
Mid-Atlantic Bankruptcy Workshop

# Bankruptcy Update Smorgasbord: A Review and Discussion of Recent Decisions and Other Changes Impacting Bankruptcy Practice

CONCURRENT SESSION

**Jason N. Kestecher**
Skadden, Arps, Slate, Meagher & Flom LLP | New York

**Alexis A. Leventhal**
Reed Smith LLP | Pittsburgh

**Jaclyn C. Marasco**
Faegre Drinker Biddle & Reath LLP | Wilmington, Del.

**Hon. Patricia M. Mayer**
U.S. Bankruptcy Judge (E.D. Pa.) | Reading

2022

# ABI MID-ATLANTIC BANKRUPTCY WORKSHOP

## Bankruptcy Update Smorgasbord: A Review and Discussion of Recent Decisions and Other Changes Impacting Bankruptcy Practice

### August 5, 2022

**Presenters:** **Hon. Patricia M. Mayer**
United States Bankruptcy Judge
United States Bankruptcy Court for the Eastern District of Pennsylvania
The Gateway Building
201 Penn Street, 4th Floor
Reading, Pennsylvania 19601

**Jason N. Kestecher**
Skadden, Arps, Slate Meagher & Flom LLP
One Manhattan West
New York, New York 10001

**Alexis A. Leventhal**
Reed Smith LLP
Reed Smith Centre
225 Fifth Avenue
Pittsburgh, Pennsylvania 15222

**Jaclyn C. Marasco**
Faegre Drinker Biddle & Reath LLP
222 Delaware Avenue
Wilmington, Delaware 19801

# TABLE OF CONTENTS

**I. Recent and Upcoming Supreme Court Cases**

**A.** Siegel v. Fitzgerald, 142 S. Ct. 752, 211 L Ed. 2d 471 (2022)

**B.** Kemp v. United States, 142 S. Ct. 1856, 213 L. Ed. 2d 90 (2022)

**C.** Bartenwerfer v. Buckley, 212 L. Ed. 2d 761 (2022)

**D.** MOAC Mall Holdings LLC v. Transform Holdco LLC, No. 21-1270, 2022 BL 220466, 2022 US LEXIS 3103 (U.S. June 27, 2022)

**II. Recent Circuit Court Cases**

**A. Second Circuit**

**i.** Law Offices of Francis J. O'Reilly, Esq. v. Selene Finance LP (In re DiBattista), No. 20-4067, 2022 WL 1548286 (2d Cir. May 17, 2022)

**B. Third Circuit**

**i.** In re Boy Scouts of America, No. 21-2035, 2022 WL 1634643 (3d Cir. May 24, 2022)
**ii.** In re Imerys Talc America, Inc., Nos. 20-3485, 20-3487, 20-3488, 2022 WL 2350264 (3d Cir. June 30, 2022

**C. Fourth Circuit**

**i.** In re Clear Packaging LLC, No. 21-1981, 2022 WL 2032296 (4th Cir. June 7, 2022)

**D. Fifth Circuit**

**i.** FERC v. Ultra Resources, Inc. (In re Ultra Petroleum Corp.), 28 F.4th 629 (5th Cir. 2022)
**ii.** Matter of Sylvester, 23 F.4th 543 (5th Cir. 2022)

**E. Ninth Circuit**

**i.** Babaee v. Marshack (In re Babaee), No. 21-1230 (B.A.P. 9th Cir. June 17, 2022)

## I. RECENT AND UPCOMING SUPREME COURT CASES

### 1. Siegel v. Fitzgerald, 142 S. Ct. 752, 211 L Ed. 2d 471 (2022).

**a. Relevant Statute(s)/Rule(s):** 28 U.S.C. § 1930

**b. Background**: In 2017, Congress enacted a temporary fee increase in the U.S. Trustee fees applicable in large chapter 11 cases to address a shortfall in the U.S. Trustee Fund. Initially, this fee increase was applicable only in districts that were part of the U.S. Trustee program, but not in districts that were part of the Bankruptcy Administrator Program, which was funded by the Judiciary's general budget. In Administrator districts, Congress provided that the Judicial Conference *may* require debtors to pay fees equal to those imposed in U.S. Trustee districts. The six districts in the two states participating in the Administrator district did not immediately adopt the 2017 fee increase.

**c. Holding**: Congress' enactment of a significant fee increase that exempted debtors in two states violates the uniformity requirement of the Bankruptcy Clause of the U.S. Constitution.

Nothing in the Bankruptcy Clause suggests a distinction that between substantive and administrative laws. And because this fee increase is on the subject of bankruptcy, it is subject to he uniformity requirement.

Although Congress has an ability to account for differences that exist between different parts of the country, Congress cannot subject similarly situated debtors to different fees in different states because it chooses to pay the costs for some (i.e., those in Administrator districts) but not in others (i.e., those in Trustee districts). Congress itself created the geographic disparity here, and the government cannot rely on that disparity to justify different treatment of these debtors based upon geography.

