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Business Bankruptcy Legal Update

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Confirmation Issues

Discrimination

In *In re CHC Group Ltd.*, No. 16-31854-bjh11 (Bankr. N.D. Tex. Mar. 3, 2017), the Bankruptcy Court of the Northern District of Texas confirmed a plan where some members of a class of claims had the option to be plan sponsors and receive a pro rata share of the debtors put option premium while other members of the same class of claims did not have the same opportunity. Regardless, the court found no discrimination within the class.

The *CHC Group* court approved, over a creditor's objection, the debtors' entry into a plan support agreement, including approval for the debtors to execute a backstop agreement. Under the agreement, the plan sponsors were required to purchase any new notes that remained unsold following the consummation of the rights offering under the plan. The new debt was sold at a discount, with the purchasers paying $300 million for $433.3 million in debt. The plan sponsors were also entitled to a put option premium. This put option premium was paid in an amount dependent on whether the rights offering was consummated. If the rights offering was consummated, the plan sponsors were to receive $30,814,815 worth of new convertible notes. If the rights offering was not consummated, the plan sponsors would receive $21,333,333 in cash from the bankruptcy estate.

A creditor objected to the confirmation of the plan on the grounds that allowing some members of the class the opportunity to be plan sponsors and not others was disparate treatment within a single class and this made the plan unconfirmable under 11 U.S.C. section 1123(a)(4)). The court overruled the objection on the grounds that any money received by the creditors serving as plan sponsors are not a distribution on the creditor's claim, but consideration paid in return for the plan sponsors' agreement to backstop the rights offering. The court states that the debtors needed the money for assurance that the "substantial funds they needed to demonstrate feasibility of the plan were committed," regardless of what happened between the filing of the plan and its confirmation and consummation.

In making this determination, the court relies on *In re TCI 2 Holdings, LLC*, 428 B.R. 117 (Bankr. D.N.J. 2010). As in *CHC Group.* the debtors in *TCI 2* offered a group of noteholders the right to receive twenty percent of the equity in the reorganized debtors in consideration for their agreement to backstop a rights offering contained in the plan. The debtors did not offer this option to all creditors in the noteholders class. The court in *TCI* uses similar reasoning to the *CHC Group* court, stating that "[t]he Backstop Fee proposed to be paid to the Backstop Parties is not a distribution to the Second Lien Noteholders on account of their Second Lien Note claims. Rather, the Backstop Fee is offered as consideration for the $225 million commitment made by the Backstop Parties, which will be paid only if the $225 million is funded."

While facing a similar issue in the future, practitioners should be aware of the *In re Washington Mut., Inc*., 442 B.R. 314 (Bankr. D. Del. 2011) decision. The court in *Washington Mutual* found discriminatory treatment when there was a $2 million claim threshold necessary for a claimant to participate in the rights offering to purchase stock of the reorganized debtor. While the debtor argued that the rights offering provides no value, the court disagreed. The court stated

that "[t]he right to buy into a company does have inherent value; it includes the 'upside' if the company is successful."

Takeaway: While the *CHC Group* court approved a plan that allowed certain members of a class to be plan sponsors and not awarding others in the same class an equal opportunity, it is important to note that the Delaware Bankruptcy Court in *Washington Mutual* came out the opposite way on the same issue. This issue is still developing and thus practitioners should be aware that there is not yet a clear answer as to how courts will act when faced with this issue.

Comparison to the New Value Exception: The new value exception to the absolute priority rule is a device used by a plan proponent to allow a subordinate class to pay or transfer new value to the debtor's estate in order to retain that class's existing interest or to receive a payment, even though one or more senior classes have not been paid in full. There is currently a circuit split over the validity of the new value exception, with the Seventh and Ninth Circuit relying on the new value exception to support confirmation of debtors' plans and the Second and Fourth Circuits disapproving of the exception. *Compare In re 203 North LaSalle Street Partnership*, 126 F.3d 955 (7th Cir. 1997), *and In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), *with In re Coltex Loop Central 3 Partners, LP*, 138 F.3d 39 (2nd Cir. 1998), *and In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir. 1992).

The Supreme Court in *Bank of America National Trust & Saving Assn. v. 203 North LaSalle Street Partnership,* 526 U.S. 434 (1999), reversed the confirmation of a plan of reorganization that relied on the new value exception. The Court focused on the language of 11 U.S.C. section 1129(b)(2)(B)(ii), stating that "on account of" should be read with its common understanding of "because of." This made for a causation element in the 1129 confirmation analysis, where the Court found that if the opportunity to contribute new value by a subordinate class of claims was "because of" their junior liens, such participation would be prohibited without market forces assisting in determining whether the new value was actually new, substantial, necessary, and fair. The Court did not address the significant issue of whether there is in fact a new value exception, it only made clear that if there is such an exception, bankruptcy plans providing junior interest holders with exclusive opportunities free from competition without benefit of market valuation fall within the code's prohibition.

The underlying issue the court in *CHC* was wrestling with is a similar issue to the one courts have been wrestling with when it comes to the new value exception. Circuit courts have disagreed on both issues. As courts continue to deal with these issues, it appears that the similar logic of whether new value the claimholder receives is value given because of their claim or status, or value given for the new value provided to the debtor.

Chapter 11 Plan Interest Rates

In *Matter of MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017), the Second Circuit adopts the Sixth Circuit's approach in *In re Am. HomePatient, Inc.*, 420 F.3d 559 (6th Cir. 2005) for determining a cramdown rate of interest in chapter 11 cases, eschewing (where an efficient market exists for pricing) automatic adherence to the "formula rate" approach established by the Supreme Court plurality in *Till v. SCS Credit Corp*, 541 U.S. 465 (2004).

The plan in *MPM* was confirmed despite rejection by the senior-lien notes holders. Because of this, they received replacement notes (without make-whole), which would pay out their claims over time at a "cramdown" rate of interest. The lower courts used the "formula rate" as instructed by the plurality opinion in *Till*, even though the result was undisputedly lower than market. The senior-lien notes holders argued this rate was too low, and as a result the Plan was not "fair and equitable" as required by § 1129(b).

The Second Circuit in its review of *Till* brings attention to the fact that in footnote 14 the Supreme Court stated that the approach best applied in the Chapter 13 context may not be suited to Chapter 11. The Court in *Till* noted that in chapter 13 cramdowns there is not a free market of cramdown lenders, which is not true in the chapter 11 context and "[t]hus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce." The Second Circuit then adopted the Sixth Circuit's two-step approach, stating that this approach "best aligns with the Code and relevant precedent." The court stated that "where, as here, an efficient market may exist that generates an interest rate that is apparently acceptable to sophisticated parties dealing at arms-length, we conclude, consistent with footnote 14, that such a rate is preferable to a formula improvised by a court." The court further found that the *Till* decision did not make efficient market rates irrelevant in determining value in the Chapter 11 cramdown context, as disregarding such rates would be a "major departure from long-standing precedence."

The *MPM* court found that the lower courts erred in dismissing the probative value of market rates of interest and remanded to the bankruptcy court to ascertain if an efficient market rate does exist.

This case has not yet been heard on remand.

Takeaway: The Second Circuit has adopted the Sixth Circuit's two-step approach to choosing a Chapter 11 Plan interest rate. If there is an efficient market that exists and generates an interest rate, then that interest rate may be acceptable. If such an interest rate does not exist, then the formula rate approach should be applied.

Insured v Insured: Exclusion in D&O Insurance

In *Indian Harbor Ins. Co. v. Zucker*, 860 F.3d 373 (6th Cir. 2017), the court found that under the facts and circumstances of the case, the litigation trust action fell within the insured v. insured exclusion" in the insurance policy, as an action by, on behalf of, or in the name or right of, the company or any insured person.

The relevant facts are: *Indian Harbor* stems from the bankruptcy case *In re Capital Bancorp Ltd*. Pursuant to a joint chapter 11 liquidating plan, the debtors in *In re Capital Bancorp Ltd.* agreed to transfer all causes of actions belonging to them, including, claims against their directors and officers, into a liquidating trust. The plan further provided that any recovery on those claims would be limited to the amounts that may be recovered from applicable insurance policies. Indian Harbor Insurance issued the primary directors' and officers' liability insurance policy to the debtors. The insurance policy included an endorsement providing for an insured v. insured exclusion that, in part, precluded coverage for claims brought by, on behalf of, or in the name or

right of, the Company or any Insured Person (as defined in the applicable policy), except in three circumstances. Specifically, the exclusion would not apply if a claim was (1) brought derivatively by a security holder who is acting independently of an Insured Person or the Company, (2) was in the form of a crossclaim, third party claim or other claim for contribution or indemnity by an Insured Person that is part of or results directly from a claim that is not otherwise excluded by the terms of the policy, or (3) an employment practices claim.

On August 8, 2014, the liquidation trust filed a complaint against three of the debtors' former directors for breach of fiduciary duties. Indian Harbor subsequently commenced an action seeking a declaratory judgment that, among other things, the insurance policy does not provide coverage for any loss, including defense expenses in connection with the liquidation trust action because the policy's insured v. insured exclusion bars coverage.

The court first found that due to the split in authority over whether an insured v. insured exclusion applies in lawsuits against a corporation's former directors and officers brought by a debtor in possession, trustee, creditors' committee, or post-confirmation liquidating trustee, the court must apply a fact specific analysis. In doing so, the court concluded that there was a direct connection between the insured and the liquidation trust. Specifically, the court pointed to a former officer of the debtors who was a defendant in the litigation trust action and also one of the three members serving on the litigation trust oversight committee. This person also signed the settlement agreement with the creditors' committee providing for the creation of the liquidation trust, signed the liquidation plan, and signed the liquidation trust agreement that caused the lawsuit naming her and two others as defendants. Finally, the insured debtor had transferred its claims and causes of action to the litigation trust, thus having the trust step into the debtor's shoes in terms of asserting its claims and causes of action. The court found that these facts were enough to hold that the litigation trust action fell within the insured v. insured exclusion.

Takeaway: A split in authority exists over whether an insured v. insured exclusion applies in lawsuits against a corporation's former directors and officers brought by a debtor in possession, trustee, creditors' committee, or post-confirmation liquidating trustee. When faced with the issue of whether these exclusions apply, bankruptcy courts will likely look to the factors discussed above in *Indian Harbor*.

