debtor owned the mezzanine debtors, which owned the operating debtors, which, in turn, owned two resort hotels. The five entities filed a joint plan of reorganization, under which the operating debtors were to be sold to a third party, thereby extinguishing the mezzanine debtors' ownership interest in the operating debtors.

Prepetition, a lender (the "Lender") made a loan to the operating entities secured by the hotels. A different lender made a loan to the mezzanine debtors, which loan the Lender acquired during the bankruptcy cases. The Lender's claim against the operating entities was under-secured.

Under section 506(a) an under-secured claim is typically bifurcated into a secured claim (up to value of the collateral securing the claim) and an unsecured claim for the balance. Nonetheless, with certain limitations, section 1111(b)(2) allows an under-secured creditor to elect to have its entire claim treated as secured. Here, the Lender made the section 1111(b)(2) election.

The joint plan included a due-on-sale provision requiring the debtors to pay the Lender the outstanding balance of its claim in the event the hotels were sold. However, this clause did not apply if the hotels were sold between years 5 and 15 of the 21-year term of the plan. The

Lender asserted that the 10-year exception to the due-on-sale clause improperly undermined the benefit of its section 1111(b)(2) election. The Ninth Circuit disagreed, based upon a plain reading of section 1111(b)(2). The court found that neither the text of section 1111(b)(2), which is silent as to due-on-sale provisions, nor the broader context of chapter 11, requires a plan involving an electing creditor to have a due-on-sale clause, which is a mechanism regarding the terms of payment of a debt, not a substantive right.

Under section 1129(a)(10), if there is an impaired class under a plan, at least one impaired class must accept the plan for confirmation. Here, the lower courts found section 1129(a)(10) applied on a "per plan" rather than a "per debtor" basis. The Lender argued that section 1129(a)(10) required that at least one impaired class as to each debtor accept the joint plan. As a matter of first impression among the circuit courts, the Ninth Circuit held that section 1129(a)(10) applies on a "per plan" basis. The court again applied a plain language analysis, noting that section 1129(a)(10) does not distinguish between single-debtor and multi-debtor plans. If Congress had intended otherwise, it easily could have said so. The court noted that *In re Tribune Co.*, 464 B.R. 126 (Bankr. D. Del. 2011) had found to the contrary, based on section 102(7) which provides that the singular includes the plural under the Code. The Ninth Circuit found that section 102(7) did not undermine its "per plan" position. Accordingly, the Ninth Circuit found that section 1129(a)(10) was satisfied so long as one impaired class accepted the joint plan.

<u>Lawski v. Frontier Insurance Group, LLC (In re Frontier Insurance Group, Inc.)</u>, 2018 WL 922194 (Bankr. S.D.N.Y. Feb. 15, 2018)

Judicial estoppel may not protect a party's claimed interests in property if the party knew or should have known that the debtor was (or could be) asserting a contrary claim and the claimant fails to act, regardless of the debtor's failure to fully disclose its interest or claim.

A dispute arose between the reorganized debtor and a state law statutory liquidator for a subsidiary of the debtor over title to a reversionary interest in real property. Under state law, title to the reversionary interest would typically vest with the liquidator. The chapter 11 plan, however, vested all the debtor's assets in the reorganized debtor.

The liquidator alleged that the debtor failed to sufficiently disclose the real property because of the descriptions used in the debtor's schedules. The bankruptcy court examined whether judicial estoppel warranted a ruling for the liquidator.

The bankruptcy court examined two schools of thought: (1) the approach applied in *Eastman v. Union Pac. R.R.*, 493 F.3d 1151 (10th Cir. 2007) and *Adelphia Recovery Trust v. Goldman Sachs & Co.*, 748 F.3d 110 (2d Cir. 2014), which recognizes the importance of accurate disclosure and, thus, applies judicial estoppel whenever there is any intentional failure of disclosure, regardless of which party invokes the doctrine's role in the bankruptcy case and whether there has been any adverse effect; and (2) the "nuanced" approach applied in *Slater v. United States Steel*, 871 F.3d 1174 (11th Cir. 2017), whereby in the bankruptcy context, the court should consider all the circumstances of the case to reduce the risk that the party invoking the doctrine would receive an unjustified windfall or harm innocent creditors.