The Supreme Court declined to reach the question of the appropriate remedy (charging additional fees in Administrator districts vs. refunds in Trustee districts) and remanded to the Fourth Circuit to consider the question in the first instance.

**d. Note:** On June 13, 2022, the Supreme Court issued a summary order granting a writ of certiorari to review the Tenth Circuit's decision in the Office of the United States Trustee v. John Q. Hammon*s* case, vacated the decision, and remanded for consideration in light of Siegel v. Fitzgerald.

**2. Kemp v. United States, 142 S. Ct. 1856, 213 L. Ed. 2d 90 (2022).**

**a. Relevant Statute(s)/Rule(s):** Fed. R. Civ. P. 60(b)

**b. Background**: In 2011, a federal jury convicted Kemp of various drug and gun crimes, and he was sentenced to 420 months in prison. Kemp, along with seven codefendants, appealed his conviction. The Eleventh Circuit consolidated the appeals and, in November 2013, affirmed the convictions and sentences. Kemp did not seek rehearing of the Eleventh Circuit's judgment or petition for certiorari. Two of Kemp's codefendants did seek rehearing, which the Eleventh Circuit denied in May 2014.

In April 2015, Kemp moved the district court to vacate his sentence under 28 U.S.C. § 2255. The Government objected that Kemp's § 2255 motion was untimely. As relevant here, such motion was required to be filed within one year of "the date on which the judgment of conviction becomes final." The district court concluded that Kemp's judgment became final in February 2014 (90 days after the Eleventh Circuit's judgment affirming his conviction and sentence), making his April 2015 motion over two months late. The district court therefore dismissed Kemp's motion in September 2016, and Kemp did not appeal.

Almost two years later, in June 2018, Kemp attempted to reopen his § 2255 proceedings under Federal Rule of Procedure 60(b)(6) on the stated ground that the 90-day clock to seek certiorari did not begin to run until *all* parties' petitions for rehearing are denied, and the Eleventh Circuit denied his codefendants' rehearing petitions in May 2014. Thus, according to Kemp, the one-year period to file his § 2255 motion began in August 2014, making his April 2015 motion timely.

The district court rejected Kemp's timeliness argument and, in the alternative, held that his Rule 60 motion to reopen was itself untimely. The Eleventh Circuit affirmed. While it agreed with Kemp that his original § 2255 motion "appear[ed] to have been timely," the Eleventh Circuit nonetheless concluded that he had filed his Rule 60(b) motion too late; that motion, the Eleventh Circuit explained, alleged "precisely the sort of judicial mistak[e] in applying the relevant law that Rule 60(b)(1) encompasses," and thus was subject to Rule 60(b)(1)'s one-year limitations period, and not the more flexible limitations period set forth in Rule 60(c). Kemp then petitioned the Supreme Court for review.

**Holding**: In resolution of a circuit split, the Supreme Court held that a judge's error of law qualifies as a "mistake" under Federal Rule of Civil Procedure 60(b)(1). The Court construed "mistake" broadly, explaining that Congress could have drafted language qualifying "mistake" as one of fact, not law, had it intended a narrow meaning instead. It also rejected the argument that the term "mistake" includes only "obvious" legal errors because none of the English language dictionaries or legal dictionaries consulted suggested an "obviousness" gloss to the term. Moreover, the Court was reluctant to impose a rule requiring courts to determine not only whether

there was a mistake, but whether the mistake was sufficiently obvious. The Supreme Court therefore affirmed the Eleventh Circuit's determination that Kemp's Rule 60(b) motion alleged a legal error cognizable under Rule 60(b)(1), and as such, was untimely under the one-year limitations period.

**3. Bartenwerfer v. Buckley, 212 L. Ed. 2d 761 (2022).**

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. § 523(a)(2)(A)

**b. Background:** David and Kate Bartenwerfer renovated and sold a house to Kieran Buckley in San Francisco, California. After the sale, Buckley discovered undisclosed defects in the house and sued the Bartenwerfers in California state court. A jury found for Buckley on several claims and awarded damages. The Bartenwerfers then filed for bankruptcy before the state court could rule on Buckley's motion for attorneys' fees.

In the bankruptcy court, Buckley initiated an adversary proceeding against the Bartenwerfers arguing that the state-court judgment could not be discharged in bankruptcy under 11 U.S.C. § 523(a)(2)(A) which prohibits the discharge of debts obtained through fraud. The bankruptcy court agreed, finding that the Bartenwerfers had intended to deceive Buckley, that Mr. Bartenwerfer had actual knowledge of the factual misrepresentations, and that Mr. Bartenwerfer's fraudulent conduct could be imputed onto Mrs. Bartenwerfer because of their partnership relationship. The Bartenwerfers appealed.

