AMERICAN BANKRUPTCY INSTITUTE

2017 Alexander L. Paskay Memorial Bankruptcy Seminar

Supreme Court Review and Recent Case Law Update

PLENARY SESSION

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2017

Supreme Court Review and Recent Case Law Update

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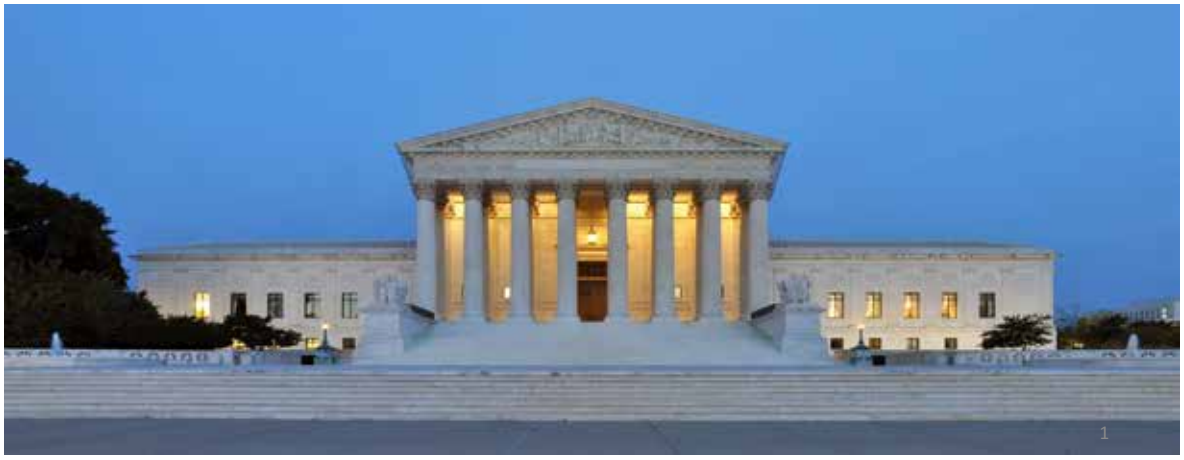

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Our Panelists

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Catherine Peek McEwen, Moderator

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Husky Int'l Electronics, Inc. v. Ritz

- 136 S. Ct. 1581 (2016)
- Interpreting 11 U.S.C. § 523(a)(2)(A)

- If a fraudulent conveyance creates a possibility of nondischargeable debt, can *every* creditor claim nondischargeability as a result of the transfer such that it mimics § 727's complete denial of discharge for concealment of assets?

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Husky Int'l Electronics, Inc. v. Ritz

- 136 S. Ct. 1581 (2016)
- Interpreting 11 U.S.C. § 523(a)(2)(A)

- Would a fraudulent conveyance to an unrelated entity also qualify for nondischargeability?
- Does it make a difference whether the transferor or transferee is filing for bankruptcy?

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Czyzewski v. Jevic Holding Corp.

- 787 F.3d 173 (3d Cir. 2015), *cert. granted,* 136 S. Ct. 2541 (2016)
- Regarding structured dismissal that departs from the Bankruptcy Code's distribution scheme

- Prediction re outcome?
- Is there a potential for impacting plans that provide for gifting (in which a claim holder senior in priority agrees to carve out some of its distribution for a junior class)?

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Estate Augmentation Claims (FDCPA)

- *Bishop v. Ross Earle & Bonan, P.A.*, 817 F.3d 1268 (11th Cir. 2016)
- Regarding lawyer-to-lawyer communications

- Does this impact any other federal/state consumer protection laws (e.g., TCPA, FCCPA)?
- Does this impact the other components of the FDCPA (e.g., the time you can call the attorney)?

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Estate Augmentation Claims (FDCPA)

- *Johnson v. Midland Funding, LLC*, 823 F.3d 1334 (11th Cir. 2016)
- Bankruptcy Code doesn't preempt FDCPA; filing stale proof of claim violates FDCPA

- Does this resolve everything with *Crawford*?
- *Crawford* is now on appeal with the Supreme Court. Thoughts?

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U.S. Bank, N.A. v. The Village at Lakeridge, LLC *(In re The Village at Lakeridge, LLC)*

- 814 F.3d 993 (9th Cir. 2016), *petition for cert. filed* (U.S. June 15, 2016) (No. 15-1509)
- Regarding "insiderness" relative to assignment of claim to friend of insider

- Is this the right result—what's to stop debtors from getting around the requirements of § 1129 by assigning insider claims to friendly non-insiders?