Applying the nuanced approach from *Slater*, the bankruptcy court considered, among other things, the non-disclosure's harm to the debtor's general creditors (none), the debtor's intent in not disclosing the asset (no malicious or willful intent), and the understanding of the parties, including the liquidator's predecessor, throughout the case and in confirming the plan as to what entity held title to the reversionary interest (all parties understood the debtor to hold title). Considering these factors, the bankruptcy court refused to apply judicial estoppel and held that notwithstanding the contrary outcome under state law, the reorganized debtor held title to the reversionary interest in the real property. In sum, a party may lose its interest in property if it knows or should have known that the debtor is (or could be) asserting a contrary claim and fails to act, regardless of the debtor's failure to fully disclose its interest or claim.

<u>Momentive Performance Materials Inc. v. BOKF, NA (In re MPM Silicones, L.L.C.)</u>, 874 F.3d 787 (2d Cir. 2017)

A bankruptcy court should require that cram down notes pay a market rate of interest where an efficient market exists for comparable loans, notwithstanding the formula approach adopted in Till v. SCS Credit Corp. Court disallows make whole premium based upon automatic acceleration of notes upon bankruptcy filing.

The bankruptcy court confirmed the debtor's plan of reorganization, which provided for issuance of cramdown notes to senior secured lenders who voted to reject the plan. The interest rates under the notes were based upon the "formula" approach adopted by the plurality in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004). Under the *Till* formula, the bankruptcy court starts with the largely risk-free national prime rate and then determines a plan-specific risk adjustment to the prime rate, typically 1% to 3%. In following *Till*, the bankruptcy court declined to consider expert testimony offered by the lenders that an efficient market existed for the types of loans/notes they were receiving. Section 1129(b)(2)(A) requires that a secured creditor who rejects a plan must receive deferred payments with a value equal to present value of its claim, which is achieved by the inclusion of an appropriate rate of interest. The secured creditors argued that under section 1129(b)(2)(A), they were entitled to notes at a market rate rather than at a rate determined under the *Till* formula approach.

The Second Circuit agreed with the lenders. *Till* was a chapter 13 case where there was no efficient market for the loan being made under the plan. The *Till* plurality had suggested that the formula approach might not be appropriate in a chapter 11 case where an efficient market for the loans in question might exist. The bankruptcy court erred in dismissing the testimony on market rates of interest, and thus the case should be remanded so that the bankruptcy court can ascertain if an efficient market rate exists. If it does, bankruptcy court should apply that rate rather than the *Till* formula rate.

The senior secured lenders also asserted that they were entitled to receive payment of a "make-whole" premium provided under their original loan documents. The make-whole premium was intended to ensure that the lenders received additional compensation to make up for the interest they would not receive if their prepetition notes were redeemed prior to their maturity date. The lenders argued that the replacement notes they were receiving under the plan represented an optional redemption of the original notes prior to their maturity date, thus triggering the lenders' right to receive the make-whole premium.

The Second Circuit rejected the claim for a make-whole premium. The bankruptcy petition triggered a default under the notes and this default automatically accelerated the debt, changing the maturity date to the date of the bankruptcy petition. Thus, the notes were not being paid prior to maturity, and payment of the notes (made mandatory by their acceleration) was not made at the debtor's option. In reaching this result, the court followed its reasoning in *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013). The court noted that the Third Circuit had reached a contrary result in *In re Energy Future Holdings Corp.*, 842 F.3d 247 (3d Cir. 2016).

PROFESSIONALS AND COMPENSATION

In re Hungry Horse, LLC, 574 B.R. 740 (Bank. D. N.M. 2017)

A debtor may retain counsel whose employment includes a "fee-defense provision" if the terms of the provision are reasonable as required by section 328.

A chapter 11 debtor retained bankruptcy counsel whose employment was approved by the bankruptcy court. During the case, the primary attorney representing the debtor changed law firms. The old law firm withdrew its representation and the debtor sought approval to employ the new law firm. The terms of the new law firm's engagement agreement included a fee-defense provision.

The fee-defense provision permitted the firm to recover its fees and expenses for defending any objections to court approval of its fees, and collecting and/or obtaining approval of those fees. The unsecured creditors committee objected, arguing that the fee-defense provision was contrary to the Supreme Court's holding in *Baker Botts LLP v. ASARCO*, 135 S. Ct. 2158 (2015). In considering the committee's objection, the bankruptcy court examined two post-*Baker Botts* decisions that each reached a different conclusion regarding the viability of a fee-defense provision in a bankruptcy counsel's engagement agreement.