The Ninth Circuit Bankruptcy Appellate Panel (BAP) adopted a "knew or should have known" standard and remanded the case to the bankruptcy court to determine whether Mrs. Bartenwerfer knew or should have known of Mr. Bartenwerfer's fraud.

The bankruptcy court held that Mrs. Bartenwerfer was not liable for fraud because she did not know of his fraudulent conduct, and thus, Mrs. Bartenwerfer's debt was dischargeable. The BAP affirmed, and Buckley appealed.

The U.S. Court of Appeals for the Ninth Circuit reversed and remanded, concluding that the bankruptcy court applied the incorrect legal standard for imputed liability for fraud in a partnership relationship. The correct standard, based on binding Supreme Court and Ninth Circuit precedent, is whether the fraud was performed "on behalf of the partnership and in the ordinary course of business of the partnership." This standard is largely based on the Ninth's Circuit's interpretation of Strang v. Bradner, 114 U.S. 555 (1885) which reasoned that a partner without knowledge of another partner's fraud cannot escape liability, especially when the innocent partner benefited from the partner's fraudulent conduct. Thus, the court held that found Mrs. Bartenwerfer's debt was not dischargeable regardless of her knowledge of the fraud.

The arguments of the parties in this case largely mirror the current circuit court split on whether debtor's actual or constructive knowledge of fraud is required for the § 523(a)(2)(A) discharge exemption. Mrs. Bartenwerfer argues some level of scienter or wrongful state of mind is required for the discharge exemption based on an alternative interpretation of Strang, statutory amendments, and subsequent

decisions that suggest a scienter requirement. Buckley instead argues that the text of § 523(a)(2)(A) focuses on the character of debt on not on the culpability of the debtor. Buckley notes that Congress expressly made the debtor's state of mind relevant to the discharge of some kinds of debt, but the fraud provision contains no such requirement and thus, it is not the place of the court to essentially write in a scienter requirement. The Supreme Court granted Buckley's petition for a writ of certiorari.

c. **Issue to be addressed:** Whether an individual may be subject to liability for the fraud of another that is barred from discharge in bankruptcy under 11 U.S.C. § 523(a)(2)(A), by imputation, without any act, omission, intent or knowledge of her own.

d. **Holding:** Petition for a writ of certiorari granted.

**4. MOAC Mall Holdings LLC v. Transform Holdco LLC, No. 21-1270, 2022 BL 220466, 2022 US LEXIS 3103 (U.S. June 27, 2022).**

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. § 363(m)

**b. Background**: In the Sears Holdings Corporation bankruptcy case, the debtors obtained court approval to sell substantially all of their assets to Transform Holdco LLC, an entity formed by Eddie Lampert, Sears' former Chief Executive Officer and controlling shareholder. The bankruptcy court approved the sale under section 363(b) of the bankruptcy code and included a finding that Transform was a good faith purchaser under section 363(m), which provides that a reversal of the sale order on appeal would not impact the validity of the sale unless the sale order was stayed pending appeal. The purchase agreement endowed Transform with "designation rights" allowing it to cause the debtors to assign their leases to Transform after closing the sale.

Thereafter, Transform exercised its designation right with respect to a lease in the Mall of America and the debtors assigned such lease to Transform, which intended to sublet the space to future subtenants. Over the landlord's objection, the bankruptcy court approved the sale. On the record, Transform confirmed that it agreed that section 363(m) was inapplicable to this assignment and it would not argue otherwise on appeal.

On appeal, the district court vacated the bankruptcy court's order authorizing assignment, finding that it did not satisfy a condition set forth in section 365(b)(3) of the Bankruptcy Code. Thereafter, Transform reversed course from its view in the bankruptcy court, seeking rehearing on the basis that the district court lacked jurisdiction on appeal due to the finding in section 363(m). The district court reluctantly vacated its initial decision, holding that it was bound by Second Circuit precedent which held that section 363(m) was jurisdictional and therefore not subject to waiver or estoppel. The Second Circuit thereafter affirmed, noting that it had previously held that section 363(m) was a jurisdictional limitation.

**c. Issue to be addressed:** Whether section 363(m) is a jurisdictional bar that is not subject to waiver.

**d. Holding:** Petition for a writ of certiorari granted.

## II. RECENT CIRCUIT COURT CASES

### A. SECOND CIRCUIT

**1. Law Offices of Francis J. O'Reilly, Esq. v. Selene Finance LP (In re DiBattista), No. 20-4067, 2022 WL 1548286 (2d Cir. May 17, 2022).**

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. § 524(g)

**b. Background**: After debtor obtained chapter 7 discharge, his mortgage lender, Selene Finance LP ("Selene"), made erroneous reports to credit agencies and more than 30 phone calls attempting to collect delinquent mortgage payments that had been discharged. The debtor reopened his case and moved for sanctions under 11 U.S.C. § 524(g) for violation of the discharge injunction. The bankruptcy court found that Selene's actions were "absolutely egregious" and assessed some $9,000 for the debtor's legal fees and $17,500 in damages. On the first appeal, the district court upheld the $9,000 award but remanded to the bankruptcy court to clarify whether the $17,500 award was for actual or punitive damages. On remand, the bankruptcy court reinstated the $17,500 award as compensatory damages.

