Case Updates: Business and Consumer Law Developments

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U.S. Bankruptcy Court (D. S.C.); Columbia

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Business Law Developments

Rosenberg v. DVI Receivables XIV, LLC
United States Court of Appeals, Eleventh Cir. No. 14-14620
April 8, 2016
2016 WL 1392642

HOLDING: Federal Rules of Bankruptcy Procedure govern cases "arising under" the Bankruptcy Code, even if tried in federal district court. Specifically, 14-day deadline on motions for judgment as a matter of law under Federal Rules of Bankruptcy Procedure, rather than the 28-day deadline applicable to such motion under Federal Rules of Civil Procedure, governed timeliness of petitioning creditors' motion for judgment as a matter of law in bankruptcy proceeding in which reference was withdrawn and the 14 days began to run immediately upon entry of district court judgment even though the question of the creditors liability for attorney's fees and costs still had to be determined by the Bankruptcy Court.

FACTS: Several entities that leased equipment (the "DVI Entities") to a debtor that operated a chain of medical imaging centers filed an involuntary bankruptcy case. The Bankruptcy Court dismissed the involuntary case, finding that the DVI Entities were not eligible creditors and, alternatively, because they were judicially estopped from prosecuting the case. The petition was dismissed with prejudice, but Court retained jurisdiction to award costs, fees, and damages under 11 U.S.C. 303(i).

Debtor filed an adversary complaint against the DVI Entities under 303(i) seeking fees defending the involuntary petition, compensatory and punitive damages caused by the filing in bad faith, and fees and costs associated with prosecuting the adversary proceeding itself. Debtor demanded a jury trial. The DVI Entities moved to withdraw the reference. The District Court granted the motion as to Debtors 303(i)(2) claims because they were analogous to common-law malicious prosecution claims. But the claims for costs and fees remained with the Bankruptcy Court.

The jury found that the petition was filed in bad faith and awarded the Debtor $1.12 million in compensatory damages as well as $5 million in punitive damages. The district court entered a final judgment on March 14, 2013 leaving the issue of attorney's fees and costs for determination by the Bankruptcy Court. Twenty-eight days later, the DVI entities filed a motion for judgment as a matter of law under FRCP 50(b) arguing that the evidence did not support the damages award.

While the motion would have been timely under the FRCP, the FRBP require that such a motion be filed within 14 days of entry of judgment. Thus, the Debtor moved to strike the motion. The District Court concluded that the FRCP controlled, and therefore denied the motion to strike. The District Court granted the Rule 50(b) motion, finding that the evidence did not support the compensatory or punitive damages awards and entered an amended judgment for $360,000.00. However, the court let the bad faith determination stand, as well as an award of emotional distress damages. The parties cross-appealed.

ANALYSIS: The primary issue was the timeliness of defendants' Rule 50(b) motion. The decision turned on whether the FRCP or the FRBP controlled. The Court of Appeals concluded that the FRBP controlled, even though the Bankruptcy Court was still required to determine liability for fees and costs, and the Rule 50(b) motion should have been denied as untimely. The Court found that FRBP 1001 makes it clear that the FRBP applies to all cases arising under title 11, whether in bankruptcy court or in district court after the reference is withdrawn. The Court concluded that the case clearly arose under title 11 so the FRBP applied. Because FRBP explicitly requires that a renewed motion for judgment as a matter of law must be filed within 14 days of entry of judgment, it controlled over the longer 28-day deadline contained in the FRCP. The Court also noted that the defendants had failed to properly renew their 50(b) motion with respect to the emotional distress damages after trial, and therefore the Court was powerless to entertain the appeal of that award.

TAKEAWAYS: The FRBP incorporate many of the FRCP in the context of adversary proceeding, but there are differences, and practitioners must be aware of them. In this case, the Court made it clear that the FRBP will control in any case arising under the bankruptcy code, regardless of where it is tried. Here, that analysis resulted in a critical deadline being missed.

Providence Hall Associates, Limited Partnership v. Wells Fargo Bank, N.A.
United States Court of Appeals, Fourth Cir. No. 14-2378
March 11, 2016
816 F.3d 273 (4th Cir. 2016)

HOLDING: Section 363 sale orders in the borrower's Chapter 11 bankruptcy for the sale of estate property to satisfy borrower's specific obligations to lender precluded borrower from bringing claims against lender in state court after the dismissal of the Chapter 11 proceeding.

FACTS: Debtor had a $2.5 million loan, a $500,000 line of credit, and an interest-rate-swap agreement with lender. The loan and line of credit were secured by various mortgages in properties owned by debtor. Debtor defaulted on the loans and filed a Chapter 11 case. Shortly thereafter, lender declared a default under the interest-rate-swap agreement triggering termination damages. Lender filed a proof of claim for nearly $3 million. Debtor objected and initiated an adversary proceeding and alleged that lender had falsely represented that it would forbear collection on the line of credit.

Meanwhile, the U.S. Trustee moved to dismiss or convert the case to Chapter 7 based on failure to file monthly operating reports. The Court ultimately appointed a Chapter 11 trustee. The Trustee took several steps, including obtaining court approval to sell two properties to satisfy the lender's claim. Both motions acknowledged debtor's obligations to lender under the loans and the interest-rate-swap agreement, and requested that sale proceeds be distributed to lender in accordance with its claims. In fact, the "[Lender] Obligations" was a defined term in the Trustee's motions. At about the same time, the Trustee consented to dismissal without prejudice of debtor's adversary compliant.

The sale proceeds were sufficient to satisfy lender's claims, so Debtor filed a motion to dismiss the Chapter 11 case, which was granted with the Trustee's consent.

More than a year later, Debtor filed a lawsuit in Virginia state court that repeated the claims made in the adversary complaint and alleged various new theories of lender liability. Additionally, the suit claimed that the interest-rate-swap transaction with lender was a "sham" because the LIBOR rate was rigged and manipulated. Lender removed the case and moved to dismiss, which was granted on res judicata grounds. The District Court gave preclusive effect to the Bankruptcy Court's sale orders.

ANALYSIS: The Court began with recitation of familiar res judicata elements. There must be (1) a final judgment on the merits; (2) an identity of causes of action; and (3) an identity of parties or their privies. The Court noted two "practical considerations" as well. First, "we consider whether the party or its privy knew or should have known of its claims at the time of the first action." Second, "we ask whether the court that ruled in the first suit was an effective forum to litigate the relevant claims." The court addressed each of the elements, and both "practical considerations."

Per the Court, the primary issue and "clearest hurdle for [lender] to overcome" was whether the sale orders were final orders on the merits. The issue was one of first impression in the Fourth Circuit. The parties conceded the orders were final - the issue was whether the sale orders were "on the merits" for purposes of res judicata. The Court analyzed case law from other circuits. The Court noted that other circuits had found that sale proceedings were *in rem*, "transferring property rights, and property rights are rights good against the world, not just against parties to a judgment or persons with notice of the proceeding." The Court also noted general concerns of "restraining litigious plaintiffs from taking more than one bite of the apple." Ultimately, the Court found these concerns to be persuasive and adopted the reasoning from sister circuits that sale orders could have preclusive effect for res judicata purposes.

The Court found significance in the fact that the Trustee had sought to sell the properties to satisfy the lender's claims - and that the bankruptcy approved the sale as proposed. The Court noted that it would "make little sense after the sales were made, the debt settled, and the bankruptcy proceeding closed, to then allow PHA to challenge...the propriety of the transactions giving rise to its now-extinguished debt." The Court also found that treating the sale orders as final orders on the merits was consistent with the basic goal of rehabilitating the debtor in a single, unified proceeding in the Bankruptcy Court. Based on this analysis, the Court concluded that the sale orders were final judgments on the merits.

The Court had little trouble with the "identity of claims" prong of the res judicata analysis. The Court used the "transactional approach" and found that "[t]he sale orders directed the liquidation of certain properties in satisfaction of [debtor's] obligations from [certain] transactions, and in the instant lawsuit, [debtor] challenges the propriety of the transactions." This was sufficient to satisfy the identity of claims requirement. The Court also easily disposed of the identify of parties prong, as the Trustee was in privity with the Debtor and further easily

concluded that the "practical factors" supported application of res judicata, because the Trustee could have effectively litigated these claims against the lender in the Bankruptcy Court.

TAKEAWAYS: Implicit in the Court's analysis is the idea that debtor/trustee has the opportunity to investigate and litigate lender liability claims, or otherwise challenge the lender's claims, before obtaining an order approving sale of estate property to satisfy those debts under 363(b). Any creditor faced with a post-bankruptcy lender liability claim where property was sold to satisfy its debt should examine the bankruptcy record and consider whether the sale order precludes the claim. It is also worth remembering that the trustee is the debtor's privy, and any claim that is transactionally related to orders the trustee obtained (i.e., sale orders) may be barred by res judicata. This case provides a great example of using somewhat routine activities (selling assets) in the Bankruptcy Court to bar subsequent litigation.

In re Trump Entertainment Resorts, Inc., et. al
United States Court of Appeals, Third Cir. No. 14-4807
January 15, 2016
810 F.3d 161 (3d Cir. 2016)

HOLDING: Affirming Delaware Bankruptcy Court's decisions applying § 1113 to allow debtors to reject an expired collective bargaining agreement.

FACTS: Trump Entertainment Resorts, Inc. and its affiliated Debtors, including Trump Taj Mahal Associates, LLC employed filed chapter 11 on September 9, 2014.

Taj Mahal employed 2,953 workers, 1,486 who were non-unionized and 1,467 who were unionized by UNITE HERE Local 54, a party to the Collective Bargaining Agreement ("CBA")

Although the debtors made several proposals aimed at keeping the Taj Majal afloat, the union staunchly refused the terms and engaged in a corporate campaign communicating to Taj Mahal customers to take their business elsewhere.

The CBA expired on September 26, 2014 and the debtors filed a motion pursuant to 11 U.S.C. § 1113(c) seeking to reject the CBA and implement terms of Trump Enterprises proposal to the union pursuant to 11 U.S.C. § 1113(b). At the trial, among other things, the debtor presented evidence that the Taj Mahal could not maintain its labor costs given its financial extremis and that the debtors would be forced to liquidate if the Court did not grant the request to reject the CBA. Such closure would mean all employees would lose their jobs, and of course salary and benefits. Faced with the financial pressure of the CBA, the debtors made a determined effort to engage the Union in discussions during which the Union engaged in picketing and a program of misinformation, most egregiously, communicating with customers who had scheduled conferences at the Casino to urge them to take their business elsewhere.

The debtors' Chapter 11 plan was contingent upon, among other things, the rejection of the CBA.

ANALYSIS: The CBA expired after the petition date but before the Debtor filed the section 1113. While courts are divided on the question of whether an expired CBA can be rejected, the Taj Majal court found that the language and legislative purpose of section 1113 establishes that the Court has jurisdiction to enter an order approving the rejection of obligation that continue in effect under the NLRA in the wake of an expired CBA.

The Bankruptcy Court balanced the need for an expedited process by which the Debtor could restructure labor obligation and protections necessary for union and non-union employees alike and held that section 1113(c) was applicable to both expired and unexpired CBAs and further that the Debtors had met their burden of establishing what was necessary to reject the CBA under section 1113. The Union appealed to the Third Circuit.

In affirming, the Third Circuit found that the Debtor had illustrated the very essence of section 1113's purpose in allowing rejection of a CBA. The Debtor needed to reject the CBA to restructure the company absent which it would have been forced to liquidate. Furthermore, the Court held that the Debtor was very willing and forthright in its efforts to bargain in good faith while the Union stalled the bargaining sessions, engaged in picketing and attempted to harm the business. As Judge Roth explained, "it is preferable to preserve jobs through a rejection of a CBA, as opposed to losing the positions permanently by requiring the debtor to comply with the continuing obligations set out by the CBA."

TAKEAWAYS: Chapter 11 debtors can explore a section 1113 motion to reject their obligation under a CBA even if it's expired. However, the debtor must remember that before the court will consider an application to reject, the debtor must engage the union proactively, make a proposal, provide relevant information, meet at reasonable times, and confer in good faith.

The jurisdiction of filing should also be considered since other circuits have refused to relieve a debtor of its obligations under an expired CBA under similar circumstances. *See*, *In re Hostess Brands, Inc.,* 477 B.R. 378 (S.D.N.Y 2012).

Stubbs & Perdue, P.A. v. Angell (In re Anderson, Jr.)
United States Court of Appeals, Fourth Cir. No. 15-1316
Jan. 26, 2016
811 F.3d 166 (4th Cir. 2016)

HOLDING: Affirming the District Court, the Fourth Circuit held that the Bankruptcy Court correctly interpreted/applied *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), to find that the version of 11 U.S.C. § 724(b)(2) in effect at the time the Bankruptcy Court rendered its decision was controlling, and that the Appellant was not entitled to the subordination of the IRS's secured tax claim to its Chapter 11 administrative expense claim.

PROCEDURAL CONTEXT: Appeal from the District Court for the Eastern District of North Carolina affirming the Bankruptcy Court's denial of appellant's attempt under 11 U.S.C. § 724(b)(2) to subordinate the IRS's secured tax claim to its Chapter 11 administrative expense claim, judgment of District Court's reviewing Bankruptcy Court de novo, Bankruptcy Court's findings of fact reviewed for clear error, and Bankruptcy Court's conclusions of law reviewed de novo.

FACTS: Law Firm represented debtor in a Chapter 11 proceeding and was awarded approximately $200,000.00 in legal fees. The IRS had an approximately $1 million secured tax claim. The case converted to Chapter 7 and the Chapter 7 Trustee did not have the funds necessary to pay both the Law Firm and IRS. Law Firm argued that it was entitled to payment of its fees first pursuant to the version of 11 U.S.C. § 724(b)(2) that existed when the case was filed, which arguably would allow it to subordinate the IRS's secured tax claim to its Chapter 11 administrative expense claim.

TAKEAWAYS: Be aware of changes and amendments to the Code over time and during the course of your case and whether such amendments are retroactive. Also be aware that many code sections must be cross referenced to gain a full understanding of the effect one may have on another.

In re Nica Holdings, Inc. v Welt
United States Court of Appeals, Eleventh Cir. No. 14-14685
Dec. 17, 2015
810 F.3d 781 (11th Cir. 2015)

HOLDING: Assignee under a Florida assignment for the benefit of creditors lacked statutory authority to initiate a Chapter 7 bankruptcy proceeding absent explicit and plain authorization by assignor absent which the assignee could not initiate Chapter 7 bankruptcy. Further, the appellants' appeals from the Bankruptcy Court's orders approving settlements between the Chapter 7 Trustee, the assignee and the assignee's attorney were not equitably moot because no complex unwinding of transactions affecting third parties was required to provide relief. The Bankruptcy Court's decisions were reversed and case remanded for dismissal.