Turnover Motion in Lieu of Adversary Proceeding

In *Bank of America NA v. Veluchamy (In re Veluchamy),* 15-2902 (7th Cir. Jan. 12, 2018), the Seventh Circuit found that the bankruptcy court did not err in finding that the purported transfer of funds to a company that the debtor had the ability to direct and control was a sham transaction and thus a turnover action could be used to recover such funds.

In 2010, Mr. Veluchamy deposited roughly $5.5 million in an account nominally held by JSM, an Indian company owned by the Veluchamy family. During the litigation of this case, it was demonstrated that Mr. Veluchamy had the ability to direct and control JSM. Mr. Veluchamy argued in both bankruptcy and district court that a turnover action cannot apply to the $5.5 million

because he relinquished control over the money when he sent it to JSM's bank account in India prior to the bankruptcy filing.

On appeal, the appellant put forward multiple arguments against the turnover order, including whether turnover under 11 U.S.C. section 542 is the appropriate remedy where there is a legitimate dispute about ownership of the property the trustee seeks to recover. The debtor's estate conceded that proof regarding the defendant's possession, custody, or control of property of the estate after filing of the bankruptcy possession is required under section 542. The estate further conceded that if the debtor relinquished control of the property by conveying it to a third party prior to the filing of the bankruptcy petition, then the proper way to recover the property would be through a fraudulent-transfer action, rather than a turnover action.

The court reasoned that while it is true that turnover relief "generally may not be used to adjudicate a debtor's underlying rights in property when ownership of that property is in dispute," and is not a substitution for a fraudulent-transfer action, there is no legitimate dispute in this case. Since the purported transfer was a sham with no proof shown that the $5.5 million paid to the JSM bank account was used as a debt payment, there was no ownership transfer of the funds and was thus part of the bankruptcy estate and subject to turnover.

Takeaway: While turnover relief is not a substitute for a fraudulent-transfer actions, when a purported transfer of property is a sham with no proof of change of control over the estate property, a turnover action may be used to retrieve such property.

Claims and Claims Trading

The Ninth Circuit, in *In re Village at Lake Ridge, LLC*, 814 F.3d 993 (9th Cir. 2016) was recently called upon to determine the insider status of a claimant whom acquired the claim at issue from a party who qualified as an insider under section 101(31).

The debtor's sole member was a limited liability company which held a general unsecured claim against the estate in the amount of $2.7 million. The only other creditor was US Bank, the debtor's secured creditor. After filing of its plan and disclosure statement, one of the five managers of the sole member orchestrated the sale of the member's claim to a person with whom she had a personal relationship but whom had no prior or independent relationship with the debtor. The claim was sold for $5,000 with no due diligence. The debtor's plan proposed a payout on the claim of $30,000. Being one of two claims against the debtor's estate, the claim could satisfy section 1129(a)(10) and thus act to cram the plan down over US Bank's objection under section 1129(b). US Bank moved to designate the claim and disallow it for voting purposes. During deposition of the claimholder, US Bank offered to purchase the claim for $60,000, which offer the claim holder did not respond and ultimately lapsed.

After an evidentiary hearing, the bankruptcy court held that the claimholder was not a "non-statutory insider" because, among other things, he did not exercise control over the debtor nor the manager who orchestrated the sale of the claim, while acknowledging the personal relationship with the manager. In re *In re Village at Lake Ridge, LLC*, 814 F.3d at 998. However, the bankruptcy designated the claim and disallowed it for voting purposes because it concluded that

the claimholder had become a statutory insider as a matter of law by acquiring a claim from a statutory insider. *Id*. The 9th Cir. BAP reversed the finding that the claimholder became a statutory insider as a matter of law by acquiring the claim from a statutory insider and affirmed the bankruptcy court's ruling that the claimholder was not a non-statutory insider. *Id*. The BAP held that insider status cannot be assigned and must be determined on a case by case basis after the consideration of various factors." *Id*.

The 9th Cir. affirmed the ruling of the BAP. The Court began its analysis by noting the legislative history definition of an insider, which provides "[a]n insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms [sic] length with the debtor." 814 F.3d at 999 (citing S.Rep. No. 95–989, at 25 (1978)). The Court then recognized two types of insiders, statutory insiders and non-statutory insiders. The Court explained that statutory insiders, or "per se insiders," are those persons explicitly described in Section 101(31) which, as a matter of law, have a sufficiently close relationship with a debtor to warrant special treatment. *Id*. Non-statutory insiders, on the other hand, were person who are not explicitly listed in § 101(31), "but who has a sufficiently close relationship with the debtor to fall within the definition." *Id*. (citing *Schubert v. Lucent Techs. Inc. (In re Winstar Commc'ns, Inc.)*, 554 F.3d 382, 395 (3d Cir.2009) ("[I]n light of Congress's use of the term 'includes' in § 101(31), courts have identified a category of creditors, sometimes called 'non-statutory insiders,' who fall within the definition but outside of any of the enumerated categories.")).

The 9th Circuit in *Village at Lakeridge* held that a person does not, as a matter of law, become a statutory insider solely by acquiring a claim from a statutory insider. *Id*. According to the Court, there are two reasons for this. First, bankruptcy law distinguishes between the status of a claim and that of the holder of such claim, and insider status pertains only to the identity of claimholder, not the claim. *Id*. Because insider status in not a characteristic of the claim, it is not subject to general assignment law which requires an assignee to takes a claim subject to both the benefits and defects of the claim. Second, the Court noted that a person's insider status is a question of fact that must be determined after the claim transfer occurs. *Id*. at 999-1000. As part of this analysis, the Court recognized that the Code's use of the term "insider" was a noun referring to a person, rather than an adjective describing the claim itself. *Id*. at 1000. Accordingly, the Court determined that whether a claimholder is an insider requires an analysis of the claimholder is and thus is purely a factual inquiry that must be concluded on a case-by-case basis rather than as a matter of law.

This inquiry, while factual in nature, starts with Section 101(31) to determine if the assignee, on its own, fits within one of the insider classifications therein. If so, the court need not go further as the assignee will be considered a statutory insider. However, if the assignee does not fit within Section 101(31)'s definitions, courts must look to the assignee's relationship to the debtor to determine if the relationship is so close as to fall within the functional ambit of a Section 101(31) statutory insider and thus considered a "non-statutory" insider. *Id*. at 1001.

Citing the 10th Circuit, the Court stated that a creditor is not a non-statutory insider unless, after a fact-intensive analysis determines that: (i) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in Section 101(31), and (ii) the relevant transaction is negotiated at less than arm's length. *Id*. (citing *Anstine v. Carl Zeiss Meditec*

AG (In re U.S. Med., Inc.), 531 F.3d 1272, 1277 (10th Cir.2008)). A close relationship, in itself, is insufficient to label the creditor as a non-statutory insider, but rather having or being subject to some degree of control is more indicative of being a non-statutory insider (although actual control is not required). *Id*.

Based on this analysis, the Court found that notwithstanding the personal relationship the claimholder had to the member's manager, there was no clear error in the bankruptcy court's finding that he was not a statutory insider, relying on the fact that there was no evidence of control over each or the debtor and disregarding US Bank's questionable attempt to put the claimholder on the spot by offering an amount in excess of the plan distribution during his deposition. *Id*. 1002.

The ruling contains a dissent which agrees with the majority's conclusion that person does not necessarily become a statutory insider by acquiring the claim, but disagrees with the majority's reluctance to overturn the bankruptcy court's finding relating to the relationship between the parties and whether the acquisition of the claim was truly arm's-length. *Id*. at 1004. The dissent noted that the manager and claimholder were not "unrelated and unaffiliated" parties as required under the accepted definition of an arm's-length transaction. *Id*. at 1005. Accordingly, since the transaction could not qualify as arms'-length, the claimholder was a non-statutory insider based on the majority's definition thereof. *Id*.

The Supreme Court granted *certiorari* in part *sub nom*. on March 27, 2017.

Trademark Licensee Rights Upon Rejection Under Section 365

In a split decision, the First Circuit recently held that Section 365(n) does not permit a licensee's continued use of a trademark license after rejection by the debtor licensor.

In *In Mission Products Holdings, Inc. v. Tempnology, LLC (In re Tempnology, LLC)*, 879 F.3d 389 (1st Cir. 2018), the debtor, Tempnology, LLC (the "Debtor"), developed specialized products such as towels, socks, headbands and related accessories which were designed to remain cool when used during exercise. The Debtor entered into an agreement with Mission Products Holdings, Inc. ("Mission") wherein the Debtor granted Mission: (i) the right to distribute its products on both an exclusive and non-exclusive basis, (ii) a non-exclusive license to the Debtor's intellectual property, and (iii) a non-exclusive, non-transferrable, limited trademark license for the limited purposes of performing its obligations under the agreement.

The Debtor moved to terminate the agreement under Section 365(a). Mission objected to rejection motion arguing that Section 365(n) allowed Mission to retain both its intellectual property license as well its exclusive distribution rights. In a one page order, the bankruptcy court granted the Debtor's motion to terminate the agreement "subject to Mission Product Holding's election to preserve its rights under 11 U.S.C. § 365(n)." 879 F.3d at 364. The Debtor then moved for a determination that Mission's rights under Section 365(n) did not extend to its distribution rights or its trademark license. *Id*. The bankruptcy court held that Section 365(n) did not preserve the

distribution rights or the trademark license, finding that Section 365(n) only protected intellectual property rights and the distributorship could not reasonably be considered an intellectual property right. Further, the bankruptcy court reasoned that trademarks absence from Section 101(35A) evidenced Congressional intent to leave trademark rights unprotected. *Id*.

The First Circuit BAP affirmed the bankruptcy court's order with respect to Mission's exclusive distribution rights, concluding that "Mission's attempt to re-characterize its exclusive product distribution rights under the Agreement as an intellectual property license [is] unsupported by either the letter or the spirit of the Agreement." As did the bankruptcy court, the BAP interpreted Section 365(n)'s protection of "exclusivity provision[s]" as encompassing only the exclusivity attributes related intellectual property rights. 879 F.3d at 395. However, the BAP reversed the bankruptcy court's finding that rejection extinguished trademark rights. This reversal was based on the Seventh Circuit's ruling in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012) which held that because Section 365(g) deems the effect of rejection to be a breach of contract, and a licensor's breach of a trademark agreement under state law does not necessarily terminate the licensee's rights, rejection under Section 365(g) likewise does not necessarily eliminate those rights. *Id*.