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Failla v. Citibank, N.A. *(In re Failla)*

- 838 F.3d 1170 (11th Cir. 2016)
- Literally, the consequences of using the "s" word

- Some courts disagree?
- What happens if the trustee abandons the property and the creditor does not want it?

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In re Motors Liquidation Co.

- 829 F.3d 135 (2d Cir. 2016), *rehearing denied* (2d Cir. Sept. 16, 2016), *petition for cert. filed*, *General Motors LLC v. Elliott*, 2016 WL 7321808 (U.S. Dec. 13, 2016)
- Regarding successor liability to debtor's known claimants without notice

- Is there successor liability under Florida law?
- How do you balance the need to protect the buyer and the need to accord due process?
- Does it make a difference if the debtor can ascertain the identity of claimants?

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In re Ocean Warrior, Inc.

- 835 F.3d 1310 (11th Cir. 2016)
- Regarding bankruptcy court contempt power

- How does this affect the contempt powers of bankruptcy courts?
- Does this change anything with respect to *Stern* and its progeny?

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Deutsche Bank Trust Co. v. Robert R. McCormick Foundation

(*In re Tribune Company Fraudulent Conveyance Litigation*)

- 818 F.3d 98 (2d Cir. 2016), *petition for cert. filed* (U.S. Sept. 9, 2016) (No. 16-317)
- Preemption of federal bankruptcy law

- How has the 11th Circuit ruled on this issue?

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Wake up, er, wrap up!

- *Wortley v. Bakst*, 2017 WL 57769 (11th Cir. Jan. 5, 2017)
- A bankruptcy judgment entered without authority is not appealable
- Could this happen in FLMB?

- *Hewitt v. Wells Fargo Bank, N.A.*, 197 So. 3d 1105 (Fla. 2d DCA 2016)
- The stay applies to the debtor's own appeal of an adverse decision in an action against the debtor. *See also TW Telecom Holdings, Inc. v Carolina Internet Ltd.*, 661 F.3d 495 (10th Cir. 2011) (Gorsuch, J.)

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SUPREME COURT REVIEW AND RECENT CASE LAW UPDATE

Husky Int'l Electronics, Inc. v. Ritz
136 S. Ct. 1581 (2016)

Issue: Whether discharge exception for "actual fraud" under § 523(a)(2) requires misrepresentation by debtor to creditor.

Holding: Actual fraud does not require affirmative misrepresentation; as a result, fraudulent conveyances can qualify as actual fraud.

Rationale: Inclusion of "actual fraud" in Bankruptcy Code, as distinguished from requirement of "false pretenses or false representations" in Bankruptcy Act, indicates Congressional intent to distinguish actual fraud from misrepresentations. Common law includes fraudulent conveyances made to hinder, delay, or defraud creditors in concept of actual fraud.

Practical Implications:

1. What actions (other than fraudulent conveyances) that do not involve misrepresentation to creditor constitute fraud?
2. If a fraudulent conveyance creates possibility of nondischargeable debt, can every creditor claim nondischargeability as a result of the transfer such that it mimics § 727's complete denial of discharge for concealment of assets?
3. Would a fraudulent conveyance to a non-related entity also qualify for nondischargeability? Does it make a difference whether the transferor or transferee is filing for bankruptcy?
4. What is the impact on types of entities that regularly transfer money and property between entities, or between business and owners (e.g., small businesses, sole proprietorships)?

5. Will this impact chapter 11 plans under 1141(d)(6)'s provision that denies discharge to debtor for debts "of a kind specified in paragraph (2)(A) … of section 523(a) that is owed to a domestic governmental unit…."?
6. How does Uniform Voidable Transfer Act play into it, now that we are moving from UFTA to UVTA?

Current Status of Case: On remand, the 5th Circuit determined that meeting the requirements under Texas Uniform Fraudulent Transfer Act also met requirements for actual fraud nondischargeability, but remanded for findings on whether creditor established all corporate veil piercing and TUFTA elements.

Failla v. Citibank, N.A. (In re Failla)
838 F.3d 1170 (11th Cir. 2016)

Issue: Whether debtor who indicates intent to surrender real property may oppose creditor's foreclosure action.

Holding: Debtor who indicates intent to surrender real property may not oppose foreclosure action.

Rationale: Surrender is to both trustee and creditor. Holding otherwise would render § 521(a)(4), which requires surrender of all property of estate to trustee, superfluous; it would also be inconsistent with other sections that specify party to whom property is surrendered. And because surrender means giving up of one's rights, once surrendered to the creditor, the debtor cannot challenge the creditor's foreclosure.