Also on remand, the debtor sought another $28,000 in attorney's fees incurred during the first appeal. The bankruptcy court denied the request for appellate attorneys' fees on the stated ground that the appeal itself did not violate the discharge injunction and that the debtor should have requested appellate attorneys' fees in district court. The district court affirmed on a second appeal, finding that the bankruptcy court lacked the power to award attorneys' fees for an appeal in district court. The debtor's counsel appealed.

**c. Holding:** The Second Circuit held that the debtor was entitled to request and recover attorneys' fees, at the bankruptcy court level, for successfully prosecuting the appeal from the bankruptcy court's order holding Selene in contempt of the discharge injunction. The Court held that Weitzman v. Stein, 98 F.3d 717 (2d Cir. 1996)"foreclosed" Selene's argument that the appeal itself had not violated the discharge injunction, because the appeal would not have been necessary had Selene respected the discharge. It explained further that "the failure to compensate the victim of contempt with appellate fees could leave the victim worse off for seeking to enforce a discharge order and would, at the very least, discount any compensatory damages award." Accordingly, the Second Circuit explained, the bankruptcy court had the authority to enforce its injunction to compensate for the debtor's losses arising from the appeals of its contempt order. The Second Circuit vacated the district court's judgment with instructions to remand to the bankruptcy court to calculate the appropriate amount of appellate attorneys' fees, or to articulate "persuasive grounds" for denying fees. The Court also directed the bankruptcy court to determine whether to grant attorneys' fees for the second appeal.

## B. THIRD CIRCUIT

### 1. In re Boy Scouts of America, No. 21-2035, 2022 WL 1634643 (3d Cir. May 24, 2022).

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. § 327; MODEL RULES OF PRO. CONDUCT 1.7 & 1.9

**b. Background:** The Boy Scouts purchased primary insurance from an insurer ("Century") that bought reinsurance from other insurers—think, insurance for insurance companies. Sidley Austin LLP ("Sidley") represented Century in disputes with the Boy Scouts' reinsurers. Around the same time that Century retained Sidley, the Boy Scouts retained Sidley to explore restructuring options. In agreeing to represent the Boy Scouts, Sidley told the Boy Scouts (and the engagement letter made clear) that it would not give counsel on insurance coverage, and the Boy Scouts retained Haynes and Boone LLP ("Haynes") for insurance matters. Three months after retaining Sidley, Century read in the *Wall Street Journal* that Sidley was counsel to the Boy Scouts, but Century made no objection to the dual representation at that time. Approximately 10 months later, Century told Sidley, for the first time, that the dual representation was a conflict and Century objected when Sidley participated in a mediation on the side of the Boy Scouts. Sidley responded to Century's objection by putting a formal ethics screen into place between its restructuring team and its reinsurance team. Because Century subsequently refused to execute a conflict waiver or consent to Sidley's withdrawal, Sidley provided notice to Century on February 16, 2020, that it was withdrawing unilaterally due to a breakdown in the attorney-client relationship. The bankruptcy court found that Sidley finished withdrawing as Century's counsel on either February 20 or 24, 2020.

Sidley filed the Boy Scouts' chapter 11 petition on February 18, 2020. The Boy Scouts filed an application to retain Sidley under 11 U.S.C. § 327(a) and Century objected to the proposed retention. After an evidentiary hearing, the bankruptcy court overruled the objection, finding that no actual conflict existed and that Sidley's two teams of lawyers had not shared Century's confidential information. Century appealed. During the pendency of the appeal, Sidley's restructuring team moved to a new firm, taking the Boy Scouts' case with them. At that point, Sidley no longer represented the Boy Scouts or Century.

The district court ultimately affirmed the bankruptcy court's analysis under section 327 without deciding the merits of the alleged violations under Rules of Professional Conduct 1.7 and 1.9. Century then appealed to the Third Circuit, contending that the district court erred in declining to determine whether Sidley violated Rules of Professional Conduct 1.7 and 1.9 and in failing to find an actual conflict under § 327.