On appeal, the First Circuit went through the history of Section 365(n) including its emanation from Congressional intent to overturn the Fourth Circuit's decision in *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985). 879 F.3d at 396.

In initially tackling the issue of the treatment of Mission's distribution rights, the Court rejected Mission's attempt to read Section 365(n)(1)(B)'s parenthetical "exclusivity provision" language expansively to cover every exclusivity provision in the contract, whether or not related to intellectual property. *Id*. Rather, the Court noted that Section 365(n) allows licensees to retain intellectual property rights and the purpose of Section 365(n)(1)(B)'s exclusivity language is to clarify that those rights "to such intellectual property" include any exclusivity attributes of those rights. *Id*. Accordingly, the Court recognized that while Subsection (n)(1)(B) protects an exclusive license to use a patent, it does not extend the same protection to an exclusive right to sell a product just because it is contained in the same contract as the license to use the patent. *Id*. In doing so, the Court noted that an exclusive right to sell a product, such as what was contained in Mission's agreement, is not the same as an exclusive right to exploit the products underlying intellectual property. *Id*. at 399.

In turning to the issue of whether a licensee retains a right to use a licensor's trademark after rejection, the First Circuit, like the bankruptcy court and many courts before, recognized that trademarks are noticeably absent from the list of intellectual property provided in Section 101(31A). However, unlike the bankruptcy court, the Court did not conclude that such absence evidenced a congressional mandate not to protect trademark rights. Rather, the Court recognized the Congressional history in which Congress expressly postponed inclusion of trademarks for Section 365(n) protection rather than making an affirmative decision to exclude them. *Id*. at 401.

In so doing, the Court recognized alternative treatment of rejected trademark licenses as espoused by the Seventh Circuit in *Sunbeam.* *Sunbeam* held that nothing in the rejection process under Section 365 "vaporizes" the non-debtor's contract rights. *Sunbeam*, 686 F.3d at 377. Rather, the Seventh Circuit noted that under Section 365(g), a Section 365(a) rejection constitutes a breach of contract that merely "frees the estate from the obligation to perform" thus converts a debtor's duty to perform into a liability for pre-petition damages, yet it leaves in place the counterparty's right to continue using a trademark licensed to it under the rejected agreement. *Id*.

The First Circuit challenged *Sunbeam's* conclusion by reasoning that while rejection does effectuate a breach of contract by the debtor, the Congressional purpose of doing so was to "release the debtor's estate from burdensome obligations that can impede successful reorganization." *See* 879 F.3d at 402 (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 531–32, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984)). When considered in the context of trademarks, *Sunbeam's* rational erodes as the Court reasoned that effective trademark licensing requires the licensor (the debtor) to continuously monitor and exercise control over the quality of goods sold through use of the trademark. *Id*. The continuing obligation to monitor and control use of the trademark is therefore inconsistent with the release burdens for which Section 365(a) rejection was enacted. This is even more important considering that failure to monitor and exercise such control results in so-called "naked license" which puts the debtor's trademarks at risk. Accordingly, a debtor would be required to choose between continued use of the trademark in the hands of the licensee or potential loss of the trademark. *Id*. at 403. The Court reasoned that this result would be a significant departure from how Section 365(a) is intended to operate.

The dissent follows the Seventh Circuit and BAP in finding that the Mission's right use the debtor's trademark did not "vaporize" as a result of rejection. 879 F.3d at 405. In opposing the majority's "bright-line rule" the dissent also relies on Section 365(n)'s legislative history, focusing on its express decision to withhold application of 365(n) to trademarks to allow more time for study by the courts. This express reservation is interpreted by the dissent as providing an avenue to encourage courts to apply "equitable treatment" to resolve disputes until Congress acts further. *Id*. In so doing, the dissent agrees with the BAB and the Seventh Circuit that rejection should be viewed as a breach outside of the bankruptcy context in which counter-parties' rights are not automatically terminated. In this regard, the dissent encourages courts to look at the terms of the contract and non-bankruptcy law for a determination of the licensee's rights. *Id*. at 406-407.

Judicial Estoppel Cases

Asarco LLC v. Noranda Mining, Inc., 844 F.3d 1201 (10th Cir. 2017)

Asarco LLC ("Asarco"), a mining, smelting, and refining company, filed for bankruptcy in 2005 as a result of, among other things, massive environmental claims. After years of negotiating and hearings, the bankruptcy court approved a comprehensive settlement agreement

in which Asarco agreed to pay $1.79 billion to resolve numerous claims at contaminated sites, including $7.4 million to resolve claims at site called The Lower Silver Creek/Richardson Flat site (the "Site"). *Id*. at 1204-05. In reviewing the settlement agreement, the bankruptcy court acknowledged it was bound by two different legal standards: (1) Bankruptcy Rule 9019(a), which directs the court to approve a settlement when it is "fair, equitable, and in the best interests of the estate," and (2) CERCLA, which requires the court to ensure that settlements are procedurally and substantively fair, "reflect a reasonable compromise of the litigation," and roughly correlate to a reasonable estimate of the parties' liability. *Id*. at 1206. The bankruptcy court found the evidence submitted by Asarco demonstrated that the $7.4 million settlement was fair under both Rule 9019(a) and CERCLA and approved the settlement. *Id*. Notably, as part of the settlement, the bankruptcy court approved a reservation of rights by Asarco preserving claims against non-settling parties related to the Site. Asarco's confirmed plan of reorganization also expressly reserved any contribution actions Asarco might have against non-settling PRP's, specifically listing the Site as a preserved litigation claim. *Id*.

In 2013, post-confirmation, Asarco filed an action against Noranda Mining, Inc. ("Noranda") seeking contribution under CERCLA related Site. The district court granted Noranda's summary judgment motion in its entirety finding that judicial estoppel barred Asarco's claims, relying on statements Asarco made years earlier in bankruptcy proceedings concerning its liability for the Site. *Id*. at 1207.

The Tenth Circuit Court of Appeals reversed. The Court identified three factors upon which judicial estoppel can be found (i) where a party takes a position clearly inconsistent with its earlier position, (ii) where adoption of a later position would create the impression that either the first or second court was misled, and (iii), allowing the party to change its position would give it an unfair advantage or impost an unfair detriment on the opposing party if not estopped. Id. at 1208 (citing *New Hampshire v. Maine*, 32 U.S. 742, 749–50, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001)). Based on these factors, the Court rejected Noranda's argument, noting that Asarco's positions were not clearly inconsistent because, among other things, CERCLA, upon which the settlement agreement was partially based, allows a party to settle for an inexact amount and later seek contribution from other PRPs for any amounts it overpaid. Since doing so, without more, does not equate to pursuing inconsistent positions. The Court further concluded that the bankruptcy court was not duped or otherwise misled by Asarco's statements, noting that Asarco, both in its approved settlement agreement and plan, specifically preserved its contribution rights against other potentially responsible parties. *Id*. at 1209-10. Furthermore, the Tenth Circuit rejected Noranda's argument that allowing the contribution claim would give Asarco an unfair advantage. *Id*. at 1210-11. The Court distinguished this situation from those in which a debtor "conveniently" forgets to inform the court of key information because there was no evidence that Asarco attempted to deceive the bankruptcy court. Rather, Noranda's argument was based upon one vaguely worded sentence that Asarco had correctly clarified elsewhere. *Id*.

Slater v. United States Steel Corp., 871 F.3d 1174 (11th Cir. 2017) (en banc).

In *Slater*, the chapter 7 debtor commenced an employment-discrimination suit in federal district court against her employer two years before filing her chapter 7 petition. *Id*. at 1177. While the bankruptcy case was pending, the employer filed a motion to dismiss the debtor's lawsuit based on judicial estoppel, because she failed to list the suit on her Schedules. The debtor amended her schedules to list the claim the business day after the employer filed its motion to dismiss. *Id*. at 1178 The chapter 7 trustee retained her litigation counsel as special counsel in order to pursue the suit on behalf of the estate and the case was converted to chapter 13, and the debtor confirmed a plan. However, the debtor did not receive a discharge because he case was subsequently dismissed. *Id*.

The district court applied Eleventh Circuit precedent which allowed the mere fact of the debtor's nondisclosure to serve as a basis to infer that she intended to manipulate the judicial process. *Id*. Although the debtor immediately corrected her schedules after the employer raised the omission, the district court found this act irrelevant because "waiting until after being caught to rectify the omission is too little, too late." *Id*. Moreover, the district court suggested that she had motive to conceal the claims to defraud creditors into believing her case was a no asset case. *Id*. Accordingly, the district court granted the employer's motion for summary judgment. The Eleventh Circuit affirmed, but then vacated its decision and granted *en banc* review at the urging of one of the judges on the original panel to review the precedent upon which the ruling was based. *Id*.

The Court started its analysis by reaffirming the circuit's application of judicial estoppel in the bankruptcy context when a two-part test is satisfied: the plaintiff: (i) took a position under oath in the bankruptcy proceeding inconsistent with the plaintiff's pursuit of the civil lawsuit and (ii) intended to make a mockery of the judicial system. *Id*. Reversing its prior precedent with respect to application of the second prong, the Eleventh Circuit announced that nondisclosure of a claim alone was not sufficient for the invocation of judicial estoppel. Rather, courts must consider all of the facts and circumstances of the debtor's nondisclosure in order to determine whether he/she intended to "make a mockery of the judicial system." Courts should also "look to factors such as the plaintiff's level of sophistication, his explanation for the omission, whether he subsequently corrected the disclosures, and any action taken by the bankruptcy court concerning the nondisclosure." *Id*. at 1176-1177.

The Eleventh Circuit *en banc* panel remanded the case back to the original three-judge panel to determine whether the district court abused its discretion in light of this new standard. In doing so, the panel noted that a circuit split exists with respect to the standard for invocation of judicial estoppel. *Id*. at 1189 A certiorari petition has been filed with the U.S. Supreme Court.

BPP Illiniose, LLC v. Royal Bank of Scotland Group PLC, 859 F.3d 188 (2nd Cir. 2017)

BPP Illinois, LLC, as one of a consortium of single-purpose entities that own and manage hotels (collectively, "BPP"), borrowed $66 million from Citizens Bank of Pennsylvania

("Citizens") to finance the purchase of several hotel properties. The loan required BPP to pay an interest rate of a set percentage above the London Interbank Offered Rate ("LIBOR") which rate was set by a banking panel which included, among others, the Royal Bank of Scotland Group PLC ("RBS").

