**BANKRUPTCY UPDATE**
October 2014

# Recent Developments in Bankruptcy Law

(Covering cases reported through 514 B.R. 719 and 756 F.3d 555)

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# 1. AUTOMATIC STAY

## 1.1 Covered Activities

**1.1.a. Creditor's action against fraudulent transfer defendants based on independent claims does not violate the stay.** Funds that had invested in a Ponzi scheme collapsed when the Ponzi scheme was uncovered and the debtor filed bankruptcy. The funds' investors sued the funds and their managers for securities law violations, fraud, and other common law claims. The bankruptcy trustee sued the funds to avoid and recover fraudulent transfers. When the investors settled with the funds and their managers, the trustee sued to enjoin the settlements, claiming an automatic stay violation. The automatic stay enjoins actions against the debtor on account of a prepetition claim, any act to obtain possession or exercise control over property of the estate, or any act to collect or recover a prepetition claim against the debtor. A fraudulent transfer claim requires a claim against the debtor and therefore is an action on account of and to collect and recover a prepetition claim. Therefore, a creditor's fraudulent transfer claim violates the automatic stay. Here, the investors' claims against the funds and their managers are independent of any claims they might have against the debtor and therefore are not disguised fraudulent transfer claims. An action that adversely affects property of the estate also violates the stay's injunction against obtaining possession of or exercising control over property of the estate, but only if the effect is inevitable, such as if the effect occurs by operation of law, not where the effect is only likely as a factual matter. Although the investors' actions against and settlements with the managers might prevent the defendants from satisfying any judgment that the trustee might receive against them, this effect is not sufficiently inevitable to constitute a stay violation. Therefore, the court dismisses the trustee's action to enjoin the settlements. *Picard v. Fairfield Greenwich Limited*, 762 F.3d 199 (2d Cir. 2014).

**1.1.b. Withholding exempt bank account balance does not violate the stay.** The debtor filed a chapter 7 petition. The bank where the debtor maintained deposits learned of the bankruptcy, froze the debtor's accounts and three days after the petition date sent a letter to the trustee advising that the balances were "in bankruptcy status" and would remain so until receipt of the trustee's direction or until the time for objecting to exemptions expired (30 days after the section 341 meeting) and requesting instructions on where to send the account balances. The same day, the bank sent a letter to debtor's counsel advising of its actions. The bank was not a creditor and so did not assert a setoff right. The debtor did not claim the account balances as exempt in the schedules filed with the petition but amended his exemption claim 5 days after the date of the letter to claim 75% of the account balances as exempt. The debtor brought an action against the bank for damages for an automatic stay violation. Property that the debtor claims as exempt first becomes property of the estate and remains such at least until the trustee abandons it or sets it aside as exempt or the deadline for an exemption objection expires. Section 362(a)(3) stays any act to exercise control over property of the estate but not over property of the debtor. Where an asset is exempt without regard to value, it revests in the debtor immediately upon the expiration of the period to object to exemptions. But if the asset is exempt only to the extent of a certain value, the debtor's interest up to that value revests in the debtor, but title to the property does not revest until it is abandoned or otherwise administered. Here, the property revested in the debtor upon the objection period's expiration. Until then, it was property of the estate. The bank did not violate the stay because it offered the property to the trustee and sought direction on its disposition, which the trustee did not provide. Once the property became property of the debtor, the automatic stay no longer applied. Therefore, the bank did not violate the stay. *Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi)*, 764 F.3d 1168 (9th Cir. 2014).

**1.1.c. Automatic stay does not apply to prepetition contempt proceeding.** Before bankruptcy, the debtor violated a discovery order in a state court action. The state court imposed a sanction against him, which the debtor did not pay. The court issued an order to show cause why the debtor should not be held in contempt. Before the hearing, the debtor filed bankruptcy. The state court ordered the plaintiff to file a brief on the applicability of the automatic stay, which it did, and ordered the debtor to respond. Before the response deadline, the debtor filed a bankruptcy court proceeding to sanction the plaintiff for a stay violation. Section 362(a) stays the continuation of a proceeding to collect a prepetition debt. However, under *David v. Hooker Ltd.*, 560 F.2d 412 (9th Cir. 1977), the stay does not apply to a contempt

proceeding against the debtor whose purpose is to vindicate the court's authority rather than to collect the underlying debt. Here, the contempt proceeding was solely to vindicate the court's authority with respect to the award of discovery sanctions, not to collect the underlying debt the debtor owed to the plaintiff. Therefore, the stay did not apply, and the plaintiff was not in contempt. *Yellow Express, LLC v. Dingley (In re Dingley)*, 514 B.R. 591 (9th Cir. B.A.P. 2014).