Practical Implications:

1. Will a split arise with other Circuits? *See In re Ryan*, 2016 WL 6102312 (D. Haw. Oct. 19, 2016) (expressly disagreeing with *Failla*).
2. What happens if the trustee abandons the property and the creditor does not want it? *See Canning v. Beneficial Maine, Inc. (In re Canning)*, 706 F.3d 64 (1st Cir. 2013) (holding that surrender does not require creditor to take the property, and that refusal to take title to property does not violate discharge injunciton); *HSBC Bank USA, N.A. v. Zair*, 550 B.R. 188 (E.D.N.Y. 2016) (chapter 13 plan vested property in mortgage lienholder over lienholder's objection; court held that debtor's right to choose surrender does not allow mandatory vesting in creditor).
3. What if the defendant never formally surrendered the property? *See* Jones v. CitiMortgage, 2015 WL 11978705 (N.D. Ga. 2015) (plaintiff received discharge in 2006, with some indication of intent to reaffirm but without reaching formal

reaffirmation agreement; unsuccessfully argued that bank violated discharge injunction by foreclosing when he fell behind on payments post-bankruptcy), aff'd in relevant part in unpublished 11th Circuit opinion, 2016 WL6610208 (Nov. 9, 2016).

Bishop v. Ross Earle & Bonan, P.A.
817 F.3d 1268 (11th Cir. 2016)

Issue: Whether communications between lawyers could violate the FDCPA.

Facts: Law firm sent debt collection letter to debtor's lawyer; letter indicated ability to dispute debt, but did not mention need for it to be in writing;

Practical Implications:

1. Letter sent to attorney constituted communication with the debtor (acknowledged Circuit Split on this issue);
2. Failure to indicate need to dispute claim in writing constituted violation of FDCPA; and
3. Whether communication was "false, deceptive, or misleading" was based on least sophisticated consumer standard even if communication went to attorney (acknowledged Circuit Split on this issue).

Johnson v. Midland Funding, LLC
823 F.3d 1334 (11th Cir. 2016)

Issue: Whether the Bankruptcy Code preempts FDCPA.

Facts: Creditors purchased debt owed by debtors. The statute of limitations on collecting the debt expired four years prior to debtor's bankruptcy filing, but creditor filed a proof of claim in the case. Debtors alleged violations of FDCPA for attempting to collect uncollectible debt.

Practical Implications: Following its earlier decision in *Crawford v. LVNV Funding, LLC*, 758 F.3d 1254, 1261 (11th Cir. 2014), which had declined to determine whether the Code preempted the FDCPA, the Court determined that the Code does not preempt the FDCPA. It remanded the case to the district court. Supreme Court granted cert in October 2016 to resolve circuit split with *Dubois v. Atlas Acquisitions, LLC*, 834 F.3d 522 (4th Cir. 2016), which found that filing of time-barred proof of claim did not constitute FDCPA violation.

In re Ocean Warrior, Inc.
835 F.3d 1310 (11th Cir. 2016)

Issue: The extent of contempt powers of Bankruptcy Courts.

Facts: Civil contempt proceedings were instituted against president of corporate Chapter 7 debtor for not complying with bankruptcy court's orders, in failing to keep vessel that was debtor's sole asset in United States waters, failing to maintain insurance on vessel, and failing to deposit money into registry of court. The United States Bankruptcy Court for the Southern District of Florida awarded contempt sanctions, and president appealed. The District Court affirmed. President appealed.

Practical Implications: The Court of Appeals held that:

1. Bankruptcy court had subject matter jurisdiction over allegations of civil contempt against president of corporate Chapter 7 debtor and authority to enter a final order, not merely a proposed judgment, finding president in civil contempt;
2. Time for alleged contemnor to appeal award of sanctions by bankruptcy court did not begin to run, as to what court characterized as "interim" award, from time of entry of that award; but
3. Fee award could not include fees beyond those reasonably related to litigation and asset recovery efforts surrounding the contempt litigation.

Deutsche Bank Trust Co. Americas v. Robert R. McCormick Foundation
818 F.3d 98 (2d Cir. 2016) *petition for cert. filed* (U.S. Sept. 9, 2016) (No. 16-317)

Facts: Creditors of a Chapter 11 debtor asserted claims against former shareholders of the debtor to recover, as constructively fraudulent transfers under state law, payments they received for their stock as part of a leveraged buy-out shortly before the debtor's bankruptcy. The UCC had failed to assert such claims within the time provided under 11 U.S.C. § 546(a) and stay relief had been granted.