Two years later, BPP filed bankruptcy in the Eastern District of Texas. Throughout BPP's bankruptcy proceedings, there were indications that RBS might be implicated in an improper manipulation of LIBOR, including a disclosure that RBS was cooperating with investigations into LIBOR manipulation as well as numerous law suits alleging LIBOR manipulation had been filed against certain banks, including RBS. However, BPP failed to list any potential claims against RBS on its schedules during it case. BPP's plan of reorganization was confirmed and the case closed without ever listing the potential claims.

Subsequently, BPP filed claims in the SDNY District Court against RBS and Citizens for fraudulently induced BPP to enter a loan agreement with Citizens. The District Court ultimately dismissed the claims on multiple grounds including lack of standing and judicial estoppel for failing to list the claims in its schedules.

The Second Circuit affirmed the District Court and held that BPP was judicially estopped from bringing its claim. The Court ruled that judicial estoppel applies if: (i) a party's later position is "clearly inconsistent" with its earlier position, (ii) the party's former position has been adopted in some way by the court in the earlier proceeding, and (iii) the party asserting the two positions would derive an unfair advantage against the party seeking estoppel. *Id*. 859 F.3d at 192 (citing *Adelphia Recovery Trust v. Goldman, Sachs & Co.*, 634 F.3d 678, 695-96 (2d Cir. 2011)).

With respect to the first element, the Court looked to Fifth Circuit law based on the location of the bankruptcy to determine when BPP was obligated to list the potential claims. It found that the "debtor need not know all the facts or even legal basis for cause of action; rather, if the debtor has enough information … prior to confirmation to suggest that it may have a possible cause of action, then that is a "known" cause of action such that is must be disclosed." *Id*. (citing *In re Coastal Plains, Inc*. 179 F.3d 197 (5th Cir. 1999)). Based on this law, the Second Circuit found that BPP should have been on notice about the possible claims based on media reports, disclosures and pending lawsuits and thus advanced inconsistent position when it failed to list a LIBOR-fraud claim in its bankruptcy proceeding and then asserted the claim in the District Court after the bankruptcy proceeding closed. *Id*. The Court further found that this inconsistent position was adopted by the bankruptcy court when it confirmed BPP's plan. *Id*. at 194. Lastly, the Court found that the inconsistent position gained BPP an unfair advantage by depriving the creditors of its bankruptcy estate of the benefit of such claims. *Id*.

Feuerbacher v. Wells Fargo Bank, 701 Fed. Appx. 297 (5th Cir. 2017).

In *Feurbacher*, the debtors entered into a residential home equity loan which was ultimately held by Wells Fargo Bank. Three years later, the debtors filed for chapter 7 in which

they sought to retain their property and reaffirm the Wells' debt. Shortly thereafter, they received a discharge. Five years after receiving such discharge, the debtors filed suit against Wells in the federal district court alleging both federal question and diversity claims which sought to vacate an order permitting Wells to foreclose. They subsequently amended their claims to assert solely state law clams of quiet title and breach of contract and then sought removal to the state court, which was denied. The district court granted Wells' summary judgment motion on judicial estoppel grounds for failure to list such claims in their bankruptcy schedules.

On appeal, the debtors argued that their breach of contract and quiet title claims did not accrue until after their bankruptcy filing and thus their failure to disclose the causes of action to the bankruptcy court could not serve as a basis for judicial estoppel. *Id*. at 300.

The Fifth Circuit looked to state law to determine when such claims accrued, finding that both a breach of contract claim and a quite title claim accrue under Texas law when the promissory note and deed were executed and the lien created. *Id*. at 300-301. Accordingly, the Court found that both causes of action accrued prior to filing their bankruptcy petition and their failure to disclose the potential claims provided ground for applying judicial estoppel. *Id*. (relying on *In re Coastal Plains, Inc*. 179 F.3d 197 (5th Cir. 1999)).

Barring Unknown versus Known Claims

In Re Placid Oil Co., 753 F.3d 151 (5th Cir. 2014)

Placid Oil Co. (Placid") owned and operated a natural gas production and processing facility where the plaintiff worked for many years. During the course of his employment, the plaintiff and his wife were exposed to asbestos. While Placid was aware of the potential dangers of asbestos and the plaintiff's exposure, Placid had no specific knowledge of any actual injuries related to asbestos.

Placid filed its chapter 11 case filed in 1986 and a claims bar date was set for January 1987. Placid published notice of this bar date on three occasions in the Wall Street Journal. Thereafter, Placid confirmed a reorganization plan that provided for the discharge of all pre-confirmation claims except for its obligations under the plan.

Six years after confirmation, the plaintiff filed a state law suit against Placid on behalf of himself, his widower and his family alleging that its negligence caused his widow's death. In November 2008, Placid reopened its bankruptcy proceeding and commenced an adversary proceeding to determine whether the plaintiffs' claims were discharged by the prior confirmation order.

The bankruptcy court first determined that the plaintiffs, as post-confirmation tort claimants, held pre-confirmation claims against Placid given that the claimants' exposure to

asbestos prior to confirmation of Placid's plan. Therefore, the issue to be addressed was whether the claimants had received proper notice of the claims bar date and thus due process. The bankruptcy court found that the claimants were "unknown" creditors for which constructive notice of the bar date by publication was sufficient. 753 F.3d at 153. The district court affirmed.

The Fifth Circuit first addressed what notice is required for "known" versus "unknown" claimants, noting that level of due process differs based on what category the claimant falls, "known" claimants requiring actual notice and "unknown" claimants requiring only constructive notice, satisfied through publication notice. *Id*. 154-155. It further noted that known creditors include both claimants actually known to the debtor and those whose identities are "reasonably ascertainable." *Id*. (quoting *Tulsa Prof'l Collection Servs., Inc. v. Pope*, 485 U.S. 478, 489–490, 108 S.Ct. 1340, 99 L.Ed.2d 565 (1988). Seeking to clarify prior precedent, the Court held that for purposes of whether a claim is "reasonably ascertainable," the debtor must possess "specific information" about a manifested injury, to make the claim more than merely foreseeable." *Id*. at 155. Conversely, "[i]nformation, however specific, that makes a claim only foreseeable or conjectural is insufficient." *Id*. at 156-157. To apply different standards, the Court observed, would alter the limits of a debtor's duty to notify creditors, and in turn affect a debtor's ability to obtain a fresh start. *Id*. at 157.

Based on these standards, the Court found that Placid lacked the requisite "specific knowledge" of any actual injury prior to the confirmation of its plan. *Id*. The Court also noted that "[p]ress clippings about widely known, but general, risks of asbestos exposure" were insufficient to have the claimants viewed as known creditors. *Id*. Accordingly, the Court determined that the claimants were "unknown" as of the confirmation of the plan and thus publication notice, without specific reference to possible asbestos-related injuries, was sufficient. *Id*. at 157 In so holding, the Court recognized the policy of providing debtors a fresh start and weighing that with due process considerations, there is a need to place a practical limit on a debtor's duty to notify. *Id*.

The dissent argued that the panel failed to consider whether a latent asbestos claim of an asbestos-exposed, but not yet knowingly injured, person is dischargeable and, if so, under what circumstances. *Id*. at 159. The dissenting judge noted that that that several courts have held that constructive notice to such unknown future claimants fails to comport with the guarantee of due process. *Id*. at 161. The dissenting judge argued that, because such individuals cannot recognize that they have a claim in a bankruptcy case, and, therefore, cannot make a decision about how to assert that claim, that person is functionally or constructively "incompetent" and has no ability to represent their own interests in the bankruptcy case. *Id*. at 162. Accordingly, under such circumstances, the dissenting judge argued that a future-claims representative should have been appointed pursuant to Section 524(g) in order to satisfy due process. *Id*.

In re Energy Future Holdings Corp., 522 B.R. 520 (Bankr. Del. 2015)

The debtors in Energy Future Holdings (collectively, "EFH") operated nuclear and electric power plants which, at some point during their operation, included asbestos-laden materials in their insulation. EFH scheduled as numerous asbestos-related liabilities but estimated the claims

to be minimal in comparison to its assets and liabilities. EFH sought to establish a bar date for all claims, including unmanifested asbestos-related claims. A group of law firms (the "PI Law Firms"), while not representing any particular claimaint, objected to a bar date for unmanifested asbestos claims, arguing that (i) because asbestos-related injuries may not be diagnosed for up to 50 years after exposure, publication notice would not satisfy due process requirements for classes of creditors "who are so unknown as to be unknown even to themselves"; and (ii) asbestos liabilities are best addressed—and required to be addressed—through the creation of an asbestos personal injury trust under section 524(g) of the Bankruptcy Code. 522 B.R. at 525.

The court began its analysis by evaluating when a "claim" is deemed to have arisen. *Id*. at 527. The court noted that in the Third Circuit, a "claim" arises under when an individual is exposed pre-petition to a product or other conduct giving rise to an injury underlying a "right to payment" under the Bankruptcy Code. *Id* at 528. The court thus observed that, where a party is exposed to asbestos products prepetition, any related claim is deemed to have arisen prepetition and therefore can be discharged in bankruptcy if a timely claim is not filed, even though the injury may not manifest until a later date.

The court continued its analysis by examining prior cases on the issue of notice to unknown claimants to determine whether it was possible for EFH to provide constitutionally sufficient notice of a bar date to the unknown claimants with unmanifested injuries. After analyzing the conflicting cases on the issue, the court concluded that the "weight of developing authority" holds that notice by publication may be sufficient to satisfy due process to unknown claimants. *Id*. at 537. The court then turned to the propriety of establishing a bar date for claimants with unmanifested injuries.

EFH argued, and the court agreed, that a bar date for unmanifested claims was necessary to facilitate the debtor's ability to propose a plan of reorganization giving consideration to *all* of the debtor's creditors. *Id*. at 537 (emphasis in the original). The PI Law Firms argued that the Bankruptcy Code did not require the court to set a bar date for claimants with unmanifested injuries and that the court's only avenue to address these claimants was through use of a channeling injunction under Section 524(g). *Id*. at 538. Both arguments were rejected by the court, which held that the plain language of FED. R. BANKR. P. 3003(c)(3), which provides that a court "*shall* fix … the time within which proofs of claim or interests may be filed," required it to establish a bar date for all claims. *Id*. The court next considered Section 524(g)(1)(A), which provides, in relevant part, that "a court … **may** issue … an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section." *Id*. at 538-539. Based upon this language, the court concluded that 524(g) channeling injunctions for asbestos claims are permissive and not required. *Id*. (emphasis in original). The court explained, "If establishment of an injunction under section 524(g) is the only way to satisfy due process then Congress would have made section 524(g) mandatory in cases in which asbestos related liabilities or claims arise and would have carved unmanifested claims out of Bankruptcy Rule 3003(c)(3)." *Id*. at 539. The court rejected the imposing such terms on EFH which would be required to be incorporated into a plan when no plan had yet been proposed and the exclusivity period was still in place. *Id*. Thus, the court therefore concluded it was appropriate to establish a bar date for all claims, including for claims stemming from unmanifested asbestos injuries.