In *In re Boomerang Tube Inc.*, 548 B.R. 69 (Bankr. D. Del. 2016), the bankruptcy court sustained an objection to a fee-defense provision in a committee counsel's retention agreement. The *Boomerang Tube* court noted that section 328 is not a statutory exception to the American Rule because it does not provide a specific and explicit authorization of attorneys' fees to a prevailing party. The *Boomerang Tube* court also noted that the retention agreement at issue was not a contractual exception to the American Rule because the party responsible for paying the fees (the estate) was not a party to the agreement, which was between the committee and its counsel.

In the second case, *In re Nortel Network, Inc.*, 2017 WL 932947 (Bankr. D. Del. 2017), an indenture trustee asserted a right to be paid its fees in defending its attorneys' fee claim against the bankruptcy estate. The bankruptcy court, after reviewing *Baker Botts* and *Boomerang Tube*, found that the indenture trustee's contract qualified as an exception to the American Rule.

After considering the two Delaware cases, the bankruptcy court overruled the committee's objection. The court found that the contract exception to the American Rule remains viable in bankruptcy cases. Further, it found that a properly drafted fee-defense provision could be a "reasonable term" under section 328(a). Specifically, the court found that a "reasonable term" should: (i) be agreed to by the bankruptcy estate; (ii) allow the bankruptcy court to review and approve the reasonableness of any fee-defense fees sought; (iii) provide that the estate will also agree to a similar provision for committee counsel; and (iv) provide that no fees will be allowed for unsuccessful fee-defense work.

The holding in *Hungry Horse* reflects an effort to strike a balance between the concerns raised in *Boomerang Tube*, the requirements under sections 328 and 330 for professional retention and compensation, and a party's right to contract to reasonable terms with its chosen counsel. In reaching its decision, the bankruptcy court also considered that in its jurisdiction (New Mexico) cases were typically small, which meant that fee-defense fees could often amount to a sizeable percentage of a professional's total fees billed.

<u>In re NETtel Corp.</u>, 2017 WL 5664840 (Bankr. D.D.C. Sept. 29, 2017).

Bankruptcy court orders trustee to disgorge interim compensation to achieve pro rata distribution to administrative claimants. Funds recovered from a secured creditor under section 506(c) are for the benefit the estate in general rather than for the benefit of the claimants whose expenses were the basis of the section 506(c) surcharge.

The debtor's chapter 11 case was quickly converted and a chapter 7 trustee appointed. The trustee operated the business. The trustee paid the debtor's operating expenses and the bankruptcy court approved payments of interim compensation to the trustee and his law firm. The case became an administrative insolvency. The interim compensation paid to the trustee and his firm came, in part, from a surcharge of secured creditor collateral under section 506(c). The trustee filed a final report under which the trustee and his firm would receive roughly 99 percent of their administrative claims, while the other administrative claimants would receive about 62 percent of their claims. The court, *sua sponte*, ordered the parties to brief the issues of how the remaining funds held by the trustee should be distributed and whether the trustee and his firm should be required to disgorge funds to allow for pro rata payment of the administrative claims.

Section 506(c) allows a trustee to surcharge a secured creditor's collateral so that the estate's unencumbered funds are not used for a secured creditor's benefit. The issue arises as to whether a recovery under section 506(c) is for the benefit of the estate in general or should be used to compensate the claimants who provided the benefit to the secured creditor. The trustee argued the latter position in seeking to justify the greater percentage payments to himself and his firm. Section 726(b) requires pro rata distribution of estate funds to pay administrative claims when there are insufficient funds to pay all such claims in full.

Noting a split of authority, the court ruled that section 506(c) is a “recovery” provision rather than a “distribution” provision, and thus amounts recovered under section 506(c) must be distributed in accordance with section 726(b), notwithstanding that the surcharge was paid on account of work of the trustee and his firm. The court adopted much of the reasoning of the Fourth Circuit in *Ford Motor Credit Co. v. Reynolds & Reynolds Co. (In re JKJ Chevrolet, Inc.)*, 26 F.3d 481 (4th Cir. 1994). Among other things, the Fourth Circuit noted that in an administrative insolvency the trustee would have no incentive to pursue a section 506(c) recovery beyond the amount necessary to pay his own claim if such a recovery was paid directly for his benefit.