FACTS: Nica Holdings, Inc. assigned its assets to Welt as Assignee under Florida assignment for the benefit of creditors statute. After the assignee's sale of NICA's only valuable asset, a tilapia farm, fell through, the would-be buyer brought suit against the assignee alleging he botched the sale and prevented NICA's effective liquidation. The Assignee in turn brought a malpractice suit against his attorneys. The Assignee then filed chapter 7 petition on behalf of NICA removing the disputes to Bankruptcy Court. The Chapter 7 Trustee and the Assignee reached a settlement which included a bar order in favor of the Assignee, insulating him from pre-petition personal liability. The Chapter 7 Trustee then reached a settlement with the malpractice defendants, providing for a cash payment to the estate. After challenging the propriety of the Assignee's bankruptcy filing, the would-be buyer challenged both orders approving settlements, lost, and appealed. The S.D. affirmed.

ANALYSIS: The 11th Circuit reversed and remanded with instructions to the Bankruptcy Court to dismiss the Chapter 7 proceeding, concluding that an assignee under a Florida ABC lacked authority to initiate a Chapter 7 bankruptcy proceeding absent explicit and plain authorization by assignor absent which the assignee could not initiate Chapter 7 bankruptcy. Specifically, the 11th Circuit

found "…[Nica] trusted Mr. Welt to 'faithfully and without delay carry out his or her duties under the assignment." Fla. Stat 727.104(b). "He didn't do that. Instead when trouble started, he terminated the ABC by purporting to send Nica into bankruptcy. Mr. Welt had no such authority".

TAKEAWAYS: Carefully consider options in deciding whether to file under Florida Statute 727. An assignee should confirm all corporate authority in place from the assignor in the event the assignee initiates an act outside the scope of the Florida Statute.

SE Property Holdings, LLC v Seaside Engineering & Surveying, Inc. (In re Seaside Engineering & Surveying, Inc.)
United States Court of Appeals, Eleventh Cir. No. 14-11590
780 F.3d 1070 (11th Cir. 2015)

HOLDING: Bankruptcy court did not abuse its discretion in approving nonconsensual non-debtor releases where the releases were fair and equitable, and wholly necessary to ensure that the Debtor may continue to operate as an entity, where the case has been a death struggle and the non-debtor releases are a valid tool to help halt that fight. Dow Corning factors and additional "fair and equitable" considerations in In re Munford decision, 97 F.3d 4449 (11th Cir 1996) are appropriate considerations when considering bar order releasing non-consenting creditor's claims against a non-debtor pursuant to plan of reorganization, which are reviewable for abuse of discretion. Dow Corning factors are: (1) identity of interests between debtor and third party, usually an indemnity relationship, such that a suit against non-debtor is, in essence, a suit against the debtor; (2) non-debtor has contributed substantial assets to the reorganization; (3) injunction is essential to reorganization - it hinges on the debtor being free from indirect suits against parties that would have indemnity or contribution claims against the debtor; (4) the impacted class has overwhelmingly voted to the accept the Plan; (5) the plan provides a mechanism to pay for all or substantially all of the class(es) affected by the injunction; (6) plan provides opportunity for non-settling claimants to recover in full; and (7) bankruptcy court made a record of specific factual findings supporting its conclusions. The court also affirmed the Bankruptcy Court's findings of good faith and of the appropriate interest rate. Affirmed.

FACTS: Chapter 11 debtor, a closely held civil engineering and surveying firm that conducted forms of technical mapping, sought confirmation of a second amended plan of reorganization which contained non-debtor nonconsensual releases. Confirmation order and plan included limited non-debtor releases/bar orders in favor of debtor and reorganized debtor, officers, directors, and members for any act, omission, transaction, or other occurrence in connection with, relating to, or arising out of the Chapter 11 or the plan except for fraud, gross negligence, or willful misconduct. An outside equity holder in debtor objected. In applying the

Dow Corning factors, the Bankruptcy Court approved nonconsensual non-debtor releases. The District Court upheld the propriety of these non-debtor releases.

ANALYSIS: In affirming, the 11th Circuit provided guidance to the Circuit Bankruptcy Courts with respect to a significant issue: the authority of Bankruptcy Courts to issue nonconsensual, non-debtor releases or bar orders in bankruptcy restructuring plans, though such releases or orders should not be issued lightly.

The Seaside court examined the history on non-debtor releases in the Eleventh Circuit and the controlling case of *In re Munford*, 97 F.3d 449 (11th Cir. 1996) where the 11th Circuit held that 11 U.S.C 105(a) gives Bankruptcy Courts authority to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, including the bar order in that case. In *Munford*, the 11th Circuit upheld the non-debtor release because the settlement "would not have entered into the settlement agreement" without the bar order and because the bar order was "integral to settlement in an adversary proceeding." *Munford*, 97 F.3d at 455.

The facts of *Seaside* differ from those in *Munford*. Instead of the settlement context in which the releases arose in *Munford,* in *Seaside,* the releases prevented claims against non-debtors that would undermine the operations of, and doom the possibility of success for, the reorganized entity.

In its analysis, the 11th Circuit examined holdings from other circuits that have addressed substantively similar releases finding that other circuits are split as to whether a Bankruptcy Court has the authority to issue a non-debtor release and enjoin a non-consenting party who has participated fully in the bankruptcy proceedings but who has objected to the non-debtor release barring it from making claims against the non that would undermine the operations of the reorganized entity, finding that the circuits are split as follows:

The minority view which is held by the Fifth, Ninth and Tenth circuits (the anti-release circuits) prohibit such bar order basing their conclusions on 11 USC 524(e).

The majority view in the Second, Third, Fourth, Sixth and Seventh circuits (the pro release circuits) hold that such releases/injunctions are permissible, under certain circumstances.

The First and D.C Circuits (and now the Eleventh) have indicated their agreement with pro-release circuits.

The *Seaside* Court confirmed its agreement with the majority view that 105(a) codifies the established law that a bankruptcy court applies the principles and rules of equity jurisprudence. The 11th Circuit further went on to recommend for consideration the seven factors set forth in *Dow Corning Corp* as a guide to bankruptcy courts in analyzing non debtor non consenting releases.

TAKEAWAYS: In proposing non debtor non-consensual releases, it is important to consider the circuit you are in and in a majority Circuit, propose a plan that satisfies the *Dow Corning* factors.

Wells Fargo Bank, N.A. v Beltway One Development Group, LLC (In re Beltway One Development Group, LLC)
United States Bankruptcy Appellate Panel, Ninth Circuit
BAP No. NV-14-1564-KiDJu
March 31, 2016
547 B.R. 819 (B.A.P. 9th Cir. 2016)

HOLDING: If an over secured creditor is impaired under the plan, the creditor is presumptively entitled to interest at the contractual default rate from the petition date through the plan effective date if the creditor is entitled to such interest under applicable nonbankruptcy law, and the burden is on the debtor to demonstrate equities that warrant a different result.

FACTS: Chapter 11 debtor owned and operated the Desert Canyon Business Park in Las Vegas. The lender entered into a term-loan agreement for a $10 million loan secured by real estate. The interest rate was 1-month LIBOR plus 2.18%. The default rate was an additional 3%. In May 2010, the lender issues notices of default based on an alleged loan-to-value covenant default claiming the value of the property was $10.15 million and demanding a tender of $2,793,419 to reduce loan balance to meet LTV ratio of no less than 70%, The Debtor defaulted and filed for bankruptcy protection. The Debtor proposed a plan that paid the claim in full over time and restructured the terms. In calculating the amount of the secured creditor's claim, the Debtor calculated pendency interest from the petition to the plan effective date at the contractual non-default rate. The secured creditor objected to the plan, arguing it was entitled to pendency interest at the contractual default rate and did not satisfy the "fair and equitable" test under section 1129(b)(a) because it treated the lender as fully secured but deprived it of its contractual right to default interest, late fees and other charges.. The Bankruptcy Court ultimately adopted the Debtor's valuation of the property at $11.1 million, approved the cram-down interest rate of 4.25%, overruled the lenders objection, and confirmed the plan.

ANALYSIS: Citing *In re Entz-White Lumber and Supply, Inc.*, 50 F.2d 1338 (9th Cir. 1988), the Court held that if the plan provides for payment in full, the fair and equitable standard does not require the payment of default interest. The BAP reversed. The *Entz-White* decision applies where the secured claim is paid in full

on the effective date of the plan and, therefore, is unimpaired, and not where the terms are restructured and the creditor is impaired. Surveying the case law in the Ninth Circuit, the BAP held that, while a Bankruptcy Court has the discretion to deny default interest, an oversecured creditor is presumptively entitled to contractual default interest if the default interest is allowed under applicable nonbankruptcy law. If the creditor is entitled to default interest under nonbankruptcy law, the burden then shifts to the debtor to demonstrate the equities warrant a different rate. The BAP remanded to the Bankruptcy Court with instructions to follow the presumptive rule.

TAKEAWAYS: At least in the 9th Circuit, an oversecured creditor will be entitled to interest at the contractual rate notwithstanding that the secured claim is unimpaired under the plan. Valuation of the property will therefore be key to the determination of the application of contract default rate in a plan.

City of Concord, N.H v Northern New England Telephone Operations, LLC (In re Northern New England Telephone Operations, LLC)
United States Court of Appeals, Second Cir. No. 14-3381
August 4, 2015
795 F.3d 343 (2d Cir. 2015)

HOLDING: The Second Circuit in affirming the Bankruptcy Court held as a matter of first impression that under 11 U.S.C. § 1141(c), a lien on property that is dealt with by a confirmed plan that does not preserve the lien is extinguished if four conditions are satisfied: (1) the text of the plan does not preserve the lien; (2) the plan is confirmed; (3) the property subject to the lien is "dealt with" by the terms of the plan; and (4) the lienholder participated in the bankruptcy proceedings. The Court concluded that all four requirements were satisfied in this case and the plan extinguished the city's lien.

FACTS: On October 26, 2009, Northern New England Telephone Operations LLC (NNETO), and its parent, FairPoint Communications, Inc. filed petitions for relief under Chapter 11 in the Bankruptcy Court for the Southern District of New York, which confirmed a plan on January 13, 2011. The plan provided that "all property of FairPoint and Reorganized FairPoint shall be free and clear of all Claims, Liens and interests, except as specifically provided in the Plan, the Confirmation Order, or the New Credit Agreement" (Free and Clear Provision).

NNETO owned several pieces of real property located in Concord, New Hampshire. Under applicable state law, a single statutory lien arises at the beginning of each tax year on April 1 to secure property taxes for the entire year, for which the City of Concord (City) would bill NNETO quarterly. At the time of the petition date, the City had already billed NNETO for Q1 and Q2 of the 2009-2010 tax year. While the City timely filed proofs of claim relating to the pre-petition Q1 and Q2 tax bills, it mailed, but did not file proofs of claim for, the post-petition taxes arising in Q3 and Q4.

After reducing some of the amounts, the Bankruptcy Court eventually allowed the City's claims for the Q1 and Q2 tax bills. After confirmation of the plan, the City moved the court to allow its claims on the Q3 and Q4 tax bills and order payment, arguing that these claims were secured by a lien and that lien was not discharged by the plan. The Bankruptcy Court denied the City's motion on the grounds that the

plan extinguished the City's lien. The District Court affirmed on appeal, and the City further appealed to the Second Circuit.

ANALYSIS: The Second Circuit began its analysis by noting the "longstanding background rule" that "lines pass through bankruptcy unaffected" (*Dewsnup v Timm,* 502 U.S. 410, 417 (1992)). While the text of the Bankruptcy Code leaves that general principal intact, the Second Circuit noted that section 1141(c) contains a caveat to this general rule in Chapter 11 cases providing that

> "Except as provided in subsections (d)(2) and (d)(3) of this section and **except as otherwise provided in the plan or in the order confirming the plan**, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor."

11 U.S.C. §1141 (emphasis added). Therefore, the Second Circuit explained that the express wording of section 1141(c) provides that a lien is extinguished if:

- The plan is confirmed.
- Neither the plan nor the confirmation order preserves the lien.

The Second Circuit noted that while a lienholder's participation in the bankruptcy proceedings is not expressly required by the text of section 1141(c), it is inherent in the requirement that the underlying property be "dealt with" in the bankruptcy proceeding

The City contended that the plan did not sufficiently deal with the property subject to its lien and that the City did not sufficiently participate in the bankruptcy proceedings.

The Second Circuit held that the Free and Clear provision of the plan dealt with the property subject to the City's lien, rejecting the City's argument that such a broad catch-all clause was insufficiently specific to satisfy the requirement of section 1141(c). It explained that a plain reading of this provision establishes that "all property" categorically includes each individual parcel and lot of the debtor's property, including the property subject to the City's lien. In addition, the Second

Circuit noted that administrative considerations weighed heavily against requiring a plan to list each specific property and that the plan's categorical phrasing alerted all participants in the proceedings to the risk that their rights might be affected.

Further, the City's limited participation in the bankruptcy proceedings was sufficient to satisfy the participation requirement. The Court rejected the City's argument that it did not participate with respect to the Q3 and Q4 tax bills, nor with respect to the lien that secured their payment reasoning that when the City filed proofs of claim for the Q1 and Q2 tax bills with respect to the same parcels of real property, it participated as to the property subject to the lien. Further, payment of the Q1 and Q2 tax bills was secured by the same lien as the Q3 and Q4 tax bills, which bills related to the same tax years and the same properties. Therefore, the Court was not persuaded by the fact that the City did not participate with respect to the specific claims at issue.

TAKEAWAYS: This decision clarifies the standard for debtors seeking to extinguish liens under Chapter 11 plans in the Second Circuit and stresses that secured creditors must closely monitor bankruptcy proceedings in for developments regarding the treatment of their liens and collateral.

Under the reasoning of the US Court of Appeals for the Fifth Circuit's decision in *Acceptance Loan Corp., Inc. v. S. White Transportation, Inc. (In re S. White Transportation, Inc.),*United States Court of Appeals, Fifth Circuit, Case No. 12-6068, August 5, 2103, had the City not participated at all, it may have been able to preserve its lien. However, the risks of failing to appear and protect collateral in a bankruptcy case, as well as the delay caused by doing so, may not justify this strategy.

Fees For Defending Fees /post *Baker Botts L.L.P v Asarco, LLC*, 135 S. Ct. 2158 (2015)

In re Boomerang Tube, Inc.
United States Bankruptcy Court, D. Del. Case No. 15-11247 (MFW)
Jan 29, 2016
548 B.R. 69 (Bankr. D. Del. 2016)

FACTS: On June 9, 2015, the Debtor and its affiliates filed Chapter 11 petitions. The UST appointed a committee, which thereafter retained counsel. Committee counsel each sought approval of their retention applications under 11 U.S.C. § 328(a) of a provision in their retention applications entitling them to compensation from the Debtors' estates (subject to approval under sections 330 and 331) for any fees and expenses incurred from the successful defense of their fees.

The United States Trustee objected to the inclusion of the fee defense provision on the grounds that such provision was: 1) precluded by *Baker Botts;* 2) section 328(a) creates no exception to the American Rule's general prohibition against fee shifting; and 3) the fee defense provisions cannot be approved under section 328(a) because they are unreasonable and seek to compensate professionals for work not within the scope of their employment.