Elliott v. Gen. Motors LLC (In re Motors Liquidation Co.), 829 F.3d 135, 158–59 (2d Cir. 2016), cert. denied, —— U.S. ——, 137 S.Ct. 1813, 197 L.Ed. 2d 758 (2017)

General Motors Corporation ("Old GM") filed for relief on June 1, 2009, before the United States Bankruptcy Court for the Southern District of New York and quickly moved forward with the sale of substantially all of its assets to newly formed New GM, owned primarily by the U.S. Government (the "Sale"). The Sale provided that Old GM retained most of its liabilities. *Id*. at 145-146. Except for New GM's specific assumption of liability for certain items, including accidents that happened after the Sale, the Sale was otherwise, "free and clear" of claims related to cars sold by Old GM. *Id*. at 147. After filing of the motion to approve the Sale, the court ordered notice of the Sale and proposed sale (the "Sale Order") to be given by publication in a number of national publications, such as the Wall Street Journal and New York Times, as well as direct mail notice to various other parties, including those "known to have asserted any lien, claim, encumbrance, or interest in or on [the to-be-sold assets] . . . ." *Id*. at 147.

The Sale was approved over hundreds of objections and quickly closed five days later. New GM continued the debtors' business of manufacturing and selling vehicles, while pursuant to a confirmed plan of liquidation, a trust was established liquidate those assets not sold to New GM and satisfy claims against Old GM (the "GUC Trust"). *Id*.

Years later, class action lawsuits began being filed against New GM asserting injuries relating to defects in airbags installed on Old GM cars were instituted against New GM. The law suits asserted claims for injuries incurred both before and after closing of the Sale. New GM defended these clams, as well as an adversary proceeding filed in the Old GM bankruptcy case on the "free and clear" contained in the Sale Order, arguing that it's liabilities with respect to Old GM cars was limited to post-closing personal injuries, making repairs, and following Lemon Laws, but nothing else. *Id*. at 150. The claims asserted in these proceedings included: (a) individuals who had allegedly sustained injuries prior to closing of the Sale; (b) those who had suffered economic losses arising from the ignition switch in the Old GM cars; and (c) those with damages arising from defects other than the ignition switch in Old GM cars. *Id*. at 150-151.

The bankruptcy court first determined claimants were deprived of procedural due process be the ignition switch claims were known to or reasonably ascertainable by Old GM prior to the Sale, and thus were entitled to actual notice, as opposed to the mere publication notice which was the only notice the claimants received. *Id*. However, the court also held that while they were not given proper notice of the Sale, the claimants were not prejudiced thereby, and, as a result, enforced the Sale Order enjoining many of the claims against New GM. *Id*. Accordingly, "New GM could not be sued -- in bankruptcy court or elsewhere -- for ignition switch claims that otherwise could have been brought against Old GM, unless those claims arose from New GM's own wrongful conduct." *Id*.

As part of its due process analysis, the Second Circuit began by determining the preclusive effect of the "free and clear" provisions of the Sale Order to what extent successor liability claims can be precluded under Section 363. *Id*. at 154. In this regard, the Court held that a Section 363 sale can be '''free and clear'' of successor liability claims if those claims flow from the debtor's ownership of the sold assets. Such a claim must arise from a (1) right to payment (2) that arose before the filing of the petition or resulted from pre-petition conduct fairly giving rise to the claim." *Id*. The Court further held that there must be some contact or relationship between the debtor and

the claimant such that the claimant is identifiable. *Id*. Based on the foregoing legal holding, the Court concluded that the Sale Order only barred "preclosing accident claims and economic loss claims based on the ignition switch and other defects" but not "independent claims" against New GM or the claims of those who had purchased used GM vehicles after the sale to New GM. *Id*. at 156-157.

In addressing whether the claimants were deprived of due process, the Second Circuit focused its analysis on two issues: (1) what notice claimants were entitled to, and (2) if they were provided inadequate notice, whether the bankruptcy court erred in denying relief on the basis that they were not "prejudiced." *Id*. at 158. The Court recognized that because legal claims constitute property, any deprivation thereof entitled the claimants to due process. *Id*. The Court then considered the question of "what process is due." *Id*. The Court held that "[i]f the debtor knew or reasonably should have known about the claims, then due process entitles potential claimants to actual notice of the bankruptcy proceedings, but if the claims were unknown, publication notice suffices." *Id*. at 159 (citing *Chemetron Corp. v. Jones*, 72 F.3d 341, 345–46 (3d Cir. 1995). Accordingly, the Court found no clear error in the bankruptcy court's finding that "Old GM knew or reasonably should have known about the ignition switch defect prior to bankruptcy . . ." and, therefore, "should have provided direct mail notice to vehicle owners." *Id*. In so finding, the Court noted that "[I]f a debtor reveals in bankruptcy the claims against it and provides potential claimants notice consistent with due process of law, then the Code affords vast protections." *Id*. Recognizing that both Sections 1141(c) and 363(f) permit ''free and clear'' provisions that act as liability shield and that such provisions provide enormous incentives for a struggling company to be forthright. *Id*. The Court then cautioned that "if a debtor does not reveal claims that it is aware of, then bankruptcy law cannot protect it." *Id*.

The Court then turned to the bankruptcy court's determination that prejudice is an "essential element" of procedural dues process and the claimants were not prejudiced by the inadequate notice. *Id*. at 161. Rather than reaching a determination of whether prejudice is an "essential element" of procedural due process, the Court stated that the relevant inquiry is whether the courts can be confident in the reliability of prior proceeding when there has been a procedural defect. *Id*. at 162. Accordingly, the Court "need not decide whether prejudice is an element when there is inadequate notice of a proposed § 363 sale . . . ." *Id*. Nonetheless, the Court found that the claimants were prejudiced as it could not "say with fair assurance that the outcome of the § 363 sale proceedings would have been the same had Old GM disclosed the ignition switch defect and these plaintiffs voiced their objections to the 'free and clear' provision." *Id*. at 163. The Court therefore reversed the bankruptcy court decision enforcing the Sale Order provision enjoining ignition switch defect claims. *Id*. at 163-164. In doing so, the court stated: "Because enforcing the Sale Order would violate procedural due process in these circumstances, the bankruptcy court erred in granting New GM's motion to enforce and these plaintiffs thus cannot be 'bound by the terms of the [Sale] Order' . . . ." *Id*. at 166.

"Blocking" or "Golden" Shares

On a direct appeal from a bankruptcy opinion, in *In re Franchise Servs. of N. Am.*, *Inc.*, No. 17-02316-EE, 2018 WL 485959 (Bankr. S.D. Miss. Jan. 17, 2018), the Fifth Circuit agreed to

review, on an expedited basis, the latest decision to address the enforceability of bankruptcy blocking provisions. Such provisions are sometimes contained in an entity's organizational documents. The bankruptcy court in *Franchise* concluded that a blocking provision contained in the Delaware corporation's organization documents was enforceable, where the blocking position was held by a substantial equity holder that was controlled by a creditor.

In *Franchise*, Boketo, a subsidiary of Macquarie, was formed for the sole purpose of making a sizable equity investment in Franchise to help fund Franchise's acquisition of a business. In exchange, Boketo received Franchise's preferred stock and became its largest single shareholder. Macquarie, Boketo's owner, had an unsecured claim in the amount of $2.5 million for arrangement fees and expenses that Macquarie incurred in connection with Franchise's acquisition of the same business. Franchise's organizational documents provided that a "Liquidation Event" required a majority vote of both the common and preferred holders, each voting separately as a class. A "Liquidation Event" was defined as any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Corporation or the Corporation taking any preparatory steps towards or filing a petition for bankruptcy, insolvency, receivership or similar relief." Because Boketo held all the preferred stock, Boketo's affirmative vote was required for Franchise to commence bankruptcy. All of Boketo's managers were Macquarie directors. Boketo managers expressly disclaimed any fiduciary duty to act in the best interests of Franchise, and took the position that they could act solely in Macquarie's self-interests.

Without Boketo's consent, Franchise's board passed a resolution authorizing the filing of chapter 11. Forty-five days after the bankruptcy was filed, both Boketo and Macquarie moved to dismiss the bankruptcy. The bankruptcy court denied the motion as to Macquarie, finding that "to the extent that the Macquarie Parties claim to hold a golden share or blocking position, it is void as a matter of public policy." 2018 WL 485959 at *17. The court granted, however, the motion to dismiss as to Boketo, finding that the "only hat Boketo wears is that of a substantial equity holder." *Id.* Further, even "[a]ssuming that the control Macquarie has over Boketo is such that there is no practical difference between the two entities, the result would not change." *Id.* Finally, the court also found that the blocking provision was valid under Delaware law. *Id*. at *20.