The court noted that interim compensation awards are not final and remain subject to modification at any time during a case. Further, the court has discretion under section 105(a) to require disgorgement of interim compensation to enforce section 726(b)’s pro rata distribution requirements. While disgorgement is a harsh remedy, the equities weighed in its favor: other administrative claimants should not be penalized because they are unable to receive interim compensation and professionals should not receive a windfall because they can collect such payments. The court ordered the trustee and his firm to disgorge over $200,000 and directed that all of the remaining funds held by the trustee be distributed to other administrative claimants.

<u>In re Stanton</u>, 569 B.R. 840 (Bankr. M.D. Fla. 2017)

Notwithstanding the Supreme Court’s holding in <u>Baker Botts</u>, a professional employed under section 327(a) may recover the costs of amending a fee application to address objections because such amendments serve the estate as they permit the U.S. trustee and parties-in-interest to understand the work performed and make further objections. A <u>Baker Botts</u> objection can be waived if not timely raised.

A chapter 7 trustee hired special counsel to prosecute a fraudulent transfer claim. After negotiating a settlement, special counsel filed a fee application. The U.S. trustee objected, insisting on additional details. Special counsel supplemented the fee application with additional detail. The bankruptcy court approved the application.

Special counsel then filed a second fee application, which included fees for preparing and “successfully defending” the first application. While the second application was pending, the Supreme Court issued its decision in *Baker Botts LLP v. ASARCO*, 135 S. Ct. 2158 (2015), which held that estate professionals are not entitled to attorneys’ fees for work performed defending a fee application because such work did not benefit the estate and violated the American Rule (under which each side pays its own legal fees in the absence of a statutory or contractual obligation to the contrary). The U.S. trustee, however, did not raise a *Baker Botts* objection and the court approved the second application.

When special counsel filed a third fee application, the U.S. trustee objected, seeking to set-off the amounts previously approved in the second application for "successfully defending" the first application. The bankruptcy court overruled the objection on two grounds.

First, the bankruptcy court reiterated its prior holdings that *Baker Botts* does not impose a temporal limitation on a professional's ability to recover fees for work performed after an objection to a fee application. Instead, *Baker Botts* "stands for the proposition that fees are only recoverable if they are incurred in service to the estate." *In re Stanton*, 569 B.R. 840, 843. Time spent by special counsel supplementing its first fee application, *e.g.*, "successfully defending" the application, was in service to the estate because it provided parties-in-interest with information to understand the work performed, and thus, if necessary, the ability to object.

Second, the court found that the U.S. trustee's *Baker Botts* objection was untimely. Although bankruptcy courts can revisit interim fee awards, the bankruptcy court found that the U.S. trustee waived its *Baker Botts* objection. First, the court noted that the proper time for the U.S. trustee to insist on heightened disclosures was at the commencement of special counsel's employment, not near its conclusion. Second, the court found that the U.S. trustee knew or should have known, that he had a right to assert a *Baker Botts* objection, particularly because *Baker Botts* reaffirmed a Fifth Circuit decision, which was based on the prior (and previously controlling) Eleventh Circuit decision in *Grant v. Schumann Tire & Battery Co.*, 908 F.2d 874 (11th Cir. 1990). As such, the U.S. trustee had a viable and good faith basis for objecting when the second fee application was filed, even without the *Baker Botts* decision.

In short, bankruptcy courts continue to interpret and apply *Baker Botts*, with courts emphasizing the need that fees be incurred in service to the estate, but a *Baker Botts* objection can be waived if not timely raised.

<u>McProud v. Siller (In re CWS Enters.)</u>, 870 F.3d 1106 (9th Cir. 2017)

When pre-petition attorneys' fees are evaluated for reasonableness under section 502(b)(4), that section acts as a federal cap on any fees previously awarded under state law, but if the previous analysis considers reasonableness under a standard similar to the Code, the state court determination precludes any later analysis of reasonableness.

Section 502(b)(4) limits claims for pre-petition attorneys' fees upon objection of an interested party, if the claim exceeds the reasonable value of the provided services. The Code does not define "reasonable" in this context.