**c. Holding:** The Third Circuit affirmed, declining to "adopt a new rule and hold that courts must always consider the applicable Rules of Professional Conduct before

reaching a conclusion on § 327." While bankruptcy courts have discretion to apply a state's rules of professional conduct, the disqualification of a lawyer for a conflict in a bankruptcy case is governed by 11 U.S.C. § 327(a). Conflicts under § 327 are divisible into 3 categories: (1) actual conflicts; (2) potential conflicts; and (3) appearances of conflict. If there is an actual conflict, counsel faces *per se* disqualification. If the conflict is only potential, disqualification is discretionary. An appearance of conflict cannot be the sole basis for disqualification. Violations of the Rules of Professional Conduct are not themselves sufficient to create a § 327 conflict.

An actual conflict exists when the specific facts before the bankruptcy court suggest that it is likely that a professional will be placed in a position permitting it to favor one interest over an impermissibly conflicting interest. Here, the Third Circuit found that Sidley's relationship to Century did not affect its ability to advocate on behalf of the Boy Scouts and thus, the appeal at best presented a potential conflict, requiring the court to determine whether the potential conflict implicated the economic interests of the estate. Because the Boy Scouts had retained Haynes as insurance counsel, and were not a party to the reinsurance agreement where Sidley was counsel for Century, the Third Circuit found that the bankruptcy court "came nowhere close to an abuse of discretion" and permissibly allowed the Boy Scouts to retain Sidley as restructuring counsel.

**d.** **Note:** The Third Circuit acknowledged that the retention order was not a final order subject to appeal as of right, but explained that meaningful review of potentially serious ethical issues might never occur absent immediate appeal. The Third Circuit also found that the appeal was not moot by virtue of the Sidley restructuring team's move to a new firm because the possibility of disgorgement of fees remained, such that there were continuing implications for the debtors and their creditors.

**2. In re Imerys Talc America, Inc., Nos. 20-3485, 20-3487, 20-3488, 2022 WL 2350264 (3d Cir. June 30, 2022).**

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. § 524(g)

**b. Background:** Imerys Talc and its affiliates filed chapter 11 petitions in 2019 with the intention of employing a channeling injunction to deal with the increasing number of personal injury claims for exposure to asbestos and talc. Well before the chapter 11 filing, the debtors selected James Patton to serve as the Future Claimants' Representative ("FCR"), as contemplated by 11 U.S.C. § 524(g)(4)(B)(i), and agreed that Mr. Patton could engage his firm, Young Conaway Stargatt & Taylor, LLP ("YCST"), to serve as counsel to the FCR, subject to approval of the bankruptcy court. YCST disclosed to the debtors and to the bankruptcy court that it had been serving for about 10 years as counsel in a different case (the "*Warren Pumps* Litigation") for two of the insurance companies that provided coverage for Imerys. The *Warren Pumps* Litigation was unrelated to Imerys. The two insurance companies had previously given the FCR and YCST a prospective waiver allowing them to serve in later cases where those insurers might be involved. YCST also had a long-established ethical wall insulating its FCR lawyers from a different set of lawyers providing defense to insurance companies. None of the debtors' insurers filed a timely objection to the debtors' motion to appoint Mr. Patton as FCR, or Mr. Patton's application to retain YCST based on YCST's representation of the two insurers in the *Warren Pumps* Litigation. The two insurers first raised the objection long after the objection deadline had passed, contending, for the first time, that the FCR had a conflict of interest precluding him from serving in this role because his firm also represented two of the insurers in the *Warren Pumps* Litigation. The bankruptcy court overruled the objections and the district court affirmed. Several insurers appealed.

**c. Holding:** The Third Circuit first held that the two insurance companies had standing to appeal. Even though the insurers might have waived the objection, it ruled on the merits, explaining that a party specifically affected by an alleged conflict of interest has standing to appeal a FCR appointment. given the "significant implications for bankruptcy law." With respect to the primary issue on appeal, the Third Circuit rejected the "disinterestedness" standard employed by a handful of other courts to evaluate a FCR's qualification, explaining that use of the words "legal representative" in § 524(g) means that an FCR "must be more than merely disinterested" as set forth in § 327(a); instead, it employed a standard "akin" to judging the qualifications for a guardian *ad litem* "in other contexts." The Third Circuit nonetheless declined to "prescribe any particular process the bankruptcy court must follow in making that appointment," explaining that "variations in the appointment process are otherwise within the discretion of the bankruptcy court." Accordingly, the Third Circuit affirmed the district court's decision.