ANALYSIS: Judge Walrath concluded that section 328, unlike section 330 was not a specific and explicit statute authorizing the award of defense fees to a prevailing party. Rather, section 328 merely provides that with court approval a professional may be employed on "any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis" (unlike other code sections that contain express language necessary to create an exception to the American Rule). Further, while *Baker Botts* did not preclude a contract exception to the American Rule, the parties cannot, by contract, violate another provision of the Code. Judge Walrath further determined that the retention agreements were not contractual exceptions to the American Rule because the retention agreement was not a contract between two parties providing that each would responsible for the others legal fees if it

loses a dispute between them. Rather, the retention agreement was a contract between two parties that in the event counsel won a challenge to its fees, a third party (the estate) would pay the fee defense costs, even if the estate is not the party objecting. The Bankruptcy Court found objectionable the fact that the retention agreement sought to bind a non-party, the estate, to that agreement and further that section 328(a) permits only approval of fees or expenses for performing services for the Committee where in this case, the expenses sought would be for services performed for the professionals themselves. Judge Walrath rejected arguments made by the Committee supported by cases that pre dated *Baker Botts*.

TAKEAWAYS: Judge Walrath's decision applies to Committee professionals but two subsequent Delaware judges have ruled that the *Boomerang Tube* holding is applicable to debtors in possession professionals also preventing such professionals from contracting around the *Baker Botts* holding.

In re New Gulf Resources, LLC
United States Bankruptcy Court, D. Del. Case No 15-12566 (BLS)
March 16, 2016
Docket No. 395

Debtor's counsel attempted to contract for a 10% fee premium unless the firm *did not* incur material fees and expense in defending against objections to its fee application.

On March 16, 2016, Judge Shannon issued a letter opinion pronouncing that he agreed to Judge Waltrath's opinion in *Boomerang Tube* and that the structure proposed by the Baker Botts as debtor's counsel in its retention agreement ran afoul of the holdings in the *Baker Botts* and *Boomerang Tube*. Judge Shannon went on to state that while he acknowledged the creative approach to the issue, he did not find there was a meaningful distinction between the fee premium proposed (a premium if not material fees incurred in defense of fees) proposed and the matters considered and ruled upon in *Boomerang Tube*.

In re Samson Resources, Corporation, et. al.
United States Bankruptcy Court, D. Del. Case No. 15-11934 (CSS)
February 8, 2016
Docket No. 641

Judge Sonshi has pronounced that he agreed with the reasoning in *Boomerang Tube* finding it equally applicable professionals being retained as counsel to the debtors and debtors in possession.

On February 8, 2016, in adopting Judge Walrath's opinion in *Boomerang Tube*, Judge Sonshi filed a letter to counsel addressing pending applications to retain Kirkland & Ellis, LLP, Kirkland & Ellis International LLP ("K&E") as counsel for the debtors and debtors in possession and Khler Harrison Harvey Barnzburg LLP as co-counsel for the debtors and debtors in possession ("Khler"). In both applications, each applicant sought approval of certain provisions regarding reimbursement of those fees and expenses incurred in connection with participating in, preparing for, or responding to any action, claims, suit or proceeding brought by or against any third party that relates to the legal services provided under the engagement letter. Judge Sonshi stated that he agreed with Judge Walrath and endorsed the reasoning. Although the application in *Boomerang Tube* was filed by the committee professionals, Judge Walrath ruled "the Court would reach the same conclusion if the fee defense provisions were in a retention agreement filed by any professional under section 328(a) – including one retained by the debtor. Such provisions are not statutory or contractual exceptions to the American Rule and are not reasonable terms of employment of professionals." *Boomerang Tube*, 2016 WL 385933, slip op. at *8 n.6.

TAKEAWAYS: Three Delaware courts have now followed *Baker Botts* in denying retentions applications containing provisions providing for recovery of fees for fees, whether by committee or debtor in possession professionals. It remains to be seen whether bankruptcy judges outside of Delaware will follow the *Boomerang Tube* ruling or whether other courts will determine that *Baker Botts* did not prevent contractual work-arounds. It remains to be seen whether professionals will develop other creative solutions to recover fees associated with defending fee applications.

In re Int'l Oil Trading Co., LLC
United States Bankruptcy Court, S.D. Fla. No. 15-21596-EPK
February 8, 2016
545 B.R. 336 (Bankr. S.D. Fla. 2016)

HOLDING: Petitioning creditors' compulsory counterclaims for recoupment were barred by res judicata and therefore were not subject to bona fide dispute.

FACTS: Involuntary Chapter 11 bankruptcy of alleged debtor, International Oil Trading Company, LLC ("IOTA USA"), filed by petitioning creditor Mr. Al-Saleh. IOTA USA objected to Al-Saleh's eligibility to file petition, asserting that a his claims were the subject of a bona fide dispute under 11 U.S.C. § 303(b)(1).

Al-Saleh had obtained a final, non-appealable judgment worth approximately $38 million against IOTA USA prior to the filing of the petition. Members of IOTA USA claimed that they had defenses to Al-Saleh's claim in the nature of recoupment arising from the same transaction that resulted in Mr. Al-Saleh's judgment.

ANALYSIS: Section 303 requires that a petitioning creditor be a holder of a claim against the alleged debtor that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount.

A defense to a claim in the form of recoupment goes to the heart of the claim and results in a bona fide dispute of the claim. But a defense to a claim in the form of an independent counterclaim does not in any manner challenge the original claim so does not place the original claim in a bona fide dispute.

A claim of recoupment is in the nature of a defense arising out of the same feature of the transaction upon which the plaintiff's action is grounded. Applying an objective, burden-shifting standard, the Court determined that the claims of the petitioning judgment creditor were not subject to a bona fide dispute as to liability or amount because the alleged debtor's recoupment claims against the judgment creditor were all necessarily compulsory counterclaims barred by *res judicata*. This objective standard required the Court to determine whether an objective basis existed for either a factual or legal dispute as to the validity of debt. The Court then

determined the IOTA USA's alleged recoupment claims were in fact compulsory claims that were barred by *res judicata*.

TAKEAWAYS: A defense to a claim in the form of an independent counterclaim does not challenge the original claim and therefore does not create a bona fide dispute.

In re Berau Capital Resources PTE LTD.
United States Bankruptcy Court, S.D.N.Y Case. No. 15-11804 (MG)
October 28, 2015
540 B.R. 80 (Bankr. S.D.N.Y. 2015)

HOLDING: Granting recognition of the foreign debtor's Chapter 15 case finding that that foreign debtor had property in the United States satisfying the eligibility requirement in section 109(a).

FACTS: The foreign debtor, Berau Capital Resources Pte Ltd ("Berau") did not have a place of business in the United States. It filed an insolvency proceeding in Singapore where it was headquartered. No objections to recognition were filed and all requirements for recognition were satisfied. The Court addressed only whether the debt indenture satisfied the section 109(a) requirement of property of the Unites States, an issue likely to occur in other cases. The Court concluded that the foreign debtor had property in the United States, satisfying the eligibility requirement in section 109(a). Venue in the Southern District of New York was likewise established.

ANALYSIS: The Court looked to the Second circuit opinion in Drawbridge Special Opportunities Fund LP v Barnet (In re Barnet), 737 F.3d 238 (2nd Cir 2013), which held that section 109(a) applies to Chapter 15 cases and requires that a foreign debtor must reside, have a domicile or place of business, or property in the US to be eligible to file a Chapter 15 petition. The Court recognized that the Barnet decision continues to be a frequent subject of discussion and criticism at international insolvency conferences and that no other federal circuit had addressed the "property of the United States" issue in Chapter 15 cases to date.

In analyzing *Barnet,* the Court found that foreign debtors who wish to file Chapter 15 cases often have no place of business in New York and therefore the focus must sift to whether the foreign debtor has property in New York sufficient to establish eligibility and venue.

The venue statute for Chapter 15 cases, 28 U.S.C. § 1410, permits a Chapter 15 case to be filed in a district in which the debtor has its principal place of business or assets; and absent a place of business or assets, in a district in which there is an action or proceeding pending against the debtor in federal or state court. If neither is satisfied, the Chapter 15 case may be filed in a district "in which venue will be consistent with the interests of justice and convenience of the parties, having regard to the relief sought by the foreign representative." § 1410(3).

Section 109(a) does not specify how much property must be present or when or for how long property has had a situs. Berau did not have a principal place of business in the United Status and had filed an insolvency proceeding in Singapore where it was headquartered. In order to establish assets, the foreign representative initially focused on the attorney retainer held by the foreign representative's New York counsel and the Court found this to be a sufficient basis for eligibility under section 109(a). The Court went on to find however, another substantial and frequently recurring basis existed for chapter 15 eligibility. The Court found that Berau was an obligor on over $450 million in U.S. dollar denominated debt, NY law expressly governs debt debentures, which also includes a NY choice of forum clause. Under the indenture, Berau appointed and authorized agent for service of process in NY and numerous acts must be performed in NYC. The debt was in default at the time the foreign representative filed the chapter 15 case. Thus, the Court found that because the indenture was property of Berau in the United States, section 109(a) eligibility requirement was satisfied.

TAKEAWAYS: In analyzing a Chapter 15 filing, section 109(a) requirements must be satisfied and the foreign debtor must either conduct business in the United States or have assets in the United States. In analyzing such assets, intangible assets must be examined as the Berau case made clear, contract rights can in fact qualify as assets for purposes of satisfying the eligibility requirements of section 109(a).

In re Walter Energy, Inc.
United States Bankruptcy Court, N.D. Ala. Case No. 15-02741
Dec. 28, 2015
2015 WL 9583521 (N.D. Alabama 2015)

HOLDING: Debtor's KERP motion was approved pursuant to 11 U.S.C. 105 and 363(b) where the Debtor's demonstrated a sound business purpose for a fair and reasonable plan based on the particular facts of the case.

FACTS: The Chapter 11 Debtor, a coal mining operation, proposed a motion to approve the Debtor's key employee retention plan pursuant to 11 U.S.C. 105, 363(b) and 502(c)(3) and Rules 2002 and 6004. Pursuant to the KERP, the Debtor identified 26 employees as particularly crucial to the operations and management and were individuals with no one to back them up or take over if they left the company. The Debtor determined that it would be in the best interest of all to offer a retention bonus to these 26 individuals so long as certain requirements and/or benchmarks were met. Additionally, the money to fund the KERP was cash collateral and the lenders had consented to its use for this purpose.

ANALYSIS: In approving the KERP over objections, the Court cited to *In re Friedman's Inc.,* 336 B.R. 891 (Bankr.S.D Ga 2005) and *In re Allied Holdings, Inc*. 337 B.R. 716 (Bankr.N.D. Ga 2005) which held that an employee retention plan could be approved if it met the following criteria:

"under the majority view, the proponent of the KERP must show that a sound business purpose exits for the plan and that the plan itself is fair and reasonable. This approach avoids the possibility that the debtor will have unfettered discretion in devising a plan and also permits the Court to "analyze factors, based on the facts and circumstances of each case," and "to tailor the Retention Plan to accomplish necessary goals."

TAKEAWAYS: In proposing a KERP, the proponent should consider certain factor that courts have looked to in approving KERP's such as

- Is there a reasonable relationship between the plan proposed and the results obtained, i.e., will the key employee stay for as long as it takes for the debtor to reorganize or market it assets?

- Is the cost of the plan reasonable in the context of the debtor's assets, liabilities and earning potential?

- Is the scope of the plan fair and reasonable; does it apply to all employees, does it discriminate unfairly?

- Is the plan or proposal consistent with industry standards?

- What were the due diligence efforts of the debtor in investigating the need for a plan; analyzing which key employees need to be incentivized?

- Did the debtor receive independent counseling in performing due diligence and in creating and authorizing the incentive compensation?

citing *In re Patriot and Coal Corp*., 492 B.R. 518, 521 (Bankr E.D.Mo. 2013) (quoting *in re Dana Corp*., 358 B.R. 567, 576-77(Bankr. S.D.N.Y 2006)).

In re Walter Energy, Inc.
542 B.R. 859 (Bankr. N.D.Ala. 2015), aff'd United Mine Workers of America Combined Benefit Fund v. Walter Energy, Inc., No. 2:16-cv-00064, 2016 WL 880205 (N.D. Ala Mar. 8, 2016)).

Appeal filed on March 9, 2016 to the 11th Circuit

HOLDING: U.S.C. Section 1113 and 1114 authorize a Chapter 11 debtor to reject a CBA or to modify or healthcare retiree benefits in a liquidating Chapter 11 cases and the debtor is not required to demonstrate an ability to confirm a liquidating Chapter 11 plan.

FACTS: Chapter 11 Debtors moved for authority to reject their bargaining agreement (CBA) with labor union that represented workers employed in debtors' coal mining operation, as well as to terminate retiree benefits.

The Debtors produce and export metallurgical coal ("met coal") for the global steel industry and mineral reserves in U.S., Canada and the UK. The Debtors also extract, process and market thermal and anthracite coal and produce metallurgical coke and coal bed methane gas. After a failed attempt to reorganize, the Debtors liquidated their assets pursuant to a going concern sale to an entity owned by their first lien holders. The proposed buyer however would not take the Debtors' assets subject to their legacy and current labor costs. Accordingly, the Debtor sought to reject their CBA to eliminate the successorship provisions and to implement their final proposals pursuant to which, upon the closing of the proposed sale, the Debtors would terminate their retiree benefit obligations and any other obligations remaining under the CBAs so the assets could be sold free and clear of any obligations under the CBAs or otherwise required.

ANALYSIS: U.S.C. Section 1113 and 1114 which authorize a Chapter 11 debtor to reject a CBA or to modify or healthcare retiree benefits apply in a liquidating Chapter 11 cases and the debtor is not required to demonstrate an ability to confirm a liquidating Chapter 11 plan. Sections 1113 and 1114 do not require the Debtors to establish that the requested relief will result in a confirmable Chapter 11 plan.

TAKEAWAYS: If the rejections or modifications are necessary to facilitate a going concern sale rather than a piecemeal liquidation, the Court will likely approve rejection or modification under 1113 and 1114 in a liquidating Chapter 11.

DePaola v. Sleepy's LLC (In re Prof'l Facilities Mgmt. Inc.)
United States Bankruptcy Court, M.D. Ala. Adv. Proc. No. 15-3041-WRS
October 27, 2015
2015 WL 6501231

HOLDING: When a counterclaim exceeds a trustee's claim, it becomes an affirmative claim against the bankruptcy estate. An action raised as a counterclaim seeking affirmative relief submits the claimant to the equitable jurisdiction of the Bankruptcy Court, thereby waiving the Seventh Amendment right to a jury trial.