Holding: The claims were preempted under the implied preemption doctrine because they conflicted with the purposes of 11 U.S.C. § 546(e), which provides:

> Notwithstanding sections 544 [and] 548(a)(1)(B) ... of this title, the trustee may not avoid a transfer that is a ... settlement payment ... made by or to (or for the benefit of) a ... stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a ... stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract ... except under section 548(a)(1)(A) of this title.

Issues Raised in Petition for Certiorari:

1. Whether the presumption against the federal preemption of state law applies in the bankruptcy context;
2. Whether 11 U.S.C. § 546(e) applies to claims against non-intermediaries; and
3. Whether 11 U.S.C. § 546(e) applies to actions by creditors.

2nd Circuit's Rationale:

1. The presumption against preemption did not apply because the circumstances did not raise concerns about federal intrusion into traditional state law domains: the creditors' claims were preempted when the pending bankruptcy case was filed, they were vested in the trustee under § 544 and they could only be asserted thereafter under federal authority. Moreover, § 546(e) was intended to protect securities markets, which are the subject of extensive federal regulation.
2. The language of § 546(e) covers all transfers by or to financial intermediaries that are "settlement payments" or in connection with a securities contract, and transfers in which either the transferor or the transferee is not such an intermediary are "clearly included in the language." [Following the 3rd, 6th, and 8th Circuits; contrary to the 7th and 11th Circuits].
3. The meaning of § 546(e) with respect to the creditors' rights to bring the claims was not clear because (i) when the bankruptcy case was filed, the claims vested in the trustee under § 544, (ii) the trustee was prohibited from bringing the claims under § 546(e), (iii) there is no support for the proposition that the claims, having been "diminished" in the hands of the trustee, would revert to the creditors undiminished after the expiration of the limitations period under § 546(a) and (iv) to the contrary, trustees' attempts to enforce intentional fraud claims would be undermined if creditors could bring constructive fraud claims based upon the same transfers.

Because § 546(e) is ambiguous, its effect must be determined through an examination of its language, legislative history and purpose. Based upon all of the language of § 546(e), rather than an isolated focus on the word "trustee," as well as the purpose of § 546(e) to protect securities

markets by promoting finality and certainty for investors, Congress intended to protect all transfers by debtors that fall within § 546(e)'s terms from constructive fraudulent conveyance claims.

Practical Implications: The 2nd Circuit's holding would bar virtually any theory individual creditors might use to pursue constructive fraudulent transfer claims against shareholders in connection with LBOs.

U.S. Bank N.A. v. The Village at Lakeridge, LLC (In re The Village of Lakeridge, LLC)
814 F. 3d 993 (9th Cir. 2016) *petition for cert. filed* (U.S. June 15, 2016) (No. 15-1509)

Facts: LLC which owned the debtor sold its unsecured $2.76 million claim for $5,000 to an individual with close personal and business relationships with one of the LLC's board members who later voted in favor of confirmation. The LLC did not market the claim to anyone else, the assignee did not research the value of the claim, the parties did not negotiate the price and the assignee declined an offer from another creditor to purchase the claim for $60,000 (although the debtor agreed to amend the plan so that the assignee's distribution equaled the amount of that offer).

Holding: The assignee was neither a statutory insider nor a non-statutory insider and the assignment was not made in bad faith.

Issues Raised in Petition for Certiorari:

1. Whether the assignee of an insider's claim acquires the original claimant's insider status;
2. Whether the appropriate standard of review for determining non-statutory insider status is de novo or clearly erroneous; and
3. Whether the proper test for determining non-statutory insider status requires the bankruptcy court to conduct an "arm's length" analysis or to apply a "functional equivalent" test looking for factors comparable to those of statutory insiders.

9th Circuit's Rationale:

1. Insider status pertains only to the creditor, not the claim; an assignee does not become an insider by purchasing a claim from an insider. Rather, to be a statutory insider, a claimant must fall within one of the categories listed in 11 U.S.C. § 101(31).

2. The bankruptcy court's finding that the assignee was not a non-statutory insider was a factual determination and was not clearly erroneous.
3. The bankruptcy court applied the proper standard—a creditor is a non-statutory insider if (i) the closeness of its relationship with the debtor is comparable to one of the statutory classifications and (ii) the relevant transaction was not negotiated at arm's length.

Practical Implications: Lakeridge could increase efforts by debtors to confirm plans by assigning insider claims to friendly non-insiders who will vote for the plan.

Czyzewski v. Jevic Holding Corp.
787 F.3d 173 (3d Cir. 2015), *cert. granted* 136 S. Ct. 2541 (2016).