**1.1.d. Automatic stay does not prevent collection of criminal restitution from the estate.** The debtor was subject to a criminal restitution order in favor of the United States. The debtor exempted property from the estate, but there was other property of the estate. The automatic stay prohibits any act to obtain property of or from the estate. Section 3613 of title 18 provides, "[n]otwithstanding any other Federal law … a judgment imposing [restitution] may be enforced against all property or rights to property of the person [ordered to pay restitution]." Section 3613 supersedes conflicting laws. Although property of the estate is not property of the debtor, section 3613's intent shows that it is intended to override any protection to property that a section 541(a) transfer of a debtor's property to the estate would create. Therefore, the United States may pursue its claim against property of the debtor. *U.S. v. Robinson*, 764 F.3d 554 (6th Cir. 2014).

**1.1.e. Section 362(b)(3) stay exception requires creditor to have prepetition interest in property.** Subcontractors provided the debtor contractor with goods and services before bankruptcy. After bankruptcy, they sought to perfect their mechanics' and materialmen's liens on amounts owed to the contractor by its customers. Section 362(a)(4) stays any "act to create, perfect, or enforce any lien against property of the estate." Section 362(b)(3) excepts from the stay "any act to perfect … an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b)." Section 546(b) subjects the trustee's rights and powers to applicable law that "permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection …." "Interest in property" is a broader concept than a lien, which is an interest that secures payment or performance of an obligation. Sections 362(b)(3) and 546(b) require an interest in property as of the petition date. Here, applicable state law granted the mechanics and materialmen unperfected liens, which are interests in property, upon supplying goods or services. Therefore, section 362(b)(3) applied, and the automatic stay exception permitted the creditors to perfect their liens. *Branch Banking & Trust Co. v. Construction Supervision Servs., Inc. (In re Construction Supervision Servs., Inc.)*, 753 F.3d 124 (4th Cir. 2014).

### 1.2 Effect of Stay

### 1.3 Remedies

## 2. AVOIDING POWERS

### 2.1 Fraudulent Transfers

**2.1.a. Court determines whether a fraudulent transfer action is for the benefit of the estate as of the petition date.** Before bankruptcy, the debtor settled litigation against its insurer. The state court approved the settlement. After bankruptcy, the debtor in possession sued the insurer to avoid the settlement as a fraudulent transfer. The debtor confirmed a plan that paid all creditors, other than asbestos claimants, in full. The plan created a trust for the benefit of the asbestos claimants and assigned the fraudulent transfer action to the trust. Section 550(a) permits the debtor in possession to recover an avoided transfer "for the benefit of the estate." The estate is broader than the interests of unsecured creditors. It includes all interests in the case. The court must determine whether a fraudulent transfer claim is for the benefit of the estate as of the petition date, not after confirmation, because the claim's potential value often factors into a plan. Here, where the plan did not fully fund the asbestos claimants' trust, the fraudulent transfer action is for the benefit of the estate. In addition, the state court order approving the settlement does not prevent a fraudulent transfer action. *Mt. McKinley Ins. Co. v. Lac D'Amiante Du Quebec Ltee (In re Asarco LLC)*, 513 B.R. 499 (S.D. Tex. 2014).