FACTS: Chapter 7 Trustee filed claim against Creditor, Sleepy's LLC, to collect on an account receivable worth approximately $1,077,200.29. The Trustee asserted claims for breach of contract and quantum meruit for unpaid work alleged performed by the Debtor on behalf of Sleepy's. Sleepy's denied the Trustee's claims, asserted affirmative defenses, counter-claimed, and demanded a jury trial. The counterclaim asserted breach of contract, indemnification, and quantum meruit, totaling $1,967,749.53. Sleepy's specifically stated that it did not consent to final adjudication or jury trial before the Bankruptcy Court.

The Trustee moved to strike Sleepy's jury demand, arguing that Sleepy waived its right to jury trial by filing its counterclaim because the counterclaim acts as a proof of claim and that Sleepy's impliedly consented to final adjudication by the Bankruptcy Court by filing its counterclaim.

ANALYSIS: The Court found that Sleepy's counterclaim became an affirmative claim against the bankruptcy estate akin to filing a proof of claim, even though the creditor did not file a proof of claim and bar date for filing claims had expired. Though the right to a jury trial under the Seventh Amendment would normally attach to all claims and counterclaims in this case, the Court concluded that Sleepy's did not assert a mere recoupment defense when it sought nearly twice as much money as the Trustee.

TAKEAWAYS: In determining whether to submit to the jurisdiction of the Bankruptcy Court, not filing a proof of claim is one option. But in an adversary proceeding, be cautious when deciding whether to assert a counterclaim that exceeds the trustee's claim in that adversary proceeding. Examine other options, including a moving to compel arbitration, moving to enforce a forum selection clause, or filing a motion in the district court to withdraw reference from the Bankruptcy Court.

Bank of N. Ga. v. Strick Chex Columbus Two, LLC (Matter of Strick Chex Columbus Two, LLC)
United States Bankruptcy Court, N.D. Ga. No. 15-11276-WHD
November 19, 2015
542 B.R. 914 (Bankr. N.D. Ga. 2015)

HOLDING: A portion of debtor's revenue received in exchange for its food inventory constituted cash collateral that required adequate protection in the form of a replacement lien on post-petition inventory in addition to a monthly adequate protection payment.

FACTS: Chapter 11 debtor, owns and operates a fast food restaurant. Secured creditor held a security interest in all of Debtor's personal property and the proceeds of that property. Secured creditor argued that all of Debtor's post-petition revenue constituted proceeds of its collateral, thus it was "cash collateral" requiring adequate protection.

ANALYSIS: The Court held that the only property which Debtor could dispose of was its inventory of food and drinks, which are sold as payment. A portion of the Debtor's revenue from food sales resulted from the Debtor's labor, such as preparing individual food orders, and was not "proceeds" under § 552. As a result, only the portion of the Debtor's revenue received in exchange for its food inventory constituted proceeds of Secured Creditor's collateral.

TAKE AWAYS: Revenue generated in the course of operating certain service-oriented businesses, like a restaurant, is not entirely "proceeds" to which a creditor's interest will attach. Instead, only the portion of the revenue attributable to the inventory, equipment, etc. over which the creditor holds a security interest is "proceeds."

In re E.C.J. Investments, Inc.
United States Bankruptcy Court, S.D. Fla. No. 13-32120-LMI
October 22, 2015
2015 WL 6437385

HOLDING: Chapter 11 debtor could not claim operating loss sustained by a non-debtor related company as the debtor was not the beneficial or equitable owner of the entity that sustained the loss nor was the entity that sustained the loss the agent of taxpayer or a dummy corporation of the debtor.

FACTS: Debtor, E.C.J., objected to a proof of claim filed by United States based on Debtor's claim of a net operating loss sustained by a Mexican corporation created by certain Debtor's members for the purpose of entering into a Mexican real estate transaction. The United States asserted that E.C.J. was barred from claiming the loss that was sustained by a different, foreign corporation.

ANALYSIS: As a general rule only a taxpayer can deduct his own losses. However, a court will allow an entity who is not the taxpayer who sustained the loss to take a deduction where the taxpayer is the beneficial or equitable owner of the entity that sustained the loss or where the entity that sustained the loss is the agent of taxpayer or a dummy corporation. The Court determined that the Mexican corporation was a separate entity because it was properly formed and documented as a foreign corporation for a bona fide business purpose. Debtor was not the beneficial or equitable owner of the Mexican corporation because there was no transfer of stock or property between the corporations. There was no agency relationship between because there was no written agreement that allowed the Mexican corporation to act as Debtor's agent and there was no evidence to support the contention that the Mexican corporation acted on behalf of anyone but itself.

TAKEAWAYS: It is generally difficult for a debtor to claim a net operating loss sustained by another company.

O'Halloran v. Harris Corp. (In re Teltronics, Inc.)
United States Bankruptcy Court, M.D. Fla. Adv. Proc. No. 8:13-ap-00571-MGW
November 3, 2015
540 B.R. 481 (Bankr. M.D. Fla. 2015)

HOLDING: Transfer of Chapter 11 debtor's right to block the sale of patent portfolio was not constructively fraudulent.

FACTS: Chapter 11 Debtor, Teltronics, waived its contractual right to block the sale of a patent portfolio for a payment of $5,000. Five days later, the owner of the portfolio completed a sale for $12 million. Trustee of a liquidating trust under Debtor's confirmed plan, filed an adversary proceeding seeking to avoid the transfer of the patent portfolio. Trustee argued that the transfer was constructively fraudulent because Teltronics received less than reasonably equivalent value for the transfer and was insolvent at the time of transfer.

ANALYSIS: The Court held that the Trustee failed to prove that Debtor did not receive reasonably equivalent value in exchange for the blocking right. The seller of the patent portfolio did not disclose that he had arranged for a buyer of the portfolio at the time he negotiated for Teltronics to transfer its blocking right because he was subject to a nondisclosure agreement with the buyer. The Court found that the Trustee improperly valued the blocking right at the $12 million value of patent portfolio itself. The Trustee failed to present any other evidence of the value of the blocking right, therefore, the Court was obliged to find that the Trustee failed to meet its burden of proving that the debtor received less than reasonably equivalent value. The Trustee also failed to provide adequate evidence in the form of expert testimony to prove that Teltronics was insolvent at the time of the transfer.

TAKEAWAYS: Contract rights may be difficult to value. When valuing contractual rights, consider various methods of valuation. Expert testimony is key to proving debtor insolvency.

In re TLH Investments, LLC
United States Bankruptcy Court, S.D . W. Va. No. 14-20441
January 4, 2016
2016 WL 67192

HOLDING: Denying a 363 sale motion and converting case to Chapter 7 where Court found that value maximization would be achieved in the Chapter 7 process.

FACTS: Debtor TLH Investments LLC owned two plots of real estate. A one-acre parcel was developed with residential rental units. An adjacent five-acre parcel was undeveloped. TLH moved for approval to sell the one-acre parcel to Happy Coe Investments, LLC for $450,000.00. The five-acre parcel was not part of the proposed sale.

MarkWest Energy Partners L.P. objected to the sale, indicating it would buy both parcels for $565,000 and pay the sewage bill. At the time of decision, MarkWest had not entered into a formal real estate purchase agreement, but it had conveyed its proposed price in writing and expressed its "interest and intention of bidding on and purchasing" the property.

ANALYSIS: The proposed sale of either parcel was beyond the ordinary course of the debtor's business. The Bankruptcy Code, however, permits a debtor in possession to sell assets outside the ordinary course of business prior to filing a plan pursuant to section 363(b). The court noted bankruptcy courts are particularly concerned that "property be sold on the best possible terms" in deciding whether to approve a sale of property of the estate outside the ordinary course of business under 11 USC 363(b). The Court mentioned that general "awareness" of another bidder with a better offer may be enough to disapprove a proposed sale.

The Court noted that MarkWest's appearance was "belated" and that it had "knotted the sale process" and the proposed offer to purchase the entire property was not an "apples to apples" counterpart to the deal struck between the debtor and Happy Coe. However, despite the lack of a formal purchase agreement, the Court compared the MarkWest proposal to the proposed 363 sale. The Court noted that it offered more cash, and disposed of the undeveloped 5-acre parcel, which the Court deemed beneficial. The Court acknowledged that the MarkWest proposal "may or may be...ultimately deemed superior to that presented by Happy Coe." But the possibility that it might be - and that it might spark other and even better proposals - was enough to warrant denying the motion to approve the proposed 363 sale.

The Court acknowledged that Happy Coe had "done everything right" and that the result may seem inequitable from its standpoint. The Court also acknowledged that the real estate broker that produced the Happy Coe buyer would be disappointed at losing a commission. But the Court found that maximizing value to the estate was more important than those considerations, and denied the motion to approve the sale based on the possibility that a better deal could be consummated.

The Court granted the United states Trustee's Motion to convert the case to a Chapter 7 proceeding deeming it the most efficient way to maximize value by liquidation of the entire estate, including the properties at issue.

TAKEAWAYS: The goal of maximizing value is the fundamental consideration for a bankruptcy court in deciding whether or not to approve a private 363(b) sale and therefore, the debtor should be mindful to obtain approval of bidding procedures such that all buyers operate under the same guidelines and so higher and better offers can be evaluated in an “apples to apples” bidding process.

Consumer Law Developments

Husky International Electronics, Inc. v. Ritz (In re Daniel Lee Ritz) 578 U.S. ___ (2016).

Facts: Ritz was the principal of a manufacturing company which bought components from Husky International Electronics then failed to make complete payments. Later, Ritz had his company transfer substantial funds from its accounts to various entities that he controlled.

Husky sued Ritz to hold him personally liable for the unpaid debt, Ritz filed a chapter 7 petition and Husky filed a non-dischargeability complaint.

LOWER COURTS' RULINGS: The bankruptcy court held that the "actual fraud" exception did not apply because it was not shown that Ritz had made a false representation to Husky that induced the creditor to do business with the debtor. The district court affirmed. The circuit court affirmed as well. It held that "actual fraud" could not be established absent a false representation to Husky. *Husky International Electronics, Inc. v. Ritz (In re Daniel Lee Ritz) 787 F.3rd 312 (5th Cir. 2015)*

In the opinion, the 5th Circuit disagreed with a 7th Circuit case, *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). In that case, a creditor sold machinery to the debtor's brother. When the brother defaulted, the creditors sued the brother who then sold the machinery to the debtor (his sister) for just $10. She then sold the machinery for $160,000. In a split decision, the majority ruled that a fraudulent misrepresentation was not the only form "that fraud can take or the only form that makes a debt nondischargeable."

Taking the opposite view, the 1st Circuit in *Sauer, Inc. v. Lawson (In re Lawson)* 791 F.3d 214 (1st Cir. 2015), agreed with *McClellan*, also concluding that knowing receipt of an actual fraudulent conveyance could cause a debt to fall under the section's "actual fraud" provision. In *Lawson*, James Lawson was found liable to a creditor by the state court. His daughter formed a shell company to which Lawson transferred $100,000. The daughter then transferred $80,000 from that shell company to herself. When Lawson filed chapter 13, the 1st Circuit, on direct appeal, reversed the bankruptcy court, which held in the creditors' non-dischargeability action that the Code section required that the actual fraud be obtained through fraudulent misrepresentations.

SUPREME COURT RULING: On May 16, 2016, the U.S. Supreme Court ruled on the following question and resolved the split in the circuits on the question: "'Whether the actual fraud' bar to discharge under §523(a)(2)(A) … applies only when the debtor has made a false representation or whether the bar also applies when the debtor has deliberately obtained money through a fraudulent-transfer scheme that was actually intended to cheat a creditor." *Husky International Electronics, Inc. v. Ritz (In re Daniel Lee Ritz) 578 U.S. ___ (2016).*

Justice Sotomayor, for the majority, reversed the 5th Circuit and remanded for further proceedings, holding that the Court "must give the phrase "actual fraud" in 523(a)(2)(A) the meaning it has long held, we interpret "actual fraud" to encompass fraudulent conveyance schemes, even when those schemes do not involve a false representation."

There's an interesting dissent by Justice Thomas that discusses the distinction in Section 523(a)(2) with the "inception" of the debt and how that conduct caused the creditor to enter into the transaction with the debtor.

Harris v. Viegelahn, 135 S.Ct. 1829 (2015)

FACTS: The debtor's case was converted from Chapter 13 to Chapter 7. He then filed a motion to compel the Chapter 13 trustee to turn over undistributed funds to him. The plan had been confirmed but the trustee still held the funds at the time of conversion. The bankruptcy court granted the debtor's motion.

SUPREME COURT RULING: The Supreme Court ruled that, absent a bad-faith conversion, undistributed plan payments made by a debtor from his or her post-petition wages and held by the Chapter 13 trustee at the time of the case's conversion to Chapter 7 **must** be returned to the debtor, not be distributed to creditors. The Court stated that conversion terminates the services of the Chapter 13 trustee, and replaces him or her with a Chapter 7 trustee. Chapter 13 cases are voluntary proceedings in which debtors endeavor to discharge their obligations using post-petition earnings that creditors are not entitled to in a Chapter 7 proceeding. It is therefore not a "windfall" for a debtor to receive a return of the wages he earned and would have kept had he filed under Chapter 7 in the first place.

See also *Wheaton v. Fessenden (B.A.P. 1st Cir. 2016)*- discussion on whether Chapter 13 trustee must pay all funds to the debtor on conversion or if could pay allowed fees to the attorney.

In re: Ladieu (Bankr.Vt., 2016)- discusses the voluntary nature of Chapter 13 and the ability to dismiss voluntarily and how that impacts the refund of payments.

In re: Merovich (Bankr M.D.Pa., 2016)- more discussion of post-dismissal disposal of funds held by Chapter 13 trustees.

Bullard v. Blue Hills Bank, 135 S.Ct. 1686 (2015)

FACTS: The Chapter 13 debtor filed a third amended plan in which he proposed to pay a secured creditor's debt as a "hybrid" by splitting the claim into secured and unsecured portions with the secured claim being paid in full and the unsecured portion receiving only nominal payment.

The creditor objected and the bankruptcy court denied confirmation and required the debtor to submit a new plan within 30 days. The debtor appealed and the First Circuit dismissed the appeal for lack of jurisdiction stating that the bankruptcy court's order was not final.

SUPREME COURT RULING: The Supreme Court agreed with the circuit court holding that a bankruptcy court's order denying confirmation of a proposed repayment plan with leave to amend was not a "final" order that the debtor could immediately appeal. The order denying confirmation of this debtor's Chapter 13 plan and allowing for a new plan to be filed was not final because the debtor was free to propose another Chapter 13 plan, and the issue of plan confirmation was not fully and finally resolved. The Supreme Court discussed the delays and inefficiencies if such orders were appealable. The inability to immediately appeal also encourages debtors to work with creditors to develop a confirmable plan.

See also *In re: Ladieu (Bankr.Vt., 2016)* wherein the Court reiterated the *Bullard* case in stating that plan confirmation and dismissals are final orders and appealable but a denial of confirmation is not.