Long before the debtor company was formed, the debtor's owner hired two law firms to conduct substantial legal work on his personal behalf. Both law firms were hired on contingency, and were tasked with representing the owner in difficult litigation. After the owner obtained a large settlement, the debtor was established to provide tax protection to the awarded funds. The debtor subsequently refused to pay the contingency fees earned by the law firms. Pursuant to arbitration clauses in both retention agreements, the parties arbitrated the fee disputes. The arbitrator analyzed the reasonableness of the fee arrangements and awarded the law firms the full amount of fees allowed under the contingency arrangements. The debtor ignored the award, and the law firms obtained a money judgment from a California state court. The debtor filed a chapter 11 petition to prevent execution on the judgment and objected to the amount of pre-petition fees claimed by the law firms.

The bankruptcy court ignored the value of the arbitration award, and applied a loadstar approach to evaluate the pre-petition fees for "reasonable value" under section 502(b)(4). The bankruptcy court lowered the allowed fees significantly as a result of the loadstar analysis. In doing so, the bankruptcy court found that the arbitrator had not determined "reasonableness" of the fees, but rather conducted a contract analysis of the fee agreement.

The law firms appealed and the district court reversed. The district court determined that "the similarity between the standard for determining the unconscionability of a contingent fee agreement…and the bankruptcy court's standard for determining the reasonable value of the fees" suggests that the appropriate fee was properly determined by arbitration, and issue preclusion applied to any further challenges to the amount of the award. The debtor appealed.

The Ninth Circuit followed the Third and Tenth Circuits in finding that the "bankruptcy code's reasonableness cap [under section 502(4)(b)] limits a pre-petition obligation for a debtor's attorneys' fees, even if such fees were allowable under state law, and even if such fees had been reduced to a state court judgment." To evaluate attorneys' fees under section 502(4)(b) in conjunction with the Full Faith and Credit Act[3], the Ninth Circuit found that the appropriate analysis of the "reasonableness" of pre-petition attorneys' fees first requires a determination of damages under state law because it is the "source of allowable contract damages for a breached attorney's fee arrangement". The second part of the analysis under section 502(b)(4) acts as a federal cap on any fee determined by state law. To determine if there should be a reduction in fees under that cap, the Ninth Circuit found that the proper mode of analysis is "(1) an acknowledgement or determination that the fee contract was breached; (2) an assessment of the damages for the breach under state law; (3) a determination under section 502(b)(4) of reasonableness of the damages claim afforded by state law; and (4) a reduction of the claim by whatever extent, if any, it is deemed excessive."

Here, the Full Faith and Credit Act required the bankruptcy court to give deference to the state court's judgment because issue preclusion applied to the determination of fees when the arbitration proceeding fully determined the reasonableness of the attorneys' fees based upon the presented evidence and was confirmed by the state court. Under the facts of this case, a loadstar analysis would be unreasonable as a limit under section 502(b)(4) because no attorney would have agreed to represent the client at his or her usual hourly rate under the circumstances of the litigation. Even under 502(b)(4), a contingency fee may be reasonable "where it reflects the risk of nonrecovery assumed in accepting a case." The Ninth Circuit did leave room to allow for potential reductions of state court awards in fee disputes where the issue of reasonableness was not arbitrated or considered under state law.

[3] 28 U.S.C.S. § 1738.

<u>Phoenician Mediterranean Villa, LLC v. Swope (In re J & S Properties, LLC)</u>, 872 F.3d 138 (3d Cir. 2017)

Bankruptcy trustee taking control of debtor's business premises(and locking debtor out) is entitled to qualified immunity, notwithstanding state law barring self-help evictions.

The debtor filed a chapter 7 petition and a trustee was appointed. The debtor's key asset was a building in which a lessee had previously operated a restaurant. The trustee rejected the lessee's lease. Although the restaurant was not operating, the lease had not expired and lessee remained in control of the premises and its contents, which the lessee claimed. The lessee failed to set the premises' thermostat high enough to prevent pipes from freezing, which burst, flooding the space. The trustee attempted to enter the premises but found that the key given her by the lessee did not work. The debtor's principal had the locks changed and gave the trustee the key, effectively locking the lessee out of the premises. The trustee then filed an emergency motion with the bankruptcy court to grant her immediate possession of the premises, which the bankruptcy court granted.

The lessee sued the trustee under 42 U.S.C. § 1983 for wrongful eviction, claiming violations of its Fourth and Fourteenth Amendment rights and seeking damages. The trustee moved to dismiss the suit based upon quasi-judicial immunity. The bankruptcy court found that the trustee had exercised her business judgment as to the steps necessary to preserve the estate, and thus was entitled to immunity. The district court affirmed, finding that the trustee was entitled to qualified immunity because she was taking appropriate action to preserve the estate.