**2.1.b. Ponzi scheme interest payments to net winners are recoverable under UFTA.** The debtor operated a Ponzi scheme in which it issued certificates of deposit with fixed interest rates to innocent

investors. The SEC obtained the appointment of a federal district court receiver, who sued net winners under UFTA to recover the amount they received that exceeded their investments. UFTA permits a creditor to recover a transfer that the debtor made with actual intent to hinder, delay, or defraud creditors, but the transferee may retain the transfer to the extent that the transfer was received for value and in good faith. Because the debtor's principals dominated and controlled the debtor against the debtor's interest, the court deems the principals as the transferor for UFTA purposes and the debtor the creditor, thereby giving the receiver standing to bring the actions on the debtor's behalf. Proof of a Ponzi scheme creates an irrebuttable presumption that the transfer was made with actual intent to defraud creditors. A promise to pay interest, rather than profits on an investment, might create a claim against the debtor, thereby supporting a "for value" defense. However, enforcing the claim would not result in payment from the debtor's assets but would decrease the recovery of other, less fortunate investors. Therefore, the interest claim is unenforceable as against public policy, and the interest payments are avoidable under UFTA. *Janvey v. Brown*, 767 F.3d 430 (5th Cir. 2014).

### 2.2 Preferences

### 2.3 Postpetition Transfers

**2.3.a. Section 544(b) does not apply to a postconfirmation transfer.** The debtor confirmed a chapter 11 plan that provided for payments from rental income on real estate valued at $1.2 million. Shortly after confirmation and revesting of the property in the debtor, the debtor sold the property for $3.2 million and diverted most of the proceeds to his personal use. The bankruptcy court converted the case to chapter 7. The trustee sued the purchaser to avoid the transfer as a fraudulent transfer under section 544(b), which provides, "the trustee may avoid any transfer of an interest of the debtor in property … that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 …." Because the property had revested in the debtor, the transfer was a transfer of an interest of the debtor in property. Section 544(b) does not include any limitation on the trustee's power based on when a transfer is made. However, section 544(a) grants the trustee's strong-arm power "as of the commencement of the case." Although subsection (b) might have a different temporal limitation, its placement in the same section as subsection (a) and section 549's express postpetition transfer avoiding power suggest that subsection (b) is limited to prepetition transfers. Section 544(b)'s statute of limitation runs from the petition date, unlike section 549's, which runs from the transfer date. Therefore, section 544(b) applies only to prepetition transfer of the debtor's property. *Casey v. Rotenberg (In re Kenny G Enterps., LLC)*, 512 B.R. 628 (C.D. Cal. 2014).

### 2.4 Setoff

### 2.5 Statutory Liens

### 2.6 Strong-arm Power

### 2.7 Recovery

**2.7.a. Recovery judgment brings fraudulently transferred property into the estate.** A corporate debtor in possession obtained a judgment against one of its former principals avoiding and recovering a cash payment fraudulent transfer. After the court entered judgment but before the debtor in possession collected, the principal transferred the cash to a Cook Islands asset protection trust. Before the corporate estate could collect on the judgment, the principal filed his own bankruptcy case, triggering the automatic stay against recovery of property of his estate. Property of the estate includes "the following property, wherever located and by whomever held (1) … all legal or equitable interests of the debtor in property as of the commencement of the case … (3) any interest in property that the trustee recovers under section … 550 …." The circuits are split on whether fraudulently transferred property becomes property of the estate under paragraph (1) upon the commencement of the case or under paragraph (3) upon recovery. Under the latter view, the court must determine when the trustee recovers property. The trustee need not possess the property to have recovered it. Recovered property is property of the estate "wherever located and by whomever held." The recovery judgment entitled the trustee to the fraudulently transferred property, even though not in the trustee's possession, making it property of the corporate estate, not of the principal's estate. The principal's automatic stay therefore did not apply, and the debtor in possession could continue to pursue the property from the Cook Islands trust. *In re Allen*, ___ F.3d ___, 2014 U.S. App. LEXIS 18624 (3d Cir. Sept. 26, 2014).