## C. FOURTH CIRCUIT

### 1. In re Cleary Packaging, LLC, No. 21-1981, 2022 WL 2032296 (4th Cir. June 7, 2022).

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. §§ 523(a) and 1192(2)

**b. Background:** Creditor, Cantwell-Cleary Co., Inc. ("Cantwell"), had obtained a $4.7 million judgment for intentional interference with contracts and tortious interference with business relations against Cleary Packaging LLC (the "Debtor"). Seeking to discharge this liability, the Debtor filed a chapter 11 petition and elected to proceed under Subchapter V, which discharge of debts are provided for pursuant to §1192(2). This section provides "if the plan of the debtor is confirmed . . . . the court shall grant the debtor a discharge of all debts . . . except any debt . . . of the kind specified in section 523(a) of this title." Section 523(a) provides that certain discharges "do[] not discharge an individual debtor from" a list of 21 types of debt, including a debt "for willful and malicious injury." Cantwell commenced a nondischargeability action the Debtor pursuant to §523(a)(6). The bankruptcy court found the debt owed to Cantwell dischargeable, reasoning that the exception to dischargeability incorporated in §1192(2) from §523(a) applied only to individual debtors. The bankruptcy court certified a direct appeal on the sole question of whether a corporate Subchapter V debtor can discharge a debt for "willful and malicious injury."

**c. Holding:** Noting that the question on appeal "is a close one", the Fourth Circuit reversed the bankruptcy court, finding instead that the exceptions to dischargeability incorporated into §1192(2) from §523(a) do not apply only to individual debtors. The Court reasoned there is more harmony found in the conclusion that §1192(2) provides discharges to small business debtors, whether they are individuals or corporations, except the kinds of debts listed in §523(a), which outlines the nature of the debts to be excepted from discharge only and not also defining what debtors are eligible for such exceptions.

**d. Notes:** But see Jennings v. Lapeer Aviation, Inc., 2022 Bankr. LEXIS 1032 (Bankr. E.D. Mich. April 13, 2022); In re Rtech Fabrications, LLC, 635 B.R. 559 (Bankr. D. Id. 2021).

## D. FIFTH CIRCUIT

### 1. FERC v. Ultra Resources, Inc. (In re Ultra Petroleum Corp.), 28 F.4th 629 (5th Cir. 2022).

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. § 365

**b. Background:** Ultra Resources, an energy company producing natural gas, contracted with Rockies Express Pipeline ("REX") to reserve space on a pipeline for natural gas. Anticipating a bankruptcy filing by Ultra, REX petitioned the Federal Energy Regulatory Commission ("FERC") for a declaration that Ultra could not reject the contract between Ultra and REX without FERC's approval. Ultra filed for bankruptcy before FERC issued a decision.

As part of its bankruptcy case Ultra sought to reject the contract with REX. REX objected, arguing that the bankruptcy court should refrain from issuing a decision until the proceedings before FERC could be concluded. The bankruptcy court denied that request, but invited FERC to participate as a party in interest. The bankruptcy court ultimately authorized the rejection, holding that it had authority to approve the rejection under the Fifth Circuit's decision in In re Miran Corp, 378 F.3d 511 (2004). It also held that, under heightened scrutiny required under Mirant, rejection was consistent with the public interest as it would not harm the supply of natural gas, any "free rider" concerns were due to FERC's regulation and not rejection, and rejection did not amount to a rate change requiring approval under section 1129(a) of the Bankruptcy Code. FERC appealed.

**c. Holding:** Mirant continues to govern the standard for rejection of filed-rate contracts, requiring a bankruptcy court to consider the rejection under a heightened standard an allowing FERC to participate in bankruptcy proceedings. The language in Mirant about consequences of rejection, including that FERC could not enforce full performance and payment of a rejected contract, were not dicta. Nothing in Mirant requires the bankruptcy court to allow FERC to conduct a hearing before the court can decide on rejection. Nothing about a rejection results in an impermissible rate change without FERC approval.

2. **Matter of Sylvester, 23 F.4th 543 (5th Cir. 2022).**

   a. **Relevant Statute(s)/Rule(s):** 11 U.S.C. §§ 326–28, 330, 704

   b. **Background:** In 2018, Sharon Sylvester filed a Chapter 13 bankruptcy which was converted to a Chapter 7 proceeding. With the court's approval, the Chapter 7 trustee employed a law firm to help investigate, review, and liquidate Sylvester's real property, and "act as general counsel for [trustee] and . . . assist [trustee] in evaluating other bankruptcy issues affecting the estate." At the end of her Chapter 7 proceeding, Sylvester was ordered to pay fees to the law firm that assisted the Trustee. The law firm's $16,185 fee application contained an itemized description of services performed.

      Sylvester objected and argued that the services performed were within the Trustee's statutory duties and did not require legal expertise. Sylvester noted that the court may not compensate an attorney appointed to represent the trustee for services which coincide or overlap with the duties of the trustee found in 11 U.S.C. § 704 unless the services were necessarily performed by an attorney due to reasons of complexity or difficulty, and only then to the extent legal expertise is required. The bankruptcy court agreed that some of the law firm's tasks could fall into broad categories as § 704(a) trustee duties but found some "leeway" should be given and declined to distinguish the law firm's legal and non-legal services for purposes of compensation. The court granted the fee application in full because (1) the "demarcation between" tasks a trustee must perform and tasks that can be delegated to an attorney is "often not black and white," and (2) the bankruptcy was "particularly successful" with all creditors paid in full and a return of money to the debtor.