Fustolo v. 50 Thomas Patton Drive, LLC (1st Cir., 2016) Cited *Bullard* as well: Suggesting that a bankruptcy court order that "allows the bankruptcy to go forward and alters the legal relationships among the parties" is appealable.

Baker Botts, L.L.P. et al v. Asarco LLC, 135 S. Ct. 2158 (2015)

FACTS: ASCARO was a Chapter 11 debtor in possession. Its lawyers filed fee applications requesting fees under 11 U.S.C. 330 (a)(1). ASCARO objected. The bankruptcy court awarded fees for time spent by the law firm in defending the applications.

LOWER COURT RULING: The underlying case, *In re Asarco, LLC*, 751 F.3d 291 (5th Cir. 2014) *cert. granted, 2014* WL 3795992. Was decided by the 5th Circuit which concluded that the Code did not authorize such "fees for defense of fees." The court therein acknowledged that the case law was divided but determined that a straightforward reading of § 330(a) "strongly suggests" that these costs are not to be paid from the Debtor's estate. In contrast to the services rendered by a professional, which benefits the estate or its administration, and whose costs are borne by creditors, the "primary beneficiary of a professional fee application, of course, is the professional."

SUPREME COURT RULING: The Supreme Court ruled on the issue of whether the section of the Bankruptcy code granting discretion to Bankruptcy Judges to award "reasonable compensation for actual, necessary services rendered by" an attorney or other professional employed by the estate, allowed courts to compensate counsel or other professionals for the costs incurred in defending their fee applications. *Baker Botts, L.L.P. et al v. Asarco LLC*, 2015 WL 2473336 (U.S. June 15, 2015).

In a split decision, the Supreme Court affirmed the ruling stating in part, Section "330 (a)(1) allows "reasonable compensation" only *for "actual, necessary, services rendered."* (emphasis added)." The Court went on to discuss what "services" ordinarily means.

There is an interesting dissent by Justice Breyer. It was his position that bankruptcy judges have the discretion to award attorney fees for defending the fee application where it is appropriate. *Baker Botts, L.L.P. et al v. Asarco LLC*, 2015 WL 2473336 (U.S. June 15, 2015).

See also: *In re: Abbott* (Bankr.Me., 2016)

Singer v. Charles R. Feldstein & Co. (N.D. Ill., 2016)

McFarland v. Wallace, 790 F.3d 1182 (11th Cir. 2015)

FACTS: A Georgia bankruptcy-specific exemption statute (Georgia is an opt out state), enables Georgia debtors who file for bankruptcy to exempt their aggregate interest, not to exceed $2,000, in the cash value of unmatured life insurance contracts. The debtors had claimed almost $15,000.00 CSV as exempt.

The debtor also exempted over $150,000.00 annuity that was created when debtor was 64 in 2006. Debtor retained full control and discretion over the terms of the annuity, including the ability to cancel it or withdraw all funds therein in a lump sum if he so chose. The trustee objected to the exemptions.

11th CIRCUIT'S RULING: The lower courts determined the annuity not to be exempt as it wasn't to serve as an income substitute and the life insurance exemption was capped at $2,000.00 per statute.

Georgia debtors who were not in bankruptcy could claim the full cash value of whole life insurance contracts as exempt. The bankruptcy and district courts ruled that this disparity does not violate the uniformity provisions of the bankruptcy clause of the United States Constitution. The statute applied to all debtors in bankruptcy. The statute also did not violate the Equal Protection Clause of the Georgia constitution as bankruptcy debtors and non-bankruptcy debtors are not similar in their circumstances. The law did not have to give each class the same treatment.

On further appeal, the Eleventh Circuit affirmed. *McFarland v. Wallace,* 2015 WL 3825078 (11th Cir. June 22, 2015).

See also: *In re Schafer*, 689 F.3d 601 (6th Cir. 2012);

Sheehan v. Peveich 574 F.3d 248 (4th Cir. 2009);

Mediofactoring, et al. v. McDermott (*In re Connolly North America, LLC)* 802 F.3d 810 (6th Cir. 2015)

FACTS: The original Chapter 7 trustee in the case filed an adversary proceeding that was later dismissed by the court. The court also found that the trustee and his attorney breached their discovery obligations due to gross negligence. Three unsecured creditors then sought to have the chapter seven trustee removed. This motion was granted.

The successor trustee sued the initial trustee, his firm, and his malpractice carrier for damages. Once that matter was settled, two of the unsecured creditors applied for reimbursement of attorneys' fees and costs totaling $164,336 under the general authority for allowance of administrative expenses. They relied on the opening clause of §503(b) which uses the word "including".

LOWER COURTS' RULINGS: The bankruptcy court ruled that there was a substantial benefit to the estate and a significant increase in funds made available to unsecured creditors but that the code section did not authorize the fees and costs in the context of a chapter 7 case.

The District Court affirmed, agreeing with the overwhelming majority of courts.

6th CIRCUIT'S RULING: In a split decision, the circuit court went against the weight of case law and held that a creditor which made a substantial contribution in a chapter 7 case was entitled to an administrative expense under §503(b), even though §503(b)(3)(D) which specifically addresses "substantial contribution" refers only to Chapters 9 and 11 and not Chapter 7.

The majority of the Circuit court panel concluded, as follows: "Nowhere does the [Code] say, "expenses incurred by a creditor in securing the removal of a Chapter 7 trustee are not allowable"; or "expenses incurred in making a substantial contribution in a case under Chapters 9 or 11, but not Chapter 7, may be allowed"; or, "only the enumerated expenses shall be allowed."

The court stated that, congress, by using the term "including" in the opening lines of §503(b), had anticipated that bankruptcy courts would encounter a variety of administrative expenses and circumstances warranting reimbursement and courts could evaluate the benefit conferred on the estate on a case-by-case basis depending on the specific facts of the case and that such cases would be rare.

The court concluded that to fail to award administrative expenses to the "rare Chapter 7 creditors" forced by circumstances to take action would deter them from participating in bankruptcy cases, which would be inconsistent with the purposes of the Code.

The dissent in this case is worth a read. Judge O'Malley disagreed with the majority opinion almost in its entirety. The dissent also noted that a different panel of the **same** circuit in *In re Trailor Source, Inc.* 555 F.3d 231(6th Cir. 2009) appeared to agree that Chapter 7 was excluded from substantial contribution administrative claims. The dissent also stated that the court should be hesitant to make a policy determination about the scope of §503(b) based solely on congressional inaction.

Consumer Law Developments

Spokeo, Inc. v. Robins
Supreme Court of the United States, No. 13-1339
May 16, 2016
2016 WL 2842447

FACTS: Spokeo is a company that operates a "people search engine." Spokeo allows users, such as employers, to obtain personal information about individuals, such as prospective employees.

Thomas Robins discovered that his Spokeo profile contained inaccurate information. He filed a class action against Spokeo in federal court, alleging that the company violated the Federal Fair Credit Reporting Act (FCRA) when it published the inaccurate information.

The district court dismissed Robins' claim, finding that he lacked standing to sue because for failing to sufficiently plead "injury in fact" as required by Article III. The Ninth Circuit reversed, finding that Robins demonstrated individualized injury because his complaint alleged that Spokeo violated "his" statutory rights and because Robins has a personal interest in the accurate reporting of his own credit history.

ANALYSIS: The United States Supreme Court vacated and remanded the Ninth Circuit's decision. The Court found that the Ninth Circuit failed to conduct a complete injury-in-fact analysis. To adequately plead injury-in-fact, a plaintiff must allege that the injury was both: (1) concrete, and (2) particularized. The Court found that the Ninth Circuit analyzed only whether Robins' claim was particularized, but failed to consider whether the injury was also concrete.

The Court then discussed concreteness, focusing on allegations of intangible harm. The Court implied that Robins' alleged harm was intangible because he discovered a Spokeo profile had been created about himself, at some point, and that the profile contained inaccurate information. The pleadings did not mention how Robins discovered the profile or for what purpose it may have been used.

In analyzing whether an intangible harm is concrete, the Court noted that both history and congressional judgment are important considerations. First, a court should consider whether the alleged harm "has a close relationship to a harm that has traditionally been regarded as providing a basis for a lawsuit in English or American courts." Second, a court should consider whether Congress has chosen to elevate a previously inadequate injury to the level of a cognizable injury. It will not be sufficient for a plaintiff to allege a "bare procedural violation," but a court may consider the overall purpose of a statute when determining whether a harm is concrete. For example, it would be insufficient for Robins to allege that Spokeo violated one of FCRA's procedural requirements, such as failing to provide Robins with the required notice of Spokeo's information, where that information was not materially inaccurate.

Because the Ninth Circuit failed to fully consider both prongs of the injury-in-fact analysis, its standing inquiry was incomplete.

TAKEAWAYS: A pleading alleging a violation of a federal statute does not sufficiently allege an injury-in-fact if the allegation is not both particularized and concrete. When a concrete injury is intangible, an allegation of a bare procedural violation is insufficient to adequately allege Article III standing.

POTENTIAL BANKRUPTCY IMPLICATIONS: An ultimate victory for Spokeo could end many lawsuits by consumers and claims by bankrupts for violations of the automatic stay. For example, some judges do not tolerate the slightest transgression of the automatic bankruptcy stay before finding a violation of the Fair Debt Collection Practices Act, or FDCPA.

The question of whether the Bankruptcy Code is the exclusive remedy for many debtors suing under the FDCPA is now on appeal in several circuits. Even assuming FDCPA suits by bankrupts are allowed to stand, a lack of standing could bar a debtor from suing a creditor under the FDCPA for filing a time-barred claim, absent a showing of concrete damages.

When it comes to filing claims barred by the statute of limitations, other creditors or a trustee might have standing, but not a debtor who enjoys a discharge of the debt in any event.

Likewise, a debtor might be unable to claim damages for violation of the automatic stay without proof of injury.

Chapter 13 Anti-Modification Provision — *Anderson v. Hancock*, -- F. 3d--, 2016 WL 1660178 (4th Cir. Apr. 27, 2016)

In *Anderson v. Hancock*, the U.S. Court of Appeals for the Fourth Circuit (the "Fourth Circuit") considered whether a Chapter 13 plan's proposal to reinstate the pre-default interest rate on a residential mortgage loan constituted a permissible cure or rather a prohibited modification of a mortgage lender's rights. The Fourth Circuit concluded that such a proposal was a prohibited modification and that the contractual default interest rate would apply to all of the debtors' postpetition payments to the lender.

Facts and Procedural History

In September 2011, William Anderson, Jr. and Dannie Jernigan financed the purchase of a home with a $255,000 loan from Wayne and Tina Hancock, which was secured by the purchased home. The promissory note evidencing the loan required Anderson and Jernigan to make monthly payments of $1,368.90 at five-percent interest for thirty years. The note further provided that failure to make a monthly payment within thirty days would constitute a default and that the interest rate on the loan would increase to seven percent for the remaining term of the loan.

Anderson and Jernigan missed several monthly payments, and the Hancocks repeatedly informed them that they were in default and that the interest rate had increased to seven percent for the loan's remaining term. When Anderson and Jernigan failed to continue making payments, the Hancocks initiated foreclosure proceedings. This prompted Anderson and Jernigan to file for Chapter 13 relief. In the Chapter 13 plan filed with their petition, Anderson and Jernigan proposed to (1) pay the prepetition arrears owed to the Hancocks over a sixty-month period at the original interest rate of five percent, (2) reinstate the original maturity date of the loan, and (3) make postpetition payments to the Hancocks at five-percent interest.

The Hancocks objected to the plan's treatment of their claim, arguing that both the prepetition arrears and postpetition payments should be paid at the default interest rate of seven percent. The bankruptcy court ruled in favor of the Hancocks. On appeal, the district court partly affirmed the bankruptcy court's ruling, agreeing that reinstating the pre-default interest rate would constitute an impermissible modification. However, based on its interpretation of the promissory note, the district court "held that acceleration and foreclosure was a 'disjunctive alternative remedy' to the default rate of interest, and that once the Hancocks accelerated the loan, the rate of interest reverted back to five percent."[1] Accordingly, the district court "held that this period of acceleration (and thus only five percent interest) lasted from September 16, 2013 [i.e., the petition date] until December 2013 (the effective date of the plan), after which the seven percent rate of interest reactivated due to the bankruptcy plan's deceleration of the loan."[2]

[1] *Anderson v. Hancock*, -- F. 3d--, 2016 WL 1660178, at *2 (4th Cir. Apr. 27, 2016).
[2] *Id.*

The Fourth Circuit's Ruling

The Fourth Circuit began by noting that Code § 1322(b)(2)'s antimodification provision prohibited modification of the Hancocks' rights and that, pursuant to the Supreme Court's *Nobelman* decision, such rights include "rights that are 'bargained for by the mortgagor and the mortgagee' and enforceable under state law."[3] The Fourth Circuit then emphasized that the cure provisions of Chapter 13 (i.e. Code § 1322(b)(3) and (5)) do "not undo this protection of residential mortgage lenders' fundamental rights."[4] Rather, the reference in those provisions to the cure of a default "focuses on the ability of a debtor to decelerate and continue paying a loan, thereby avoiding foreclosure."[5] On this understanding, the Fourth Circuit held "that turning away from the debtors' contractually agreed upon default rate of interest would effect an impermissible modification of the terms of their promissory note."[6] Finally, the Fourth Circuit concluded that the district court had improperly interpreted the terms of the promissory note. According to the Fourth Circuit, the remedies provided to the Hancocks in the note were cumulative, rather than disjunctive. As such, all payments to the Hancocks had to be made at the interest rate of seven percent.

[3] *Id.* at *3 (quoting Nobleman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993)).
[4] *Id.*
[5] *Id.*
[6] *Id.* at *4.

Claim-Preclusive Effect of a Chapter 13 Plan — *Covert v. LVNV Funding, LLC*, 779 F.3d 242 (4th Cir. 2015)

In *Covert v. LVNV Funding, LLC*, the U.S. Court of Appeals for the Fourth Circuit (the "Fourth Circuit") considered whether a class action filed by former Chapter 13 debtors against LVNV Funding, LLC ("LVNV") and its affiliated companies was barred as a result of the claim-preclusive effect of the debtors' confirmed Chapter 13 plans, thereby warranting dismissal of the class action. The Fourth Circuit held that such a dismissal was warranted on claim preclusion grounds.

Facts and Procedural History

All of the plaintiffs in the class action had filed for Chapter 13 relief in 2008 in the District of Maryland. LVNV had acquired defaulted unsecured debts owed by the plaintiffs to a third party, and LVNV filed proofs of claim (through its servicer) based on those debts in all of the plaintiffs' Chapter 13 cases. The claims were allowed, and LVNV received payment on account of the claims pursuant to the provisions of the confirmed Chapter 13 plans, all of which made pro rata payments to general unsecured creditors. At all relevant times, LVNV and its affiliates were not licensed to do business as a debt collection agency in Maryland.