In reaching its ruling, the bankruptcy court analyzed seven opinions that address similar blocking provisions. As noted in *Franchise*, in six of the seven cases, the debtors were limited liability companies, and in one case, the debtor was a partnership. The seven opinions include the following:

> *In re Global Ship Systems, LLC*, 391 B.R. 193, 203 (Bankr. S.D. Ga. 2007) (involuntary case was dismissed based on "bad faith," where involuntary was "orchestrated" to avoid a blocking position held by entity with "two hats," a 20% equity holder and a creditor);
>
> *In re Bay Club Partners, 472, LLC*, 2014 WL 1796688, at *5 (Bankr. D. Or. 2014) (provision in operating agreement giving creditor a blocking position held unenforceable);
>
> *In re Intervention Energy Holdings, LLC*, 553 B.R. 258, 262 (Bankr. D. Del. 2016) (provision added after loan default to give lender a blocking position was

tantamount to an absolute waiver of right to seek bankruptcy protection, and was void as contrary to federal public policy; although the lender was given a single common unit, the "nature and substance" of the relationship was that of a creditor);

In re Lake Michigan Beach Pottawattamarie Resort LLC, 547 B.R. 899, 914 (Bankr. N.D. Ill. 2016) (the blocking provision was unenforceable under both Michigan and bankruptcy law, where operating agreement was amended after loan default, so that lender was made a special member, without any obligations to the debtor, and was given a bankruptcy blocking right);

In re Squire Court Partners Ltd P'ship, 574 B.R. 701, 707 (Bankr. E.D. Ark. 2017) (the blocking provision was enforceable where a limited partner, who was not a creditor, was given blocking provision);

In re Tara Retail Group, LLC, 2017 WL 1788428, at **3-4, Case No. 17-bk-75 (Bankr. N.D. W. Va. 2017) (while court held that independent director's blocking position in Georgia formation documents did not violate public policy or create a "legal impossibility," bankruptcy filing was ratified by the independent director's "silent acquiescence," where he did not exercise his "veto" right before the bankruptcy filing, even though he had "full knowledge of all facts pertinent to exercising a veto," and he never took any action to "disavow the Debtor's filing"); and

In re Lexington Hospitality Group, LLC, Case No. 17–51568, 2017 WL 4118117, at *6 (Bankr. E.D. Ky. 2017) (prepetition granting of an blocking position in Kentucky formation documents "violate[d] federal public policy and [was] void," where lender was given a 30% membership interest until its loan was repaid).

After reviewing each of these opinions, the bankruptcy court concluded that a blocking provision should be enforceable if held by the holder of a significant equity interest. Recognizing the lack of authority at the circuit court level, the bankruptcy court certified the following three issues for direct appeal to the Fifth Circuit:

1. Is a blocking provision or share that gives a party the ability to prevent a corporation from filing bankruptcy valid and enforceable, or is the provision contrary to federal public policy?

2. If a party is both a creditor and an equity holder of the debtor and holds a blocking provision or a golden share, is the blocking provision or golden share valid and enforceable or is the provision contrary to federal public policy?

3. Under Delaware law, may a certificate of incorporation contain a blocking provision/golden share? If the answer to that question is yes, does Delaware law impose on the holder a fiduciary duty to exercise such provision in the best interests of the corporation?

Receipt of Goods by a Debtor under sections 503(b)(9) and 546(c)

In *In re World Imports, Ltd.,* 862 F3d 338 (3d Cir. 2017), goods were shipped from China and delivered "FOB" to a common carrier more than 20 days before the purchaser's bankruptcy. The common carrier, however, delivered the goods to the purchaser/debtor within the 20 day period. The bankruptcy court denied the seller's section 503(b)(9) administrative expense claim, based on the FOB provision and delivery to the common carrier. On appeal, the district court reversed. *In re World Imports*, 517 B.R. 296, 300 (E.D. Pa. 2014) ("good delivered under drop-shipment arrangements were not "received" by the Debtor for purposes of §503(b)(9).").

On appeal, the Third Circuit agreed with the district court and held that the word "received" in section 503(b)(9) requires the "taking of physical possession." In so ruling, the Third Circuit relied on both the definition of "receipt" as defined in Section 2-103(1)(c) of the Uniform Commercial Code, and the "well-known" meaning of "receipt." 862 F3d at 342. The Third Circuit also relied on the meaning of "receipt" in section 546(c). Under that section, notice for reclamation must be made within 45 days after goods are received. The Third Circuit noted that it is "quite implausible [to believe] that Congress meant for the date of receipt to be different" between sections 546(c) and 503(b)(9). 862 F3d at 344. Finally, the Third Circuit rejected the argument that the goods were constructively delivered to the debtor upon delivery to the common carrier. "While it is true that a buyer may be deemed to have received goods when his agent takes physical possession of them, common carriers are not agents." 862 F3d at 345. In conclusion, "we now hold that receipt as used in 11 U.S.C. § 503(b)(9) requires physical possession by the buyer or his agent." 862 F3d at 346. *Contra In re LMCHH PCP, LLC* (Bankr. E.D. La. 2017, ECF No. 352) (where the court held, in an unwritten opinion, that delivery to a common carrier FOB constituted receipt within the meaning of section 503(b)(9)).

In *In re ADI Liquidation, Inc*., 572 B.R. 543 (Bankr. Del. 2017), the bankruptcy court also looked at the meaning of "received" as used in section 503(b)(9) and concluded that it should have the same meaning as "received" in both section 546(c) and the Uniform Commercial Code. 572 B.R. at 548. In *ADI*, the court also refused to expand "the definition of constructive receipt . . . to include deliveries to non-bailee third parties when the debtor is substantially involved in facilitating transactions between a third party and the vendor." *Id.* As authority, the court cited the district court opinion in *In re World Imports*, 517 B.R. 296 (E.D. Pa. 2014).

When is an LLC Operating Agreement an Executory Contract?

In *BMA Ventures, LLC v. Prillaman (In re Minton),* 2017 WL 354319 (Bankr. C.D. Ill, Jan. 24, 2017), a chapter 7 debtor owned a 20% interest in a limited liability company, BMA, and was a party to the operating agreement for BMA. The non-debtor BMA members filed a complaint seeking an declaratory judgment that the operating agreement was an executory contract, and, as such, the agreement was rejected because the chapter 7 trustee did not assume the agreement within the sixty-day time period.

Using the "Countryman" definition adopted by many courts, including the Seven Circuit, *Mitchell v. Streets (In re Streets & Beard Farm Partnership*), 883 F.2d 233, 235 (7th Cir. 1989

(quoting the "Countryman" definition), the bankruptcy court concluded that the operating agreement was not executory. Relying on the unambiguous language in the operating agreement, the court found that the non-managing members owed no material duties and the debtor was not in a managerial role in the LLC. The court also held, however, that the chapter 7 trustee was bound by the right of first refusal in the agreement. *See* DEMYSTIFICATION OF CONTRACTS IN BANKRUPTCY, 91 Am. Bankr. L.J. 481, n.106 & n.222 (2017); PLANNING FOR THE UNEXPECTED: DRAFTING OPERATING AGREEMENTS TO PROTECT LLC MEMBERS FROM ANOTHER MEMBER'S BANKRUPTCY, 72 Bus. Law 981 (2017).

Voiding Powers

In *Veltre v. Fifth Third Bank (In re Veltre)*, 2017 WL 3484348, 2017 U.S. Dist. LEXIS 128540 (W.D. Pa., August 14, 2017), a debtor sought to avoid as a preference the sale of her home, pursuant to a sheriff's sale conducted under Pennsylvania law, to a foreclosing creditor holding a second-ranked lien. The foreclosing creditor purchased the home for $90,000 (the amount necessary to satisfy the first-ranked lien), while the fair market value was allegedly $200,000. The district court agreed that the preference case should be dismissed. In so ruling, the court looked to the "long-standing presumption in Pennsylvania that the sheriff's sale price is the 'highest and best obtainable.'" Therefore, a buyer cannot receive more by purchasing a piece of property at a sheriff's sale than that same buyer-creditor would have received in a hypothetical chapter 7 liquidation. The court concluded that a "valid, non-collusive sheriff's sale of property is not an avoidable preference" under section 547. The court was guided by *BFP v. Resolution Trust Corporation*. 511 U.S. 531, 114 S. Ct. 1757 (1994) (a regularly conducted sheriff's sale of property cannot be a fraudulent transfer because the price obtained at a non-collusive foreclosure sale constitutes a reasonably equivalent value as a matter of law under section 548).

In *Pirinate Consulting Group, LLC v. Kadant Solutions Division (In re Newpage Corp.)*, 569 B.R. 593 (D. Del. 2017), the district court affirmed the bankruptcy court opinion that advance payments under a contract were not preferences because they were not made on account of an "antecedent debt." In so ruling, the district court answered the question: when is a debt incurred for purposes of establishing whether a payment was made on account of an "antecedent debt" under section 547. The court held that that no "antecedent debt" existed where (a) advance payments were required under the contract between the parties (and the existence of an advance payment requirement does not create, in itself, an antecedent debt), and (b) the non-debtor party to the contract and recipient of the advance payment, Kadant, had not performed any services at the time of the debtor's advance payment. 569 B.R. at 26-27. The debt is incurred when the obligation between the parties arises under the terms of the contract, not when a potential action accrues under state law. *Id.* at 27.

In *Tow v. Bulmahn (In re ATP Oil & Gas Corp.),* 565 B.R. 361 (E.D. La. 2017), in a third amended complaint, the chapter 7 trustee of ATP Oil & Gas Corp. ("ATP") asserted claims, among other things, for allegedly constructive fraudulent transfers to certain former directors and officers of ATP, and specifically for certain cash and stock bonuses paid to them within two years of the bankruptcy. The district court granted a Rule 12(b)(6) Motion and dismissed, with prejudice. In so ruling, the court found that "[a]llegedly poor performance, without more, does not state a

plausible claim for a fraudulent transfer." The third amended complaint, like the earlier complaints, "lacks any allegation that defendants' compensation was out-of-line with peer firms, or that defendants did not honestly and diligently perform their jobs." 565 B.R. at 367.

> In *Matter of Walldesign, Inc.*, 872 F.3d 954 (9th Cir. 2017), a Ninth Circuit panel affirmed the district's reversal of summary judgment in favor of defendants in two adversary proceedings that sought to recover constructively fraudulent transfers. As noted by the court in its opening paragraph, it is said that "bad facts make bad law," and the appeal "test[s] the maxim against the often esoteric backdrop of the Bankruptcy Code." In *Walldesign*, the debtor's owner "channeled" almost $8 million that belonged to the company into an off-ledger bank account, maintained in the name of Walldesign, and gave himself and his wife signatory authority over the off-ledger account. Over the years, the owner used funds in the off-ledger account as a personal piggy bank, paying personal rather than company expenses. The creditors' committee filed almost 100 adversary proceedings to recover money paid from the off-ledger account. The appeal considered two particular adversary proceedings.

One adversary proceeding sought the recovery of money paid, with checks written on the off-ledger account, for Walldesign's owner to purchase certain property from two individuals. Over time, Walldesign's owner used $220,000 to purchase the property from the sellers. The purchase price was at fair value and the purchase was an arms' length transaction. The sellers were sued for a fraudulent transfer for $220,000. Another adversary proceeding sought the recovery of money paid, again with checks written on the off-ledger account, for interior design services for Walldesign's owner in the amount of $232,000. The interior designer, like the sellers, had no personal relationship with Walldesign's owner, his family, or his businesses. The services were billed at standard rate and were arms' length transactions. The adversary proceeding sought the recovery of $232,000.