      Sylvester appealed to the United States District Court for the Eastern District of Louisiana. The district court affirmed by essentially using the same reasoning as the bankruptcy court, relying on the bankruptcy's "successful result."

   c. **Issue:** Whether a "successful result" should relieve a bankruptcy court of its obligation to distinguish between legal and non-legal services regarding compensation of counsel under 11 U.S.C. § 330(a).

   d. **Holding:** The U.S. Court of Appeals for the Fifth Circuit held that the bankruptcy court did not apply the proper legal standard and a "successful result" is not a valid reason to compensate a law firm's non-legal services. The court began by noting that 11 U.S.C. § 327 permits the trustee to employ an attorney for assistance. 11 U.S.C. § 330(a) makes it clear that the court may compensate an attorney only for legal services that require legal expertise that the trustee would not generally be expected to perform without an attorney's assistance. 11 U.S.C. § 326 lays out the trustee's compensation scheme and limits. Citing the Fourth and Ninth Circuits, the Fifth Circuit reasoned that courts may only compensate an attorney for services that required legal expertise and § 330(a) only allows fee application for legal services.

The Fifth Circuit also noted that the law firm had the burden of justifying compensation for their services. Thus, the bankruptcy court improperly assumed that all of the law firm's services required legal expertise and applied the incorrect legal standard by declining to distinguish between legal and non-legal services because of the bankruptcy's particular success.

**e. Note:** See In re Yovtcheva, 590 B.R. 307 (Bankr. E.D. Pa. 2018).

## E. NINTH CIRCUIT

### 1. Babaee v. Marshack (In re Babaee), No. 21-1230 (B.A.P. 9th Cir. June 17, 2022).

**a. Relevant Statute(s)/Rule(s):** 11 U.S.C. §§ 363 and 522(g)

**b. Background:** Individual chapter 7 debtors claimed a homestead exemption under Cal. Code of Civil Procedure § 704.730 in the amount of $175,000 in their over-encumbered homestead located in Newport Beach (the "Property"). The bankruptcy court approved a compromise between the Chapter 7 Trustee and a certain secured creditor providing for the subordination of its claim in the amount of $410,000 to the Trustee, his professionals, and general unsecured creditors. The bankruptcy court further approved the sale of the Property for $2,860,000 free and clear of all liens and interests as well as the Debtors' homestead exemption. The sale netted the Trustee approximately $290,000 for distribution to general unsecured creditors. Debtors appealed both orders arguing approval of the compromise and sale were improper because the opportunity to realize value in a homestead property through creative transactions belongs to the Debtors and not the Trustee.

**c. Holding:** The Fourth Circuit dismissed the appeal for lack of standing because the Debtors had not established the orders on appeal resulted in an injury in fact fairly traceable to the compromises approved or that reversal of those orders would redress any injury. The Court first noted that, although there is a rebuttable presumption of impropriety when a chapter 7 trustee seeks to sell over-encumbered property subject to a carve-out agreement, there is no per se bar on such efforts to realize value for the estate. However, the trustee may rebut this presumption and had in the instant case. Further, when the Debtors filed their chapter 7 case, they gave up their ability i.e. their standing, to control their property.

## III. RECENT GUIDANCE AND OTHER UPDATES

### A. UST GUIDELINE / LEGISLATIVE UPDATE

1. ***Guidelines for United States Trustee Program (USTP) Enforcement Related to Bifurcated Chapter 7 Fee Agreements*,** https://www.justice.gov/ust/bifurcated-fee

**Summary:** The Bankruptcy Code generally prohibits post-petition payment of attorney's fees arising from prepetition retention agreements in chapter 7 cases. The Supreme Court held in Lamie v. United States Trustee, 540 U.S. 526, 537 (2004) that a chapter 7 debtor's attorneys' fees may not be paid out of the bankruptcy estate, and almost all courts that have considered the issue have held that attorneys' fees owing under a prepetition retainer agreement are a dischargeable debt. As a result, the traditional model for representation in chapter 7 cases is payment of the entire attorney's fee for the case in full before the case is filed. In recent years, however, "bifurcated" fee agreements—which split an attorney's fee between work performed prior to the filing of a bankruptcy petition and work performed post-petition—have become increasingly common, generally structured so that minimal services are performed under a prepetition agreement for a minimal fee, while all other services are performed post-petition, under a separate post-petition retention agreement (arguably rendering those fees non-dischargeable).

On June 10, 2022, the USTP took the position that, absent contrary local authority, bifurcated fee agreements are permissible so long as the fees charged under the agreements are fair and reasonable, the agreements are entered into with the debtor's fully informed consent, and the agreements are adequately disclosed in accordance with 11 U.S.C. § 329 and Rule 2016(b) of the Federal Rules of Bankruptcy Procedure. It clarified that the default remedy for failure to make proper disclosures under § 329 is return of all fees. See, e.g., SE Prop. Holdings, LLC v. Stewart, 970 F.3d 1255, 1266 (10th Cir. 2020).