The plaintiffs commenced their class action in the U.S. District Court for the District of Maryland in March 2013, alleging that the defendants had violated the Federal Debt Collection Practices Act and Maryland state law by having filed proofs of claim in the plaintiffs' Chapter 13 cases without a Maryland debt collection license. The district court granted the defendants' motion to dismiss all of the plaintiffs' claim for failure to state a claim upon which relief could be granted. The district court, however, relied on the claim preclusive effect of the plaintiffs' confirmed Chapter 13 plans to dismiss some, but not all, of the plaintiffs' claims against the defendants. The district court relied on other grounds to dismiss the remaining claims. On appeal, the Fourth Circuit affirmed the dismissal of all of the claims against the defendants, but unlike the district court, it relied *solely* on the claim preclusive effect of the plaintiffs' confirmed Chapter 13 plans to reach its holding.

The Fourth Circuit's Ruling

At the outset, it should be noted that the Fourth Circuit framed its ruling under the generic concept of *res judicata*, despite recognizing the more refined distinction between claim preclusion and issue preclusion:

> As we have applied it, the doctrine of res judicata encompasses two concepts: claim preclusion, which bars later litigation of all claims that were actually adjudicated or that could have been adjudicated in an earlier action, and issue preclusion, which bars later litigation of legal and factual issues that were "actually and necessarily determined" in an earlier action. Rather than attempting to draw a sharp distinction between these two aspects here, we conduct our

> analysis under the general res judicata framework, as has been our practice in bankruptcy cases.[7]

Nonetheless, it is quite clear that the Fourth Circuit based its ruling on the principle of claim preclusion.[8]

For its analytical framework, the Fourth Circuit relied on its past holding "that a prior bankruptcy judgment has res judicata effect on future litigation when . . . three conditions are met."[9] The court identified those conditions as follows:

> (1) the prior judgment was final and on the merits, and rendered by a court of competent jurisdiction in accordance with the requirements of due process;
>
> (2) the parties are identical, or in privity, in the two actions; and,
>
> (3) the claims in the second matter are based upon the same cause of action involved in the earlier proceeding.[10]

The Fourth Circuit concluded that all three conditions had been meet. First, the court noted that a plan confirmation order constitutes a final judgment on the merits. (Although the court did not address the bankruptcy court's jurisdiction to enter a plan confirmation order, such a finding would seemingly be axiomatic.)[11] Second, the court noted that the plaintiffs and the defendants in the class action had been parties to the prior plan confirmation proceedings. Finally, the Court stated that a finding for the plaintiffs on any of their claims "would entail a holding that the [d]efendants' proofs of claim [we]re invalid, which would directly contradict the bankruptcy court's plan confirmation order approving those proofs of claim as legitimate."[12] Or put another way, "because all of the [p]laintiffs' claims implicitly ask[ed] the district court to reconsider the provisions of the confirmed plans, they [we]re based on the same cause of action as the plan confirmation orders."[13]

The Fourth Circuit thus held that the claim-preclusive effect of the plaintiffs' confirmed Chapter 13 plan warranted dismissal of all of their claims against the defendants.

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[7] Covert v. LVNV Funding, LLC, 779 F.3d 242, 246 (4th Cir. 2015) (quoting *In re* Varat Enters., Inc., 81 F.3d 1310, 1315 (4th Cir. 1996)). As some commentators have argued, an analytical approach that eschews the distinction between claim preclusion and issue preclusion is quite unsound for a variety of reasons. *See* Christopher Klein, Lawrence Ponoroff & Sarah Borrey, *Principles of Preclusion and Estoppel in Bankruptcy Cases*, 79 AM. BANKR. L.J. 839, 843-44 (2005).

[8] *See, e.g.*, *Covert*, 779 F.3d at 246 ("The third res judicata condition requires that Plaintiffs' claims be 'based upon the same cause of action involved in' the plan confirmation proceedings." (quoting *Varat*, 81 F.3d at 1315)); *id.* at 247 ("Res judicata bars not only those claims that were actually raised during prior litigation, but also those claims that could have been raised . . . .").

[9] *Id.* at 246.

[10] *Id.*

[11] *See* 28 U.S.C. §§ 1334(b), 157(b)(2)(L).

[12] *Covert*, 779 F.3d at 247.

[13] *Id.*

Claim-Preclusive Effect of a Chapter 13 Plan — *In re Harling*, 541 B.R. 330 (Bankr. D.S.C. 2015)

In *In re Harling*, the U.S. Bankruptcy Court for the District of South Carolina considered whether confirmation of a Chapter 13 plan precluded the debtors from objecting after plan confirmation to a creditor's proof of claim. As a result of language contained in the plan reserving the debtors' right to make such an objection, the bankruptcy court held that the creditor could not invoke claim preclusion as a defense to the debtors' claim objection.

Facts and Procedural History

Derrick Allen and Teresa Harling filed for Chapter 13 relief on June 26, 2015. The bankruptcy court confirmed their plan which provided, in relevant part, that "[c]onfirmation of this plan does not bar a party in interest from objecting to a claim." Prior to plan confirmation, LVNV Funding, LLC ("LVNV") had filed a proof of claim for $3,878.86. One week after plan confirmation, the debtors objected to LVNV's proof of claim on the basis that it was barred by the statute of limitations and thus was unenforceable. While LVNV admitted that its claim was time-barred under state law, it argued that the claim preclusive effect of the bankruptcy court's confirmation order barred the debtors from objecting to LVNV's proof of claim.

The Bankruptcy Court's Ruling

The bankruptcy court noted that LVNV's claim preclusion argument was a nonstarter because "parties may agree to modify the preclusive effect of a final order by explicitly or implicitly reserving the right to later adjudicate an issue that could have been resolved."[14] Building on this principle, the bankruptcy court further observed that, "when a bankruptcy order has confirmed a plan, and the plan contains an express reservation of rights, that reservation may preserve the right of a party to later litigate the issue."[15] The bankruptcy court cautioned, however, that not all reservation-of-rights clauses will trigger an exception to a confirmed plan's claim preclusive effect: "Cases finding reservations of rights clauses unenforceable generally turn on a vague reservation clause and specific claims treatment, untimely action, and/or a reservation of rights clause that is inapplicable to the cause of action."[16] Nonetheless, the bankruptcy court emphasized that "there is not a 'general rule that naming each defendant or stating the factual basis for each cause of action are the only ways to preserve a cause of action at confirmation'" and that, "[i]nstead, a court should consider the specifics of the case and the positions of the parties."[17]

Having set forth these principles, the bankruptcy court observed that, in the District of South Carolina, "plan confirmation generally occurs prior to the expiration of the deadline for filing proofs of claim, and plans contain language specifically carving out the claims resolution process

[14] *In re* Harling, 541 B.R. 330, 334 (Bankr. D.S.C. 2015).
[15] *Id.*
[16] *Id.*
[17] *Id.*at 335 (quoting The Elk Horn Coal Co., LLC v. Conveyor Mfg. & Supply, Inc. (*In re* Pen Holdings, Inc.), 316 B.R. 495, 504 (Bankr. M.D. Tenn. 2004)).

as separate from confirmation by preserving the right to object to claims post-confirmation."[18] The rationale underlying this procedural sequencing is to "permit[] chapter 13 trustees to begin disbursements expeditiously, as they are encouraged to do by Congress."[19] As such, the reservation-of-rights clause in the district's "form plan is not accidental or vague: it deliberately envisions resolution of the claims objection process post-confirmation."[20] For these reasons, the bankruptcy court concluded that "[t]he reservation of this category of rights [i.e., claims objections] is a permissible reservation, particularly in light of how chapter 13 administration occurs in [the District of South Carolina.]."[21]

The court thus held that the debtors' "right to object post-confirmation was properly reserved in the plan"[22] and disallowed LVNV's claim in light of its admission that the claim was unenforceable under state law.

An appeal of the bankruptcy court's order is currently pending before the U.S. Court of Appeals for the Fourth Circuit.

[18] *Id.* at 336.
[19] *Id.*
[20] *Id.*
[21] *Id.* at 336-37. In reaching its conclusion, the bankruptcy court admonished LVNV for having slept on its rights. *See id.* at 337 ("If LVNV disagreed that the reservation was appropriate, it could have objected to the provision prior to confirmation. It, too, is bound by confirmation." (citing United Student Aid Funds, Inc. v. Espinosa, 559 U.S. 260, 274 (2010))).
[22] *Id.* at 337.

Claims — *Stubbs & Perdue, P.A. v. Angell (In re Anderson)*, 811 F.3d 166 (4th Cir. 2016)

In *Stubbs & Perdue, P.A. v. Angell (In re Anderson)*, the U.S. Court of Appeals for the Fourth Circuit (the "Fourth Circuit") considered whether, in a case that had been converted from Chapter 11 to Chapter 7, the IRS's secured tax claim was subordinate to a Chapter 11 administrative expense claim. The Fourth Circuit held that the tax claim was entitled to distribution ahead of the administrative expense claim.

Facts and Procedural History

Henry Anderson filed for Chapter 11 relief in 2010. Stubbs & Perdue, P.A. ("Stubbs") represented him during the pendency of his Chapter 11 case and was owed approximately $200,000 in legal fees, which the bankruptcy court had allowed as administrative expenses. Among Anderson's creditors, the IRS had an allowed secured tax claim totaling nearly $1 million. The debtor's case was subsequently converted to Chapter 7 on November 7, 2011, and the Chapter 7 estate had insufficient funds to repay both Stubbs and the IRS.

In the bankruptcy court, the Chapter 7 trustee filed a motion in aid of distribution, arguing that Stubbs's Chapter 11 administrative expense claim was subordinate to the IRS's secured tax claim. Stubbs objected, arguing that the IRS's claim was subordinate to Stubbs's administrative expense claim. The bankruptcy court ruled in favor of the Chapter 7 trustee, and the district court affirmed the bankruptcy court's ruling.

The Subordination of Secured Tax Claims in Chapter 7

Although secured claims are generally satisfied before administrative expense claims in Chapter 7 liquidations,[23] the current version of Code § 724(b)(2) (the "Chapter 7 subordination provision") provides that allowed secured tax claims are subordinate to allowed Chapter 7 administrative expenses, *but not* allowed Chapter 11 administrative expenses. But this was not always so. Prior to 2005, Code § 724(b)(2) provided that secured tax claims were subordinate to *all* allowed administrative expenses (and not just those incurred in Chapter 7). As observed by the Fourth Circuit, "that statutory scheme was criticized on the ground that it created perverse incentives, encouraging Chapter 11 debtors and their representatives to incur administrative expenses even when there was no real hope for a successful reorganization, to the detriment of secured tax creditors when Chapter 7 liquidation ultimately proved necessary."[24]

To change this state of affairs, Congress's amendments to the Bankruptcy Code in 2005 revised Code § 724(b)(2) to provide that secured tax claims would be subordinate only to certain types of Chapter 7 priority claims—specifically, those enumerated in Code § 507(a)(1). Prior to the 2005 amendments, administrative expense claims were entitled to first priority under Code § 507(a)(1). But with the 2005 amendments, Congress relegated administrative expense claims to second priority under Code § 507(a)(2) and elevated domestic support claims (and certain administrative expenses relating to such claims) to first priority under Code § 507(a)(1).

[23] *See* 11 U.S.C. §§ 725, 726(a)(1).
[24] Stubbs & Perdue, P.A. v. Angell (*In re* Anderson), 811 F.3d 166, 169 (4th Cir. 2016).

Because of Congress's failure to revise Code § 724(b)(2) to include a reference to Code § 507(a)(2), "it is not clear that Congress accomplished what it set out to do" in amending the Chapter 7 subordination provision.[25]

Stubbs's Argument for Subordinating the IRS's Secured Tax Claim

When Anderson filed for Chapter 11 relief in 2010, the 2005 version of Code § 724(b)(2) was in effect. But ten months later, while Anderson's Chapter 11 case remained pending, Congress enacted various amendments to correct various technical drafting errors that had occurred during the 2005 amendments to the Bankruptcy Code. One of those technical amendments targeted Code § 724(b)(2), revising it to indicate that secured tax claims would be subordinate to **§ 507(a)(2)** administrative expense claims incurred in Chapter 7.

While not disputing that its Chapter 11 administrative expense claim would be subordinate to the IRS's secured tax claim under the current version of Code § 724(b)(2), Stubbs argued that the IRS's claims should be subordinate to Stubbs's administrative expense claim in Anderson's case for the following reasons. First, the 2005 version of the Chapter 7 subordination provision was in effect when Anderson filed for Chapter 11 relief. Second, Stubbs argued, secured tax claims were subordinate to Chapter 11 administrative expense claims under the 2005 version of the subordination provision. Finally, although Congress made the technical amendment to that provision during the pendency of Anderson's Chapter 11 case (i.e., before it was converted to Chapter 7), Stubbs argued that applying the current version of the Chapter 7 subordination provision would have an impermissible retroactive effect on its right to a distribution from Anderson's estate.

The Fourth Circuit's Ruling

Applying Supreme Court precedent setting forth rules for interpreting statutes that do not specify their temporal reach, the Fourth Circuit stated that these "principles dictate that a court apply the law in effect at the time it renders its decision, unless that law would operate retroactively without clear congressional authorization."[26] The Fourth Circuit quickly disposed of Stubbs's retroactivity argument by noting that the 2005 version of the Chapter 7 subordination provision on which Stubbs relied never applied in Anderson's converted Chapter 7 case. By the time Anderson's case was converted from Chapter 11 to Chapter 7, the technically corrected version of the subordination provision had already been in effect for nearly a year. Thus, when applying the law in effect at the time that it rendered its decision (i.e., the current version of the Chapter 7 subordination provision), the bankruptcy court correctly determined that the IRS's secured tax claim was not subordinate to Stubbs's Chapter 11 administrative expense claim. Moreover, the Fourth Circuit concluded that application of the current version of the subordination provision to conduct predating the provision's enactment—specifically, the incurrence of legal fees by Stubbs in Anderson's Chapter 11 case that were approved by the bankruptcy court—was an insufficient basis to trigger a finding of impermissible retroactive effect. Any expectation that Stubbs may have had to acquire a subordination right vis-à-vis the IRS if Anderson's Chapter 11 case were

[25] *Id.*
[26] *Id.* at. 171.

converted to Chapter 7 was "inchoate" at best and would not "give[] rise to retroactivity concerns."[27]

[27] *Id.* at. 174.

Discharge — *Justice v. United States (In re Justice)*, 817 F. 3d 738 (11th Cir. 2016)

In *Justice v. United States (In re Justice)*, the U.S. Court of Appeals for the Eleventh Circuit (the "Eleventh Circuit") considered whether a tardily filed IRS Form 1040 constitutes a return for purposes of determining the dischargeability of tax debts specified in Code § 523(a)(1)(B). The Eleventh Circuit held that, under the facts and circumstances in the case before it, the debtor's tardily filed IRS Form 1040s did not constitute returns for purposes of Code § 523(a)(1)(B) and thus the tax debts associated with those forms were nondischargeable.