The sellers and the interior designer argued that they were "subsequent transferees" within the meaning of section 550(a), so the "good faith" defense in section 550(b)(1) shielded them from the adversary proceedings. Section 550(b)(1) provides that the trustee may not recover property or its value from a subsequent transferee if the transferee accepted the property "for value . . . in good faith, and without knowledge of the voidability of the transfers." The Ninth Circuit rejected this argument. The Ninth Circuit adopted the "majority" or "one-step transaction" approach, whereby a principal of a debtor corporation who misappropriates company funds to satisfy personal obligations is not treated as the initial transferee. *See Scafer v. Las Vegas Hilton Corp. (In re Video Depot, Ltd.),* 127 F.3d 1195, 1199 (9th Cir. 1997) (mere power of a principal to direct the allocation of corporate resources does not amount to legal dominion and control, as required for initial-transferee status). In so ruling, the court expressly rejected the "minority rule," which views misappropriation cases differently and reasons that corporate principals may be strictly liable as initial transferees when they misuse company funds for personal gain. *See Internal Revenue Serv. v. Nordic Vill., Inc. (In re Nordic Vill., Inc.),* 915 F.2d 1049, 1044 (6th Cir. 1990), *rev'd on other grounds*, 503 U.S. 30, 112 S.Ct 1011 (1992).

Under the majority rule adopted by the Ninth Circuit, a principal, such as Walldesign's owner, "does not establish dominion by misdirecting company funds directly to a third party for personal gain." *Walldesign,* 872 F.3d at 964. In that situation, the "principal is not a transferee at

all but, rather, is the party for whose benefit the transfer was made." *Id.* Because Walldesign's owner did not have sufficient dominion over the off-ledger account and was not the initial transferee, the sellers and the interior designer were the initial transferees.

In *Crystallex Int'l Corp. v. Petróleos de Venez., S.A.,* 879 F.3d 79 (3d Cir. 2018), although the facts were complex, the question at the center of the case was simple: "Can a transfer by a non-debtor be a 'fraudulent transfer' under the Delaware Uniform Fraudulent Transfer Act" ("DUFTA")? Reversing the district court, the Third Circuit ruled that a transfer by a non-debtor cannot be a fraudulent transfer under DUFTA, even where aiding and abetting-type allegations are asserted. The detailed dissent found that there was a "purposeful and complicated fraud," and that the majority was wrong to "signal[] that a party . . . may knowingly participate in a fraudulent transfer so long as it is not a debtor."

Assignment of Rents Treated as Transfer of Ownership of Rents from Mortgage to Property[1]

In *Town Center Flats LLC v. ECP Commercial II LLC (In re Town Center Flats LLC*), 855 F.3d 721 (6th Cir. 2017), *cert. denied*, 138 S.Ct. 328 (Oct. 10, 2017), the Sixth Circuit applied Michigan law to determine whether an assigned stream of rents by the debtor to the mortgagee was property of the chapter 11 estate and constituted cash collateral. In concluding that the rents were property of the estate, the bankruptcy court determined an assignment of rents creates a security interest, but does not change ownership, and an assignor continues to have a property interest in the rents. The district court reversed, finding that an assignment of rents is a transfer of ownership under Michigan law and thus the rents should not be included in the bankruptcy estate. The Sixth Circuit agreed with the district court, holding that the debtor did not retain sufficient rights in the assigned rents such that those rents could not be included in the estate.

Note: The Uniform Assignment of Rents Act ("Uniform Act") was published in 2005 by the National Conference of Commissioners on Uniform State Laws. Five states have adopted the Uniform Act, including Nevada, New Mexico, North Dakota, Texas and Utah (a bill has been introduced in Massachusetts). The Uniform Act differs from the way most states address assignments of rents. Under the Uniform Act, perfection of an assignment of rents is automatic, but in most states, perfection is not automatic.

In non-Uniform Act states, a recorded security instrument (i.e. mortgage or deed of trust) grants a lender a lien on real property (not title to the property) in most states. The security instrument alone does not give a lender the right to collect rents generated by the real property. Thus, when a mortgage lender's collateral is income-producing property, a lender should require the borrower to execute an assignment of leases and rents because the assignment of rents has been interpreted to be an inchoate lien on rents requiring affirmative steps to perfect the lien. The import to the bankruptcy arena is that in most states, the "affirmative step" to be taken by a lender after a debtor files a bankruptcy petition is to file a notice under 11 U.S.C. § 546(b). However, the filing of a Section 546(b) notice does not entitle the lender to claim a right to all of the rents collected by the

[1] This is the beginning of Matt Faga's section.

debtor. Rather, the lender receives the protection to which it would have been entitled had a receiver been appointed.

Supreme Court – Bankruptcy Opinions From This Term

Safe Harbor Under 11 U.S.C. § 546(e): *Merit Management Group, LP v. FTI Consulting, Inc.,* No. 16-784, 2018 WL 1054879, 583 U.S. ____

On February 27, 2017, the Supreme Court unanimously resolved a significant circuit split on the protection provided by the section 546(e) safe harbor for certain securities transactions from a debtor's or trustee's broad preference and fraudulent transfer avoidance powers. The Court affirmed the Seventh Circuit's holding that section 546(e) does not provide a safe harbor from avoidance under sections 547, 545, 547 or 548 for a transaction merely by being effectuated through a financial intermediary as a conduit.

Following confirmation of a chapter 11 plan, the trustee of a litigation trust commenced litigation seeking to avoid and recover as a fraudulent conveyance the debtor's pre-petition purchase of shares in a competitor's business for $16.5 million. In order to facilitate the transfer, the parties conducted the equity purchase through an escrow agent, and borrowed money from lenders to pay for the equity. It was undisputed that the transfer at issue was either a "settlement payment" or a payment made "in connection with a securities contract," that neither the debtor nor the selling shareholder was a financial institution or other protected entity under section 546(e), and that the transfers had passed through entities which were financial institutions protected under section 546(e).

The selling shareholder transferee argued that the transfer flowed through a financial institution as the conduit, and as a result, it was a margin or settlement payment to a financial institution protected by the safe harbor provision of section 546(e). The district court ruled in the transferee's favor on this basis. However, relying on its prior decision in *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890 (7th Cir. 1988), the Seventh Circuit reversed, holding that the selling shareholder did not qualify as a "transferee" entitled to protection under section 546(e), as the intermediate financial institution never had "dominion over the money" or "the right to put the money to [its] own purposes." *Merit Management Group, LP v. FTI Consulting, Inc*. 830 F.3d 690, 695 (7th Cir. 2016). The Debtor and the selling shareholder were not "parties in the security industry" but rather were "simply corporations that wanted to exchange money for privately held stock." *Id.*, at 696. The Seventh Circuit refused to "interpret the safe harbor so expansively that it covers any transaction involving securities that uses a financial institution or other named entity as a conduit for funds." *Id.*

The Seventh Circuit joined the Eleventh Circuit, and widened an existing split from the Second, Third, Sixth, Eighth, and Tenth Circuits by holding that financial institutions serving as a mere conduit cannot insulate an ultimate transferee from avoidance risk when neither the debtor nor the ultimate transferee falls under the safe harbor protection of section 546(e). *See In re Quebecor World (USA) Inc*., 719 F.3d 94 (2d Cir. 2013); *In re Resorts Int'l, Inc.*, 181 F.3d 505 (3d Cir. 1999); *In re QSI Holdings, Inc.*, 571 F.3d 545 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009); *In re Kaiser Steel Corp.*, 952 F.2d 1230 (10th Cir. 1991); *Compare Matter of Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996).

In a 9-0 decision, the Supreme Court affirmed the Seventh Circuit's judgment and held that the relevant transfer for determining the applicability of the section 546(e) safe harbor is the transfer to be avoided by the bankruptcy trustee, rather than any "component parts" of that transfer. The Supreme Court did not find section 546(e) to be ambiguous and reached its decision based on "the language of §546(e), the specific context in which that language is used, and the broader statutory structure" of the avoidance powers and safe harbor. The opinion overturned the practice in the Second, Third, Sixth, Eighth, and Tenth Circuits where courts have found that section 546(e) protects transactions where the financial institution is involved only as a conduit.

Notably, the Supreme Court pointed out in a footnote that a financial institution is defined to include, among other things, "…when any such Federal reserve bank, receiver, liquidating agent, conservator or [commercial or savings bank, industrial savings bank, savings and loan association, trust company, or federally-insured credit union] is acting as agent or custodian for a customer…such customer," but that neither party contended that Merit was a "financial institution" under such definition. The Supreme Court also rejected Merit's policy-based argument for broad applicability of section 546(e), that the safe harbor was intended to encompass all transactions made through a protected entity in order to promote finality in the securities markets, as being inconsistent with the statutory text.

The *Merit* opinion eliminates a significant limitation on potential avoidance action exposure. However, many potential defendants—and some of the deepest pockets—may fall within one of the categories of protected entities under section 546(e), namely, commodity brokers, forward contract merchants, stockbrokers, financial institutions, financial participants, or securities clearing agencies. In particular, some potential defendants may qualify as financial participants, which may be satisfied by, among other things, having gross mark-to-market positions of at least $100 million in securities contracts with the debtor or other non-affiliated entities at any time in the 15 months prior to the petition date. All market participants should review their qualifications (or those of their investment vehicles) for such protected status, and should consider the "customer as financial institution" argument explicitly not addressed by the Supreme Court. The exposure is likely greatest for smaller investment vehicles or stockholders receiving distributions or being bought out in a leveraged buyout scenario. This risk may prompt such investors to trade out of positions shortly before a transaction that may expose the holder to avoidance action risk even if such trade is effectuated at some discount to the consideration being offered for such transaction. Overall, the decision is likely to lead to additional litigation as these issues are developed and may provide additional opportunities in the distressed space.

Supreme Court – Bankruptcy Opinions From Last Term

1. **Filing a Time-Barred Proof of Claim**: *Midland Funding LLC v.* Johnson, 137 S.Ct. 1407 (May 15, 2017).