# Faculty

**Jason N. Kestecher** is an associate at Skadden, Arps, Slate, Meagher & Flom LLP in New York. He represents debtors, creditors, equityholders, investors, purchasers and other parties-in-interest in all stages of complex restructuring transactions, including prepackaged, prearranged and traditional chapter 11 cases, out-of-court workouts, mergers, acquisitions, joint ventures, financing transactions and cross-border proceedings. His representations include chapter 11 debtors Noble Corp. plc, TridentUSA Health Services, SunEdison, Inc. and Millennium Health, LLC; DIP-financing providers Bank of America in Sears Holdings Corp.'s chapter 11 case and Barclays in the NewPage/Verso bankruptcy case; Peter Thiel and Thiel Capital in the Gawker Media chapter 11 cases; and purchaser Veritas Capital in its $2.1 billion acquisition of StandardAero. Mr. Kestecher's *pro bono* work includes successfully obtaining a grant of clemency from the President for an indigent nonviolent drug offender. He received his B.A. in 2011 from Georgetown University and his J.D. in 2014 from Georgetown University Law Center.

**Alexis A. Leventhal** is a member of the Financial Industry Group in the Pittsburgh office of Reed Smith LLP, where she practices in its Financial Industry Group in the area of restructuring and bankruptcy. She represents and advises corporate clients on bankruptcy and other insolvency matters, as well as on UCC issues. She also has experience representing equipment lessors in workout and bankruptcy cases, as well as in documenting equipment leasing transactions. Prior to joining Reed Smith, Ms. Leventhal clerked in the Western District of Pennsylvania and the Middle District of Florida. She is a regular contributor to the *Norton Bankruptcy Law Adviser* and *The Legal Intelligencer*, among other publications. Ms. Leventhal received her B.A. in 2007 in the growth and structure of cities from Haverford College, her Master's degree *summa cum laude* in urban and regional planning in 2010 from the University of New Orleans, and her J.D. *cum laude* in 2013 from the University of Florida Levin College of Law, where she served on the *Journal of Law and Public Policy* and was a member of the International Commercial Arbitration Moot Court Team.

**Jaclyn C. Marasco** is an associate with Faegre Drinker Biddle & Reath LLP in Wilmington, Del., and is a corporate restructuring attorney experienced with high-profile bankruptcy cases and complex commercial litigation with a nexus to the state of Delaware. She previously served as an associate at another *Chambers*-ranked Wilmington law firm, a trial attorney for the Office of the U.S. Trustee in Delaware and a law clerk to two bankruptcy judges in New York and Delaware. Ms. Marasco has represented debtors, creditors, court-appointed fiduciaries and other parties in chapter 11 and other high-stakes commercial disputes, both in and out of the courtroom. She is a member of ABI and the Federal Bar Association, the International Women's Insolvency & Restructuring Confederation's Delaware Chapter, the Delaware Bankruptcy American Inn of Court and the Delaware State Bar Association. In addition, she participated in the National Conference of Bankruptcy Judges' 2022 Next Generation Program (NextGen) and made the firm's *Pro Bono* Honor Roll in 2021. Ms. Marasco received her B.S. *cum laude* in business administration in 2011 from the State University of New York at Geneseo and her J.D. *cum laude* from Pace University School of Law in 2014, where she served as executive articles editor of the *Pace Law Review*.

**Hon. Patricia M. Mayer** is a U.S. Bankruptcy Judge for the Eastern District of Pennsylvania in Reading, appointed in October 2019 after 22 years of private practice representing consumers and small business debtors in bankruptcy. Judge Mayer was sworn in on March 11, 2020, just days before the statewide shutdown due to COVID-19, and she spent her first year on the "virtual bench." Judge Mayer is a past chair of the Eastern District of Pennsylvania Bankruptcy Conference, was a board member and volunteer attorney for the Consumer Bankruptcy Assistance Project (CBAP), a was a Third Circuit community leader for the National Association of Consumer Bankruptcy Attorneys (NACBA) and is a frequent lecturer and course-planner for the Pennsylvania Bar Institute. In 2014, Judge Mayer served on the Local Rules Committee tasked with drafting the Model Chapter 13 plan used in the district as well as a comprehensive review and revision of the Local Rules. Previously, she was a partner with the firm of Waterman & Mayer, LLP in Yardley, Pa., where she represented individuals and small business owners in consumer bankruptcy cases, IRS collections matters and mortgage foreclosure defense cases. Judge Mayer received her B.A. *magna cum laude* in politics from DeSales University and her J.D. from Temple University School of Law, where she received the Barrister's Award for Excellence in Trial Advocacy.