Facts and Procedural History

Christopher Justice filed for Chapter 7 relief on July 22, 2011. At the time, he owed the IRS income tax debts from 2000 through 2003. Because Justice had not timely filed tax returns for those years, the IRS estimated Justice's tax liabilities through Substitute for Return ("SFR") tax assessments. After doing so, the IRS issued Justice notices of deficiency for his outstanding tax debts, which Justice did not contest in the tax court. The IRS then assessed tax deficiencies against Justice on August 28, 2006 for the amounts calculated through the SFR process.

On October 22, 2007, Justice prepared Form 1040s for each of the four tax years for which he owed income tax, reporting a lower tax liability than the amount assessed by the IRS. Upon review of those forms, the IRS abated a portion of the assessed taxes. Justice received a discharge in November 2011, and in January 2012, Justice's attorney filed an administrative claim with the IRS requesting that it write-off Justice's outstanding tax debts. The IRS refused to do so, and Justice subsequently commenced an adversary proceeding to determine the dischargeability of his tax debts. The bankruptcy court determined that the debts were nondischargeable, and the district court affirmed that determination.

The Eleventh Circuit's Ruling

In relevant part, Bankruptcy Code § 523(a)(1)(B) provides that a Chapter 7 discharge does not discharge an individual debtor from any debt for a tax with respect to which a return, if required:

> (i) was not filed; or
>
> (ii) was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition.

If Justice's Form 1040s constituted returns, then neither of Code § 523(a)(1)(B)'s nondischargeability triggers would be satisfied: The first trigger would not be satisfied because he would have been deemed to have filed a return. Moreover, the second trigger would not be satisfied because, although Justice tardily filed his forms, he did not file them after two years before he filed for Chapter 7 relief (i.e., he filed them well *before* July 22, 2009, which was the two-year mark prior to his bankruptcy filing).

If, on the other hand, Justice's Form 1040s did **not** constitute returns, then Code § 523(a)(1)(B)'s first nondischargeability trigger would be satisfied: No return for the tax debts would have been filed, thus warranting a finding of nondischargeability.

To determine whether Justice's Form 1040s constituted returns, the Eleventh Circuit began its analysis with Bankruptcy Code § 523(a)'s hanging paragraph, which provides in relevant part that, for purposes of that subsection, "the term 'return' means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements)."

The court first noted that three courts of appeals have interpreted the hanging paragraph's phrase "applicable filing requirements" to include filing deadlines, such that "late-filed tax documents do not comply with applicable filing requirements and cannot be 'returns.'"[28] The Eleventh Circuit declined to consider the validity of that interpretation. Assuming that "applicable filing requirements" did not encompass filing deadlines, the court instead focused its analysis on whether a tardily filed tax document might nonetheless fail to qualify as a return other some other principle of "applicable nonbankruptcy"—specifically, the U.S. Tax Court's *Beard* test setting forth the criteria for when a document qualifies as a tax return.

The Eleventh Circuit observed that a document will qualify as a tax return under the *Beard* test if the following four elements are satisfied: "(1) it must purport to be a return; (2) it must be executed under penalty of perjury; (3) it must contain sufficient data to allow calculation of tax; and (4) it must represent an honest and reasonable attempt to satisfy the requirements of the tax law."[29] The dispute between Justice and the IRS focused solely on whether Justice's forms satisfied the fourth prong of the *Beard* test—that is, whether his tardily filed forms represented an honest and reasonable attempt to satisfy the requirements of the tax law. More specifically, the Eleventh Circuit noted a circuit split on the issue of whether delinquency in filing is relevant to the fourth prong of the *Beard* test, with four circuits concluding that delinquency is a relevant factor (i.e., the Fourth, Sixth, Seventh, and Ninth Circuits) and one circuit concluding that it is not (i.e., the Eighth Circuit).

The Eleventh Circuit joined the majority view, holding that "[f]ailure to file a timely return, at least without a legitimate excuse or explanation, evinces the lack of reasonable effort to comply with the law."[30] Given the circumstances of Justice's case—that is, "where a taxpayer files many years late, without any justification at all, and only after the IRS has issued notices of deficiency and has assessed his tax liability"[31]—the Eleventh Circuit concluded that his tardily filed Form 1040s did not satisfy the fourth prong of the *Beard* test and thus did not constitute returns. For this reason, the Eleventh Circuit determined that bankruptcy court's nondischargeability finding was warranted.

[28] Justice v. United States (*In re* Justice), 817 F. 3d 738, 743 (11th Cir. 2016).
[29] *Id.* at. 741.
[30] *Id.* at. 744.
[31] *Id.* at. 746.

Discharge — *Green Point Credit, LLC v. McLean (In re McLean)*, 794 F.3d 1313 (11th Cir. 2015)

In *Green Point Credit, LLC v. McLean (In re McLean)*, the U.S. Court of Appeals for the Eleventh Circuit (the "Eleventh Circuit") considered various issues. The most prominent one was an issue of first impression in the Eleventh Circuit—specifically, "whether a creditor violates the discharge injunction under [Code] § 524(a)(2) by filing a proof of claim in a bankruptcy proceeding to collect a debt that was discharged in a previous bankruptcy proceeding."[32] The court held that the discharge injunction "prohibits filing a proof of claim for a discharged debt where the objective effect of the claim is to pressure the debtor to repay the debt."

Facts and Procedural History

Eric and Deborah McLean filed for Chapter 13 relief in 2006 in the Middle District of Alabama, listing Green Point Credit, LLC ("Green Point") as a creditor in their schedules of liabilities. Their case was converted to Chapter 7, and they received a discharge in 2009 that included the debt owed to Green Tree.

The McLeans subsequently filed for Chapter 13 relief in June 2012 in the same federal district. They did not, however, list Green Tree as a creditor. Notwithstanding the McLeans' prior Chapter 7 discharge, Green Tree filed a proof of claim in the McLeans second case, listing the amount owed as the same amount that Green Tree sought to recover in the McLeans' first case.

The McLeans objected to Green Tree's proof of claim, arguing that the debt had been discharged in their prior case. Before the bankruptcy court ruled on the objection, the McLeans commenced an adversary proceeding against Green Tree, alleging that it violated the discharge injunction—specifically, Code § 524(a)(2)—upon filing its proof of claim in their second bankruptcy case. Green Tree withdrew its proof of claim four days after the McLeans commenced their adversary proceeding, acknowledging that it had erroneously filed the proof of claim "due to the failure of its automated electronic system to recognize that the McLeans' debt had been discharged."[33] Despite Green Tree's action to comply with the discharge injunction by withdrawing its proof of claim, "the McLeans sought to recover actual damages for the emotional distress that the proof of claim caused before it was withdrawn and sanctions befitting of Green Tree's misconduct."[34]

In addition to sustaining the McLeans' objection to Green Tree's proof of claim, the bankruptcy court, after holding a trial in the adversary proceeding, ruled that Green Tree violated the discharge injunction. On subsequent appeal, the district court affirmed the bankruptcy court's judgment.

[32] Green Point Credit, LLC v. McLean (In re McLean), 794 F.3d 1313, 1317 (11th Cir. 2015).
[33] *Id.* at 1318.
[34] *Id.*

The Eleventh Circuit's Ruling on the Discharge Injunction Issue

Code § 524(a)(2) provides that the discharge of a debt "operates as an injunction against the commencement or continuation of an action, the employment of process, or an act to collect, recover or offset any such debt as a personal liability of the debtor." Green Tree argued that "its proof of claim for the previously discharged debt did not violate the injunction because the filing was a claim against the bankruptcy estate and not against the McLeans personally."[35]

The Eleventh Circuit began its analysis by noting that the discharge injunction's phrase "as a personal liability of the debtor" is "too ambiguous to dictate a clear result in any case where a creditor makes a claim against an estate or a [nondebtor] party . . . in a way that ultimately forces the debtor to pay."[36] Given this ambiguity, the Eleventh Circuit deemed it appropriate to look to the Code's legislative history to interpret the meaning of the phrase. According to the court, that history "demonstrates clearly that the purpose of the statute is to 'eliminate any doubt concerning the effect of the discharge as a total prohibition on debt collection efforts.'"[37] To further reinforce that point, the Eleventh Circuit pointed to another passage from the Code's legislative history, which stated that the discharge injunction "'is intended to insure that once a debt is discharged, *the debtor will not be pressured in any to repay it*.'"[38] The court then observed that the Second and Tenth Circuits "have identified 'pressure' to repay a debt as the litmus test for whether the action affected the debtor's personal liability within the meaning of [Code] § 524(a)(2)."[39]

Having established the legislative-history backdrop to the discharge injunction, the Eleventh Circuit cautioned that "[i]t is . . . inappropriate to prioritize form over substance in deciding whether a claim operates against a debtor's personal liability" and held "that the test for whether a creditor violates the discharge injunction under [Code] § 524(a)(2) is whether the objective effect of the creditor's action is to pressure a debtor to repay a discharged debt, *regardless of the legal entity against which the creditor files its claim*."[40]

Pursuant to this analytical framework, the Eleventh Circuit concluded that Green Tree's improperly filed proof of claim clearly constituted an act to recover a discharged debt as a personal liability of the McLeans. The Eleventh Circuit first noted that, pursuant to its prior case law, filing a proof of claim constitutes an "'indirect means of collecting a debt.'"[41] Additionally, the Eleventh Circuit deemed this indirect act as one "to recover a debt 'as a personal liability' of the McLeans . . . because it triggered an increase in the McLeans' projected bankruptcy plan payments," which had the effect of "creat[ing] the kind of pressure to which the statute is

[35] *Id.* at 1320.
[36] *Id.*
[37] *Id.* at 1321 (quoting H.R. Rep. No. 95-995, at 356-66 (1977)).
[38] *Id.* (emphasis added) (quoting H.R. Rep. No. 95-595, at 366).
[39] *Id.*
[40] *Id.* at 1322 (emphasis added).
[41] *Id.* (quoting Crawford v. LVNV Funding, LLC, 758 F.3d 1254, 1262 (11th Cir. 2014)).

sensitive."[42] For these reasons, the Eleventh Circuit affirmed the bankruptcy court's conclusion that Green Tree violated the discharge injunction.

[42] *Id.* at 1322 (emphasis added).

Discharge — *In re Evans*, 543 B.R. 213 (Bankr. E.D. Va. 2016)

In *In re Evans*, the U.S. Bankruptcy Court for the Eastern District of Virginia considered two issues: (1) whether a debtor is entitled to a discharge under Bankruptcy Code § 1328(a) (a "full compliance discharge") when she has completed all payments to the Chapter 13 trustee as required under the plan, but has failed to make all direct payments to a creditor as provided for in the plan; and (2) the procedural disposition that should occur when a Chapter 13 debtor fails to obtain a discharge.

As more fully set forth below, the bankruptcy court concluded that a Chapter 13 debtor is not entitled to a full-compliance discharge when she fails to make all direct payments to a creditor as provided for in a plan and that dismissal or conversion of the case are the only procedural dispositions that can occur when a Chapter 13 debtor fails to obtain a discharge.

Facts and Procedural History

Marlene Evans purchased a home using funds provided by CitiFinancial, Inc. ("CitiFinancial"). The loan had a thirty-year term and was secured by the purchased property. The loan agreement required Evans to make 360 monthly payments in the amount of $1,316.56 beginning in January 2007.

On June 11, 2010, Evans filed for Chapter 13 relief. The plan confirmed by the bankruptcy court provided that Evans would continue to make direct monthly payments to CitiFinancial and that the Chapter 13 trustee would pay the $400 prepetition arrearage claim owed by Evans to CitiFinancial. During the pendency of her Chapter 13 case, Evans fell behind on her direct payments to CitiFinancial as a result of reduced income and an increase in expenses for the support of displaced relatives who came to live with her. The amount of missed postpetition payments owed to CitiFinancial totaled $6,344.08. Evans, however, completed the sixty monthly payments that the plan provided she would make to the Chapter 13 trustee.

As a result of the payments that Evans failed to make to CitiFinancial, the Chapter 13 trustee filed a motion to close Evans's case without entry of a discharge. Evans objected to the motion, arguing that she was entitled to discharge under Code § 1328(a).

The Bankruptcy Court's Ruling

Issue 1: Evans's Entitlement to a Full Compliance Discharge

Code § 1328(a) provides that, "as soon as practicable after completion by the debtor of all payments under the plan, . . . the court shall grant the debtor a discharge." In determining whether Evans was entitled to a full compliance discharge, the bankruptcy court framed the crux of the issue to be the meaning of the phrase "after completion by the debtor of all payments under the plan." The bankruptcy court stated that the plain language of the statute and all of the case law interpreting the provision pointed to the conclusion that the phrase "all payments under the plan" clearly refers to *any* payment required to be made pursuant to a Chapter 13 plan's provisions, including payments to be made directly by the debtor to a creditor. In other words, the identity of the disbursing agent for plan payments is not relevant to the inquiry of whether a

debt is provided for under the plan. As a result of Evans's failure to make all of her direct payments to CitiFinancial during the pendency of the her case, as required by the confirmed plan, the bankruptcy court held that Evans was not entitled to a full compliance discharge.

Issue 2: The Proper Procedural Disposition of Evans's Chapter 13 Case

In addressing the issue of the proper procedural disposition of Evans's Chapter 13 case, the bankruptcy court concluded that "[a] review of the Bankruptcy Code strongly suggests that there is no sufficient statutory authorization to simply close the case . . . when . . . a discharge has not been entered because the [d]ebtor failed to comply with the provisions of and complete all of the payments required under the confirmed [p]lan."[43] In support of its conclusion, the bankruptcy court noted that, "where all of the required payments under the plan were not made, the condition of case closure, . . . that th[e] case has been 'fully administered,' is unmet."[44] Accordingly, the only procedural options available to the Chapter 13 trustee were to seek conversion or dismissal of Evans's case pursuant to Code § 1307(c).

[43] *In re* Evans, 543 B.R. 213, 235 (Bankr. E.D. Va. 2016).
[44] *Id.* at 235 n.19 (quoting 11 U.S.C. § 350(a)).

Judicial Estoppel — *Slater v. U.S. Steel Corp.*, -- F.3d --, 2016 WL 723012 (11th Cir. Feb. 24 2016) (per curiam)

Slater v. U.S. Steel Corp. involves a frequently recurring fact pattern: a debtor who did not disclose in her schedule of assets a prepetition cause of action against a third party, the omission of which subsequently provides a basis for the third party to argue that the cause of action should be dismissed pursuant to the doctrine of judicial estoppel.

The outcome in such cases generally results in the dismissal of the action, and the result in *Slater* was no different: Sandra Slater's prepetition, employment-discrimination action against U.S. Steel, which she did not originally disclose in her bankruptcy case, was dismissed by the federal district court pursuant to the doctrine of judicial estoppel.

The per curiam opinion by the U.S. Court of Appeals for the Eleventh Circuit (the "Eleventh Circuit"), which affirmed the district court's judgment, thoroughly covers the Supreme Court's and the Eleventh Circuit's well-established principles for application of the doctrine of judicial estoppel. Depending on one's familiarity with these principles, the opinion may or may not be worth reading.