The Third Circuit affirmed, finding that the trustee was entitled to qualified immunity under *Harlow v. Fitzgerald*, 457 U.S. 800 (1982). In *Harlow*, the Supreme Court held that governmental officials performing discretionary duties are shielded from civil damages if their conduct does not violate clearly established statutory or constitutional rights of which a reasonable person should have known. A bankruptcy trustee is a position created by federal statute and supervised by the U.S. trustee. Thus a trustee is a government official under *Harlow*, and entitled to qualified immunity from third party claims when he or she acts in an official capacity in a manner not contrary to clearly established law.

The lessee argued that state law prohibited self-help evictions, and that it had been evicted without due process. Nonetheless, the trustee was required under the bankruptcy code to safeguard, liquidate, and administer the estate and there was no dispute that the trustee acted within the scope of her statutory duties. Thus the trustee was entitled to qualified immunity from the lessee's claims. The court noted that a trustee is entitled to absolute immunity when carrying out a bankruptcy court's order.

A concurring opinion argued that qualified immunity was an affirmative defense under *Harlow*, which the trustee had failed to assert and preserve. Nonetheless, the trustee was entitled to quasi-judicial immunity because she was taking discretionary actions within the scope of her statutory duties and performing quasi-judicial functions. The concurrence contains a thoughtful history of trustee immunity and the distinction between qualified immunity and quasi-judicial immunity.

PROPERTY OF THE ESTATE

Arrowsmith v. United States (In re Health Diagnostic Laboratory, Inc.), 578 B.R. 552 (Bankr. E.D. Va. 2017)

Bankruptcy court finds that a debtor's Subchapter S status under the Internal Revenue Code is not property of the debtor whose transfer/revocation can support a fraudulent transfer action.

In a chapter 11 case, a liquidating trustee sued the IRS and others to avoid, as a fraudulent transfer, the pre-petition revocation of the debtor's subchapter S corporation status under the Internal Revenue Code. The United States moved to dismiss on the grounds that a corporation's subchapter S status is not property of the debtor.

Subchapter S status is available to corporations with fewer than 100 shareholders and one class of stock. Profits and losses of an "S corp." are passed through to its shareholders. In contrast, in a C corporation profits are taxed at both the corporate level and the shareholder level, resulting in a form of double taxation. All shareholders must agree to Subchapter S status.

The debtor was an S corp. when shareholders voted to revoke its subchapter S status. Thus, when the debtor filed for bankruptcy it was a C corporation. The trustee sought to create value by avoiding the "transfer" of the subchapter S status, causing the reclassification of the debtor back to an S corp. By doing so, the debtor's losses would pass through to its shareholders, who would file amended tax returns, resulting in substantial tax refunds, which the trustee planned to recover from the shareholders for the benefit of the liquidating trust. This strategy hinged in subchapter S status being property of the debtor, the transfer/revocation of which could be avoided under sections 544(b) and 548 of the Code.

While most courts to have addressed the issue have found subchapter S status to be property of a debtor, the Third Circuit in *Majestic Star Casino, LLC v. Barden Dev. Inc (In re Majestic Star Casino, LLC)*, 716 F.3d 736 (3d Cir. 2013) found it was not. Here, the bankruptcy court reached same result as the Third Circuit, and found that subchapter S status is not property of the debtor that can be subject to transfer.

Federal tax law creates no property rights but merely attaches consequences, federally defined, to rights created under state law. But federal and interpretive case law – not state law – control whether a taxpayer has a beneficial interest in property subject to levy for unpaid federal taxes. The bankruptcy court noted that the Fourth Circuit has recognized that certain interests constitute "property" for federal tax purposes when they embody "essential property rights," which include (1) the right to use; (2) the right to receive income produced by the interest; (3) the right to exclude others; (4) the taxpayer's breath of control over the interest; (5) whether the purported property right is valuable; and (6) whether the right is transferable.

The court found that only the first – the right to use – leaned in favor of subchapter S status as debtor property, and that factor was the weakest of the list. The right to use does not denote control, just as a person may have the right to use tools belonging to another. The other factors were inapplicable or belonged to the debtor's shareholders – they controlled the debtor's tax status and received the value from it. Accordingly, there had been no transfer of debtor property that the trustee could avoid.