Issue: Whether a bankruptcy court may authorize a distribution of settlement proceeds that violates the priority scheme established by the Bankruptcy Code, over the objection of priority creditors whose rights are impaired by the proposed distribution.

Facts: As part of a structured dismissal of an administratively insolvent Chapter 11 case, the Bankruptcy Court approved the settlement of fraudulent transfer claims. The settlement provided for distribution of the settlement proceeds to pay administrative claims and general unsecured claims. A certified class of employees holding priority wage claims objected to the settlement and distribution.

Practical Implications:

1. Will the Supreme Court opine on the propriety of structured dismissals, or limit its holding to the narrow issue of whether the Bankruptcy Court may approve a settlement that provides for the distribution of estate assets in a manner that is inconsistent with Section 507 of the Bankruptcy Code.
2. Potential impact of any decision on plans that provide for "gifting."
3. The extent to which the Bankruptcy Court's discretion in approving multiparty settlements may be circumscribed.

In re Motors Liquidation Co.
829 F. 3d 135 (2d Cir. 2016), rehearing denied (2d Cir. Sept. 16, 2016)

Issue: Whether successor liability of known claimants that do not receive notice by mail of an asset sale free and clear may be asserted against the asset purchaser.

Background: Old GM sold substantially all of its assets to New GM free and clear of liens, claims, and interests, pursuant to a sale order entered in 2009. In 2014, New GM issued a recall of cars manufactured since 2002 that included a defective ignition switch that caused the cars to turn off unexpectedly during operations. The evidence presented showed that Old GM had known about the defective ignition switches since 2002.

Pursuant to the asset purchase agreement, New GM agreed to assume the following liabilities: repair of defective ignition switches, warranty service on vehicles purchased from Old GM, and damages arising from any post-sale accidents causing injury, death, or property damage. After the recall, several categories of class actions were filed against New GM seeking to impose successor liabilities: (a) personal injury and property damages for pre-closing accidents; (b) economic losses (such as decreased resale value and time and expenses associated with replacement of the defective switch); (c) claims based upon post-closing conduct by New GM; and (d) claims by post-sale purchasers of used cars that were manufactured pre-sale. New GM sought the entry of an order of the Bankruptcy Court enforcing the ”free and clear” provision of the sale order. The Second Circuit held that the claims in categories (c) and (d) were not ”Claims” covered by the free and clear provisions of the sale order either because they did not result from pre-petition conduct of Old GM (category (c) claims) or because there was not a contact or relationship between Old GM and the claimant (category (d) claims). The Second Circuit further held that although the claims in categories (a) and (b) were ”Claims” that could be eliminated by a ”free and clear” sale order, the claims were not barred by the sale order because the claimants

were known claimants, who did not receive actual notice of the sale by mail. Due process requires that know claimants receive mail notification of a proposed sale free and clear; notice by publication does not suffice. The Second Circuit further held that the ignition switch claimants were not required to prove prejudice as a result of the lack of notice, but concluded that the claimants were, in fact, prejudiced by the lack of notice. Although the defective ignition switch claimants may not have any legal objections to the sale that were different that those raised by other claimants and overruled by the Bankruptcy Court, the ignition switch claimants were prejudiced by the lack of actual notice because they were deprived of the opportunity to negotiate specifically for their claims during the sale process. The Second Circuit has denied rehearing. New GM filed a petition for writ of certiorari in late December, which is not yet available online.

Practical Implications:

1. The Chamber of Commerce of the United States of America in its amicus brief in support of rehearing expressed concerns that "the Panel's requirement that debtors catalogue all speculative theories of liability against them and provide direct-mail notice of those hypothetical liabilities to any potential plaintiff would place an enormous and unworkable burden on Chamber members." The cost of mail notice to the ignition switch claimants would have been in the millions of dollars.
2. From the standpoint of a prospective purchaser, the potential for post-sale liability to undisclosed potential claimants who do not receive mail notice will undoubtedly depress the purchase offers for sales of substantially all of a Debtor's assets.
3. Do "known" claimants that do not receive actual notice of the sale receive a windfall, especially in cases such as GM where they have publication notice of the widely

publicized sale. *See In re Transworld Airlines, Inc*., 322 F.3d 283, 292 (3d Cir. 2003) (permitting a tort claimant to proceed against a bona fide purchaser in an asset sale, while restricting other creditors to the proceeds of sale, is contrary to the Bankruptcy Code's priority scheme). The facts in GM were particularly egregious with respect to Old GM's awareness of the ignition switch defect since 2002. It is unclear whether New GM had knowledge or notice of the ignition switch defect as a result of its pre-sale due diligence.