What is remarkable about the appeal is Judge Tjoflat's concurring opinion, a preview of which follows:

> I concur in the court's judgment because the result is dictated by Eleventh Circuit precedent. ***I write separately because that precedent, the doctrine of judicial estoppel as laid out in Burnes v. Pemco Aeroplex, Inc. and Barger v. City of Cartersville, was wrongly decided.*** The consequences of today's decision make the problem clear: U.S. Steel is granted a windfall, Slater's creditors are deprived of an asset, and the Bankruptcy Court is stripped of its discretion.
>
> . . .
>
> The results of today's decision speak for themselves. U.S. Steel no longer faces a set of potentially meritorious employment-discrimination claims. Judicial estoppel disposes of Slater's claims, without examination on the merits; indeed, the doctrine blocks them altogether. U.S. Steel is free and clear from any liability it may have owed to Slater. Conversely, for Slater's creditors, there will be no recovery on the claims, which belonged, by operation of law, to the bankruptcy estate the moment Slater filed her bankruptcy petition. And, the Bankruptcy Court, despite expressing no concern about the late-arriving claim, receives no "protection" through the doctrine. Instead, its experience and discretion are disregarded in favor of the District Court's judgment.
>
> This special concurrence proceeds in three parts. In Part I., I provide a brief overview of how the bankruptcy process is designed to work in the absence of judicial estoppel, with particular emphasis placed on the roles played by the trustee and the bankruptcy judge. In Part II., I trace the doctrine of judicial estoppel's historical development in the Eleventh Circuit. In Part III., I turn to the

> stark implications that stem from the continued application of judicial estoppel as required by *Burnes* and *Barger*. ***I conclude by calling for en banc review to set straight the doctrine of judicial estoppel.***[45]

Courts, attorneys, and commentators must pay attention whenever a sitting circuit judge unequivocally criticizes the circuit's precedent and calls for *en banc* review to remedy the situation. Read Judge Tjoflat's concurring opinion.

[45] Slater v. U.S. Steel Corp., -- F.3d --, 2016 WL 723012, at *12-13 (11th Cir. Feb. 24 2016) (Tjoflat, J., concurring) (emphasis added).

Procedure — *Houck v. Substitute Trustee Services, Inc.*, 791 F.3d 473 (4th Cir. 2015)

In *Houck v. Substitute Trustee Services, Inc.*, the U.S. Court of Appeals for the Fourth Circuit (the "Fourth Circuit") considered various issues in connection with the appeal of Diana Houck, a Chapter 13 debtor, from the dismissal of her action against various defendants whom she alleged had willfully violated the automatic stay during her bankruptcy case. Those issues were:

> (1) whether the Fourth Circuit had jurisdiction over Houck's appeal;
>
> (2) whether the district court had subject matter jurisdiction over Houck's complaint;
>
> (3) whether the district court had applied the correct standard in determining whether Houck's complaint should be dismissed for failure to state a claim on which relief could be granted; and
>
> (4) whether Houck had stated a plausible claim for the recovery of damages resulting from a willful stay violation.

As more fully set forth below, the Fourth Circuit concluded that appellate and trial jurisdiction existed, that the district court applied an incorrect standard in dismissing Houck's complaint for failure to state a claim, and that Houck had stated a plausible claim for recovering damages resulting from willful stay violation.

Facts and Procedural History

Houck's allegation of a willful stay violation arose from the following set of circumstances. After Houck's father deeded to her part of the family farm, Houck obtained a loan secured by that property. Shortly after refinancing the loan, Houck lost her job and struggled to remain current on the loan. This prompted Houck to seek a loan modification from LifeStore Bank, F.S.A ("LifeStore"), the creditor. LifeStore directed Houck to contact Grid Financial Services, Inc. ("Grid"), a debt collection agency, which refused to modify the loan due to Houck's unemployment. Subsequently, Houck defaulted on the loan.

After Houck's default, Substitute Trustee Services, Inc. ("Substitute Trustee") initiated foreclosure proceedings on the property securing LifeStore's loan. In response, Houck filed for Chapter 13 relief without the assistance of counsel, and Substitute Trustee halted the foreclosure proceedings. Soon thereafter, the bankruptcy court dismissed Houck's case based on her failure to file certain schedules and statements, and Substitute Trustee reinitiated the foreclosure proceedings.

Approximately three months after filing her initial Chapter 13 case, Houck filed a second Chapter 13 case to prevent the foreclosure proceedings, again without assistance of counsel. On the petition date, Houck's husband, Ricky Penley, called the attorneys representing Substitute Trustee to notify them of Houck's bankruptcy filing. The firm employee with whom Penley spoke confirmed that the firm already had a file for Houck, and Penley informed the employee about Houck's second bankruptcy filing, including by providing the case number for Houck's second case. Also on the petition date, Penley contacted LifeStore to inform it of Houck's

second case, and LifeStore responded that it would wait for notice from the bankruptcy court before taking any action. Two days after the petition date, the bankruptcy court issued an order to show cause why Houck's case should not be dismissed. Two days later, Substitute Trustee sold Houck's property at a foreclosure sale, and the bankruptcy court dismissed Houck's case on the following day. Houck did not contest the dismissal given that her property had been sold.

After unsuccessful efforts to undo the foreclosure sale and after vacating the property, Houck filed a complaint in federal district court against LifeStore, Grid Financial, and Substitute Trustee that alleged, among other claims, that they had willfully violated the automatic stay, thus entitling her to damages under Bankruptcy Code § 362(k). Substitute Trustee responded by filing a motion to dismiss Houck's complaint for failure to state a claim on which relief could be granted, arguing that the complaint failed to allege that Substitute Trustee knew of Houck's second Chapter 13 case at the time that Substitute Trustee conducted the foreclosure sale. The district court granted the motion, and Houck filed an interlocutory appeal from the court's order.

During the pendency of Houck's interlocutory appeal, Grid Financial filed a motion to dismiss Houck's complaint, arguing that the district court lacked subject matter jurisdiction over her stay-violation claim. The district court agreed, concluding that such a claim could be brought only in a bankruptcy court, and dismissed Houck's complaint.

After the district court clerk entered judgment and closed the case, the Fourth Circuit, *sua sponte*, dismissed Houck's interlocutory appeal for lack of appellate jurisdiction and further concluded that the district court's order granting Grid Financial's dismissal motion did not cure the jurisdictional defect. But upon Houck's unopposed motion for clarification, the Fourth Circuit recalled the mandate that it had issued upon dismissing Houck's interlocutory appeal and granted a panel rehearing.

The Fourth Circuit's Ruling

Issue 1: Appellate Jurisdiction

On the issue of appellate jurisdiction, the Fourth Circuit observed that the district court's order dismissing Houck's stay-violation claim against Grid Financial for lack of subject matter jurisdiction had the effect of dismissing the claim as to all remaining defendants (i.e., Grid Financial and LifeStore), thereby disposing of the entire case and thus constituting a final judgment. The Fourth Circuit further noted that, when the district court had previously dismissed Houck's claims against Substitute Trustee, it could have certified its interlocutory order as a final judgment under Federal Rule of Civil Procedure 54(b). Accordingly, the Fourth Circuit concluded that it had jurisdiction to hear Houck's appeal under the doctrine of cumulative finality, which is triggered when "'all joint claims or all multiple parties are dismissed prior to consideration of [an interlocutory] appeal,'" provided that "the appellant appeals from an order that the district court could have certified for immediate appeal under Rule 54(b)."[46]

[46] Houck v. Substitute Tr. Servs., Inc., 791 F.3d 473, 479 (4th Cir. 2015) (quoting Equip. Fin. Grp., Inc. v. Traverse Computer Brokers, 973 F.2d 345, 347 (4th Cir. 1992)).

Issue 2: The District Court's Subject Matter Jurisdiction

On the issue of the district court's subject matter jurisdiction, the Fourth Circuit noted that "[a] claim under [Code] § 362(k) for violation of the automatic stay is a cause of action arising under Title 11, and as such, a district court has jurisdiction over it"[47] pursuant to 28 U.S.C. § 1334(b). While Houck's stay-violation claim "was indeed subject to the Western District of North Carolina's standing order referring 'all bankruptcy matters' to the bankruptcy court, the district court's failure to do so did not deprive it of subject matter jurisdiction."[48] Noncompliance with the procedures that the district court had implemented under 28 U.S.C. § 157(a) "would 'not implicate questions of subject matter jurisdiction.'"[49] Additionally, Houck and Substitute Trustee had failed to object to the district court's procedural noncompliance, thus waiving or forfeiting the argument that Houck's stay-violation claim should have been decided by the bankruptcy court in the first instance. For these reasons, the Fourth Circuit held that the district court had subject matter jurisdiction over Houck's stay-violation claim and thus the authority to determine Substitute Trustee's dismissal motion.

Issue 3: The Correct Standard for Determining a Rule 12(b)(6) Dismissal

On the issue of the legal standard that the district court applied under Federal Rule of Civil Procedure 12(b)(6) in dismissing Houck's stay-violation claim against Substitute Trustee, the Fourth Circuit observed that the district court applied the following standard: "'[I]f after taking the complaint's well-pleaded factual allegations as true, a lawful alternative explanation appears a more likely cause of the complained of behavior, the claim for relief is not plausible.'"[50] Relying on the standard articulated by the Supreme Court in *Iqbal* and *Twombly* for determining the legal sufficiency of a complaint—that is, "whether the complaint contains sufficient facts, when accepted as true, to 'state a claim to relief that is plausible on its face'"[51]—the Fourth Circuit stated that "[t]his plausibility standard requires only that the complaint's factual allegations 'be enough to raise a right to relief above the speculative level.'"[52] In other words, "a plaintiff need not demonstrate that her right to relief is probable or that alternative explanations are less likely; rather she must merely advance her claim 'across the line from conceivable to plausible.'"[53] Given the Supreme Court's precedent governing the plausibility standard, the Fourth Circuit concluded that the district court erred when it "undertook to determine whether a lawful alternative explanation [to Houck's claim] appeared more likely."[54]

[47] *Id.* at 481.
[48] *Id.* at 483.
[49] *Id.* (quoting Stern v. Marshall, 131 S. Ct. 2594, 2607 (2011)).
[50] *Id.* at 484 (quoting the district court's dismissal order).
[51] *Id.* (quoting Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009)).
[52] *Id.* (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)).
[53] *Id.* (quoting *Twombly*, 550 U.S. at 570).
[54] *Id.*

Issue 4: The Plausibility of Houck's Stay-Violation Claim Against Substitute Trustee

In assessing the plausibility of Houck's stay-violation claim against Substitute Trustee, the Fourth Circuit began by setting forth the three elements required to establish such a claim: "(1) that the defendant violated the stay imposed by [Code] § 362(a), (2) that the violation was *willful*, and (3) that the plaintiff was injured by the violation."[55] In deciding Substitute Trustee's dismissal motion, the district court had acknowledged that Houck's complaint adequately alleged the first element of a stay-violation claim, but determined that the complaint *inadequately* alleged the second element. (The district court did not make a determination regarding the adequacy of the complaint's allegations regarding the third element of the stay-violation claim.)

The Fourth Circuit ultimately held that the "complaint adequately alleged that . . . Substitute Trustee had notice of Houck's second bankruptcy petition and that Houck sustained injury as a result of the violation."[56] In reaching its holding, the Fourth Circuit rejected Substitute Trustee's argument that, because it had not received written notice of Houck's second bankruptcy filing, "it could not have *willfully* violated the automatic stay."[57] The court noted that Code § 362(k) "does not include any provision that a particular form of notice be given," but "[r]ather, it imposes liability for a *willful* violation of the automatic stay."[58] Thus, oral notice can suffice as a predicate for establishing the second element of a stay-violation claim.

[55] *Id.*
[56] *Id.* at 484-85.
[57] *Id.* at 486.
[58] *Id.*

Property of the Estate — *In re Goins*, 539 B.R. 510 (Bankr. E.D. Va. 2015)

In *In re Goins*, the U.S. Bankruptcy Court for the Eastern District of Virginia considered whether, in a case converted from Chapter 13 to Chapter 7, the debtor or the trustee "is entitled to any appreciation in property of the estate that accrued post-petition while the case was pending in Chapter 13."[59] The bankruptcy court held that the Chapter 7 trustee, not the debtor, was entitled to the postpetition appreciation in the property.

Facts and Procedural History

When Wendell Goins filed for Chapter 13 relief, his schedule of real property listed his home as having a value of $98,000, subject to a mortgage that secured a debt of approximately $103,000. Goins did not claim an exemption in the home. At the time the dispute arose between Goins and the Chapter 7 trustee, the mortgage balance had decreased to approximately $76,000 as a result of $27,000 in payments on the mortgage by Goins while his case was administered under Chapter 13. After the case was converted to Chapter 7, the trustee filed an application to employ a real estate agent to sell the debtor's home at a list price of $147,500. Goins objected to the trustee's application and filed a motion to compel the trustee to abandon the home. The trustee objected to Goins's motion.

While the Chapter 7 trustee agreed that Goins was entitled to the buildup of equity in the home attributable to his postpetition mortgage payments (the "payment equity"), the parties' dispute centered on the equity that accrued as a result of the appreciation of the home's value during the pendency of Goins's Chapter 13 case (the "appreciation equity"). If the trustee were entitled to the appreciation equity, then excess funds would remain for distribution to Goins's unsecured creditors after paying the outstanding mortgage balance, the sale costs, the trustee's commission, and Goins's payment equity. On the other hand, if Goins were entitled to the appreciation equity, then no excess funds would remain for distribution to Goins's unsecured creditors, thus warranting the trustee's abandonment of the property.

The Chapter 7 trustee's claim to the appreciation equity hinged on the argument "that the 2005 amendment to Section 348(f)(1)(B) did away with any notion of implicit valuation as a result of confirmation in a Chapter 13 case, because Section 348(f)(1)(B) now expressly provides that valuations from Chapter 13 do not carry over into converted Chapter 7 cases."[60]

The Bankruptcy Court's Ruling

The bankruptcy court agreed that the Chapter 7 trustee was entitled to the appreciation equity, but on an entirely different basis—namely, relying on Code § 541(a)(1) and (a)(6), the former which provides that estate property includes "all legal or equitable interests of the debtor in property as of the commencement of the case," and the latter which provides that estate property also includes all "proceeds product, offspring, rents or profits of or from property of the estate." The bankruptcy court observed that Goins's home "was *always* property of the estate under

[59] *In re* Goins, 539 B.R. 510, 511 (Bankr. E.D. Va. 2015).
[60] *Id.* at 515.

Section 541(a) of the Code" and further noted that "[n]umerous cases relying on Section 541(a)(6) have held that post-petition appreciation in property belongs to the estate."[61]

For these reasons, the bankruptcy court held that Goins was not entitled to the appreciation equity and that the Chapter 7 trustee was authorized to sell Goins's home.

[61] *Id.*