Town Ctr. Flats, LLC v. ECP Commer. II LLC (In re Town Ctr. Flats, LLC), 855 F.3d 721 (6th Cir. 2017)

When an assignment of rents is treated as a transfer of title under state law, the rents will not be property of the estate.

The debtor built a residential complex subject to a mortgage and an assignment of rents in favor of the lender. Under the broad assignment of rents, the debtor retained a license to collect and retain rents until an event of default, but at default the debtor's license would "automatically terminate without notice to [the debtor]." The rents were the debtor's only source of income. When the debtor defaulted, the lender began collecting rents directly from the tenants, as allowed by applicable Michigan state law and the loan documents.

The bankruptcy court held that the assignment of rents created a security interest and that the debtor maintained a property interest in the rents. Accordingly, the rents were property of the bankruptcy estate subject to the lender's lien. The district court vacated the bankruptcy court's holding, finding that the assignment of rents established a change of ownership under Michigan law.

Michigan courts have consistently held that assignment of rents are ownership transfers, and that so long as all of the statutory requirements are fulfilled, the assignor has no property interest in rents after default. The Sixth Circuit affirmed the district court, holding that the assigned rents were not part of the bankruptcy estate because the debtor retained no residual interest in the assigned rents under state law.

PROPERTY SALES

Mission Product Holdings, Inc. v. Old Cold LLC f/k/a Tempnology, LLC (In re Old Cold, LLC), 879 F.3d 376 (1st Cir. 2018)

A challenge to a section 363 sale on the grounds that the sale violated the Supreme Court's holding in Jevic, which requires bankruptcy courts to apply the absolute priority rule to a structured dismissal, will not upset the finality of th sale under section 363(m) if the sale is not stayed).

A chapter 11 debtor auctioned off its assets under section 363. Following bankruptcy court approval, the debtor and the winning bidder completed the sale. On appeal, an unsuccessful bidder sought to unwind the sale and have itself treated the winning bidder.

The unsuccessful bidder argued that the winning bidder had not acted in good faith because information allegedly emerged after the bankruptcy court's approval of the sale revealing collusion during the auction. The unsuccessful bidder relied upon a recent, unpublished decision from the Ninth Circuit BAP, *Hujazi v. Schoemann (In re Zuercher Tr. of 1999)*, 2016 WL 721485 (9th Cir. BAP DATE 2016), to argue that the court could consider post-closing conduct in determining the purchaser's good faith. The First Circuit rejected the unsuccessful bidder's argument, noting that were it to adopt the unsuccessful bidder's approach it would undermine the policy of finality underlying section 363(m) and risk placing the appellate court in the shoes of a trial court.

The unsuccessful bidder also argued that the Supreme Court's decision in *Czyzewski v. Jevic Holding Corp.*, -- U.S. --, 137 S.Ct. 973 (2017), which required bankruptcy courts to apply the absolute priority rule to a structured dismissal, controlled the outcome of the appeal. The unsuccessful bidder argued that *Jevic* applied to all end-of-case distributions, including asset sales. The First Circuit rejected this argument, upholding the finality of sales under section 363(m) when bankruptcy courts act pursuant to section 363(b): even a *Jevic* challenge will not upset the finality of a section 363 sale in light of section 363(m) if the purchaser acted in good-faith and the sale is not stayed.

Mission Product Holdings, Inc. v. Tempnology, LLC n/k/a Old Cold LLC (In re Tempnology, LLC), 879 F.3d 389 (1st Cir. 2018)

Because a licensor has continuing duties regarding trademarks, a debtor/licensor can reject a trademark license under section 365(a) and require the licensee to stop using the licensed trademarks, notwithstanding section 365(n).

A chapter 11 debtor rejected an agreement giving the counterparty a license of patents and technology, exclusive marketing and distribution rights as to certain products of the debtor, and a license to use the debtor's trademarks Section 365(g) treats rejection as a breach, converting contract rights into a prepetition claim for damages. Nonetheless, section 365(n) allows a licensee of intellectual property to forego a damages claim and instead retain its rights in the licensed intellectual property.

The debtor and the counterparty agreed that the patent licenses were protected under section 365(n), , but the debtor argued that section 365(n) did not protect the counterparty's right to use debtor's trademarks or the exclusive right to sell certain products of the debtor. The bankruptcy court held that the exclusive distribution rights were not intellectual property protected under section 365(n). The bankruptcy court likewise held that trademarks did not fall within the definition of intellectual property under section 101(35A), and thus were not protected under section 365(n). Consequently, the rejection left the counterparty with a pre-petition damages claim, but no continuing right to use the debtor's trademarks or to exercise exclusive distribution rights.