A creditor filed a proof of claim in the debtor's chapter 13 bankruptcy case. The claim accurately reflected that the last time any charge appeared on the debtor's account was more than ten years ago—well after the applicable six-year statute of limitations had expired. The debtor objected and the bankruptcy court disallowed the claim. The debtor then sued the creditor, alleging that filing a claim on a time-barred debt violated the FDCPA. The district court dismissed the suit, holding that "the [Bankruptcy] Code authorizes filing a proof of claim on a debt known to be stale

. . . [and] the [FDCPA] must give way to the [Bankruptcy] Code." The Eleventh Circuit reversed. The creditor filed a petition for certiorari, noting a division of opinion among the circuits as to whether the creditor's conduct violated the FDCPA. The Supreme Court granted certiorari and reversed the Eleventh Circuit.

Majority: The Supreme Court held that the filing of a proof of claim that on its face indicates the statute of limitations for the underlying debt has expired does not violate the FDCPA. The Court reasoned that the creditor's conduct was not "false, deceptive, or misleading" because a creditor has a right to payment of a debt even after the statute of limitations period has expired.

Dissent: Justice Sotomayor authored the dissent in which she was joined by Justices Bader-Ginsberg and Kagan. The dissent found the practice of "buying stale debt, filing claims in bankruptcy proceedings to collect it, and hoping that no one notices that the debt is too old to be enforced by the courts" is unfair and unconscionable. The dissent took issue with the majority's suggestion that the "structural features of the bankruptcy process" reduce the risk that time-barred debt will be allowed. "[E]veryone with actual experience in the matter insists that" relying on the trustee as gatekeeper to ferret out time-barred claims is unrealistic. The dissent took comfort in "the knowledge that the Court's decision today need not be the last word on the matter. If Congress wants to amend the FDCPA to make explicit . . .what is already implicit in the law, it need only say so."

2. Scope of the Term "Debt Collector": *Henson v. Santander Consumer USA Inc.*, 137 S. Ct. 1718 (June 12, 2017).

Individuals who had defaulted on their car loans filed a class action suit against the car lender, claiming that it had violated state repossession laws. While the suit was pending, the lender sold the delinquent accounts. The buyer was aware of the lawsuit and that the parties had entered into a settlement, in which the vehicle lender agreed to waive any deficiency claims on these loans. The settlement, however, required court approval. At the time of the sale of the accounts, the district court had not yet granted final approval, but subsequent to the sale it granted its approval. Nevertheless, the buyer contacted the borrowers, misrepresenting both the amount of the deficiency claims and its authority to collect the debts. The borrowers sued the buyer for violation of the FDCPA. The buyer filed a motion to dismiss, arguing it was exempt from liability under the FDCPA because it was not a debt collector. Instead it was attempting to collect debts on its own behalf. Both the district court and the Fourth Circuit held that the buyer was not a debt collector because there was no indication it had acquired the debts "solely for the purpose of collection." Due to a circuit split on the definition of a "debt collector," the Supreme Court took the case to resolve this conflict.

Justice Gorsuch delivered the unanimous opinion of the Supreme Court. The Court focused on the FDCPA's plain definition of the term "debt collector," which did not take into account the circumstances of "how a debt owner came to be a debt owner." The Court recognized that "all that matters is whether the target of the lawsuit regularly seeks to collect debts for its own account or does so for 'another.'" With these tenets in mind, the Court held that buyer may collect purchased debts for its own account without falling under the statutory definition of "debt collector."

Supreme Court - Pending Bankruptcy Issues

Non-Statutory Insider: *In re The Vill. at Lakeridge, LLC*, 814 F.3d 993 (9th Cir. 2016), *cert. granted in part sub nom. U.S. Bank Nat. Ass'n v. Vill. at Lakeridge*, LLC, 137 S. Ct. 1372 (2017).

This chapter 11 case involved two creditors and two votes. The secured creditor voted to reject the plan and challenged confirmation under 11 U.S.C. § 1129(a)(10) asserting that the plan lacked an accepting class because the insider's vote could not be counted. To create an accepting class, the insider sold her $2.8 million unsecured claim for $5,000 to a buyer, who voted to accept the plan that provided for a $30,000 distribution on account of the unsecured claim. The bankruptcy judge reasoned that when a statutory insider sells or assigns a claim to a non-insider, the non-insider automatically becomes a statutory insider as a matter of law. The Ninth Circuit BAP affirmed the bankruptcy court's findings that the buyer was not a non-statutory insider and that the unsecured claim assignment was not made in bad faith, but reversed the bankruptcy court's finding that the buyer became a statutory insider solely because it acquired a claim from a statutory insider. The Ninth Circuit agreed with the BAP on appeal, stating the determination insider status is a "factual inquiry that must be conducted on a case-by-case basis."

The Supreme Court accepted certiorari and limited its review to resolve a circuit split on the proper appellate standard of review for non-statutory insider status. In the Tenth, Third, and Seventh Circuits, the courts apply the *de novo* standard of review when the underlying facts are undisputed. In *Lakeridge*, the Ninth Circuit applied a "clearly erroneous standard" reasoning that the bankruptcy court drew factual inferences from undisputed facts.

Recent Third Party Release Opinions

In re Midway Gold US, Inc., 2017 WL 4480818 (Bankr. D. Colo. Oct. 6, 2017).

In a jointly administered case, fourteen debtors sought confirmation of a joint plan that included third party releases. Relying on *Landsing Diversified Properties – II v. First Nat'l Bank and Trust Co. of Tulsa (In re Western Real Estate Fund, Inc.),* 922 F.2d 592 (10th Cir. 1991) *and Abel v. West*, 932 F.2d 898 (10th Cir. 1990), the United States Trustee objected, asserting all third-party releases are prohibited in the Tenth Circuit. The chief judge of the bankruptcy court considered whether Tenth Circuit precedent forbid all third party releases in chapter 11 plans or whether prospective releases of "inchoate third-party claims" may be allowed under appropriate circumstances. The bankruptcy court concluded that there are exceptions to the general bar to third party releases within a chapter 11 plan. In distinguishing prior Tenth Circuit precedent relied upon by the UST, the bankruptcy court determined that a narrow exception allowed releases for claims by or against the debtor. Applying the broad interpretation, the bankruptcy court further noted that any release within a plan that releases non-debtors claims against other non-debtors was not within the bankruptcy court's jurisdiction. Ultimately, the bankruptcy court denied confirmation because the exculpation provision that included prepetition actions was too broad and, therefore, impermissible. Following the ruling, the UST and the Debtor agreed to certain language and the court confirmed the plan with the revised provisions.

In re Millennium Lab Holdings II, LLC, 575 B.R. 252 (Bankr. D. Del. Oct. 7, 2017)

The procedural history of this matter is unique. In a bench ruling, the bankruptcy court confirmed the debtors' chapter 11 plan, overruling lenders' objections which included challenges to the third party releases in the plan. The lenders subsequently sought certification directly to the Third Circuit to determine *inter alia* the issue of whether post-*Stern* bankruptcy courts have the authority under Article III to adjudicate "private rights" and enter an order releasing a third party's non-bankruptcy claims against non-debtors without the third party's consent. The bankruptcy court agreed with the lenders that the question regarding the authority of bankruptcy courts to approve third party releases warranted certification. However, the Third Circuit denied the petition for certification, and the appeal was subsequently docketed with the district court. On appeal, the lenders argued that the bankruptcy court lacked authority to release the lenders' direct, state law, and federal RICO claims against other non-debtors.

The district court agreed with the bankruptcy court that it had "related to" subject matter jurisdiction over the lenders' released claims, but held that the bankruptcy court must also have Article III authority to enter a final order discharging the lenders' non-bankruptcy claims against non-debtors without the lenders' consent. The district court ultimately declined to rule with respect to the bankruptcy court's constitutional authority because the bankruptcy court had not had the opportunity to consider and address the issue and, remanded the matter to the bankruptcy court.

On remand, the bankruptcy court issued a thorough opinion and concluded that it had both statutory authority to confirm a chapter 11 plan and constitutional authority to approve third-party releases as essential components of that plan. The bankruptcy court held that it has core jurisdiction to enter confirmation orders. After a detailed examination of post-*Stern* precedent, the bankruptcy court adopted the broad interpretation of *Stern*, and notwithstanding the broad interpretation found it had constitutional authority to enter confirmation orders containing third party nonconsensual releases under any interpretation of *Stern*. *See In re Lazy Days' RV Center Inc.*, 724 F.3d 418 (3d Cir. 2013) (recognizing constitutional authority to enter orders on quintessential bankruptcy matters, even where those orders directly or indirectly impact *Stern*-like state court actions); *compare In re Wash. Mut.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011) (applying a seemingly broader view). Further, the bankruptcy court held that *Stern* did not prevent it from entering final confirmation order on plan that released claimants' third-party RICO claims against non-debtor entities, but even if it did, the released claimant's waived the right to raise this argument.

In re SunEdison, Inc., et al., 576 B.R. 453 (Bankr. S.D.N.Y. Nov. 8, 2017)

The bankruptcy court *sua sponte* entered an order holding that the debtors failed to sustain their burden of proving that the court had subject matter jurisdiction to approve the broad third-party release in favor of numerous non-debtors because it could not bind the non-voting releasors in the provision's current form. The court reasoned that the debtors' reference to certain indemnity obligations owed to only a few parties did not prove that the outcome of the universe of claims debtors sought to enjoin would have a conceivable effect on the estate. In addition, the court found the debtors failed to demonstrate that the third party releases were appropriate under the standards enunciated in *Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136 (2d Cir. 2005). Specifically, the court determined that the non-voting

releasors did not consent to the release, the creditors were not being paid in full, and their third party claims would be extinguished rather than channeled to a fund that would pay them. Although the bankruptcy court acknowledged that some form of a third party release may appropriately bind the non-voting releasors, the release as drafted did not bind those releasors. Ultimately, the bankruptcy court concluded that the debtors failed to demonstrate: 1) implied consent to the release; 2) that the court has jurisdiction to release the non-voting releasors' third party claims to the extent set forth in the release; or 3) that approval of the nonconsensual release is appropriate under *Metromedia*.

Note: On the *Stern* issue, the bankruptcy court noted that the Second Circuit has interpreted Stern narrowly. The court further stated "Under similar circumstances, the bankruptcy court in *In re Millennium Lab Holdings II, LLC*, Case No. 15-12284 (LSS), 575 B.R. 252, 2017 Bankr. LEXIS 3419, 2017 WL 4417562, at *1 (Bankr. D. Del. Oct. 3, 2017), concluded that it had the authority to enter a final judgment enjoining the assertion of a third party claim by a non-consenting creditor. Since I am not approving the Release, I do not resolve the question." *SunEdison*, 576 B.R. 453, at n.5.