The First Circuit BAP affirmed the bankruptcy court as to the exclusive distribution rights, but reversed as to the trademark rights, following *Sunbeam Products, Inc. v. Chicago Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012). The BAP held that, because 365(g) deems the effect of a rejection to be a breach of contract, and a licensor's breach of a trademark agreement under non-bankruptcy law does not necessarily terminate the licensee's rights, rejection of the trademark agreement did not terminate the counterparty's right to use the trademarks.

The First Circuit affirmed the bankruptcy court and the BAP regarding the exclusive distribution rights, but reversed the BAP as to the counterparty's rights to use the trademarks. The First Circuit noted that for trademarks to have value, the licensor must monitor and control a trademark's use to ensure that the nature or quality of the goods sold are not degraded. Further, failure to monitor could result in abandonment of the trademark. Consequently, the First Circuit found that following *Sunbeam* would allow the appellant to retain use of the debtor's trademarks while forcing the debtor to choose between performing executory obligations or risking the permanent loss of its trademarks and diminishing their value. This would undermine section 365(a) and degrade the debtor's ability to have a fresh start. Thus, because a licensor has continuing duties regarding trademarks, a debtor/licensor can reject a trademark license and require the licensee to stop their use.

Montana Opticom, LLC v. CH SP Acquisitions, LLC (Matter of Spanish Peaks Holdings II, LLC), 872 F.3d 892 (9th Cir. 2017)

There is no conflict between sections 363(f) and 365(h) when a party purchases real property subject to pre-petition leasehold interests. Absent a motion to reject, section 365(h) is not triggered and a section 363(f) sale can be free and clear of leasehold interests.

Becoming only the second circuit court to address the issue, the Ninth Circuit considered the apparent conflict between sections 363(f) and 365(h) when a party purchases real property from a bankruptcy estate that is subject to pre-petition leasehold interests. The leasehold interests were not mentioned in the list of encumbrances and liens that would survive the sale, but the tenants argued that section 365(h) gave them a continuing right to retain possession notwithstanding sale of the property. The purchaser argued that its purchase of the property was free and clear of the leases and the tenants had no possessory rights under section 365(h). The bankruptcy court approved the sale, subject to a post-closing determination of whether section 365(h) protected the tenants' possessory rights.

On appeal, the Ninth Circuit noted that the issue required it to consider the apparent conflict between sections 363(f) and 365(h). The Ninth Circuit noted that courts have developed two approaches to resolving the "conflict." The majority approach holds that sections 363(f) and 365(h) overlap because "each provision seems to provide an exclusive right that when invoked would override the interest of the other." *Spanish Peaks Holdings II*, 872 F.3d at 898. Under this approach, section 365(h) trumps section 363(f) because Congress intended to protect a tenant's estate when its landlord files for bankruptcy. The minority approach – set forth in *Precision Industries, Inc. v. Qualitech Steel SBQ, LLC (In re Qualitech Steel Corp. & Qualitech Steel Holdings Corp.)*, 327 F.3d 537 (7th Cir. 2003) – focuses on the statutory text of both sections and finds that sections 363(f) and 365(h) do not suggest that one section supersedes or limits the other. In *Qualitech*, the Seventh Circuit reasoned that section 363(f) confers a right to sell property free and clear of "any interest," without excepting from that right leases entitled to protection under section 365(h). The Seventh Circuit further reasoned that lessees' rights were protected under section 363(e) because that section obliges the bankruptcy court to ensure that lessees are adequately protected, if a lessee seeks such protection.

The Ninth Circuit agreed with *Qualitech*'s holding that sections 363(f) and 365(h) can be harmonized: one deals with sales of estate property while the other governs rejection of a lease. The Ninth Circuit further noted that while Congress intended to protect lessees under section 365(h), "that intent is not absolute; it exists alongside other purposes and sometimes conflicts with them." Section 363(f)(1) permits a sale free and clear of an interest in property if applicable non-bankruptcy law permits sale free and clear of such interest. In this case, state foreclosure law would permit such a sale. Thus, the trustee may sell the property free and clear of the leases but subject to tenants' rights to adequate protection under section 363(m).