**2.7.b. A conduit is never an entity for whose benefit a transfer is made.** An agency agreement between the insurance agent and the insurer required the agent to hold any premiums it received in a separate account, in trust for the insurer, but also made the agent liable to the insurer for all premiums for policies that it wrote, whether or not the insured paid the agent the premium. The debtor paid insurance premiums to the agent within 90 days before bankruptcy. The trustee sued to avoid and recover the payments. Section 550(a)(1) permits the trustee to recover an avoided transfer from the initial transferee or from an entity for whose benefit a transfer is made. A mere conduit—one who does not have legal control over transferred property—is not liable as an initial transferee. One who is contingently liable to a third party for the debtor's obligation is a beneficiary of the debtor's transfer to the third party to satisfy the obligation. A conduit who fails to pass on funds to the initial transferee is always contingently liable to the initial transferee and would therefore always be an entity for whose benefit the transfer was made. Adopting such a rule would effectively erase the conduit defense. Since that remains a good defense, the court concludes that a conduit is never liable as an entity for whose benefit a transfer is made and dismisses the action against the agent. *Guttman v. Construction Program Group (In re Railworks Corp.)*, 760 F.3d 398 (4th Cir. 2014).

**2.7.c. Defendant in a recovery action may litigate avoidability only as an affirmative defense.** The trustee obtained a default judgment avoiding a postpetition transfer under section 549 and then sued under section 550 for recovery from a subsequent transferee, who claimed that the trustee needed to plead and prove the initial transfer's avoidability. Avoidance and recovery are separate concepts and claims. Section 550(a) permits a trustee to recover an "avoided" transfer, making prior avoidance an element of the trustee's standing and recovery cause of action. Moreover, section 550(f) imposes on the trustee a statute of limitations of one year after avoidance. If a recovery defendant could defend on avoidability grounds, then he could assert any defense to avoidability, including the avoiding power statute of limitations, which would moot section 550(f). Rule 7019 requires joinder of a person if the court cannot grant complete relief among the existing parties in the person's absence or if the person claims an interest relating to the action and resolving the action in the person's absence may impair his ability to protect the interest or leave an existing party subject to a substantial risk of inconsistent obligations. The court may grant complete relief in an avoidance action between the trustee and the initial transferee without the subsequent transferee's presence or without subjecting either party to inconsistent obligations. Resolving the avoidance action does not impair the subsequent transferee's ability to protect his interest, because section 550(b) allows him to defend if he took for value, in good faith, and without knowledge of the voidability of the transfer. If he can show that the transfer was not avoidable, then he could not have had knowledge of voidability. Thus, non-avoidability is an affirmative defense, not part of the trustee's case in chief. *Tibble v. Farmers Grain Express (In re Mich. Biodiesel, LLC)*, 510 B.R. 792 (Bankr. W.D. Mich. 2014).

## 3. BANKRUPTCY RULES

## 4. CASE COMMENCEMENT AND ELIGIBILITY

### 4.1 Eligibility

### 4.2 Involuntary Petitions

**4.2.a. Limited liability partnership is not a general partnership.** A partner in a limited liability partnership filed an involuntary petition against the partnership. Section 303(b)(3) permits a general partner to file an involuntary petition against a general partnership. Section 101(9)(A)(ii) defines "corporation" to include a "partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association." The Bankruptcy Code treats the terms corporation and partnership as mutually exclusive: if an association is a corporation, it is not a general partnership. Applicable nonbankruptcy law determines whether an association's partners or members are liable for the association's debts, but labels are not determinative. Here, applicable nonbankruptcy law protects the LLP's partners from personal liability for the LLP's debts. Therefore, the LLP is a corporation for Bankruptcy Code purposes, and its "partners" are not general partners as that term is used in section

303(b)(3). Therefore, the court dismisses the involuntary petition. *In re Beltway Law Group, LLP*, 514 B.R. 341 (Bankr. D.D.C. 2014).

### 4.3 Dismissal

## 5. CHAPTER 11

### 5.1 Officers and Administration

### 5.2 Exclusivity

### 5.3 Classification

### 5.4 Disclosure Statements and Voting

### 5.5 Confirmation, Absolute Priority

## 6. CLAIMS AND PRIORITIES

### 6.1 Claims

**6.1.a. Trustee may not settle claims to which a creditor's objection is pending.** A creditor objected to another creditor's proof of claim. The trustee settled with the claiming creditor and moved under Rule 9019 for approval. The objecting creditor objected to the settlement. Under section 502(b), the objecting creditor, as a party in interest, has standing to object to another creditor's claim. Approval of the settlement would deprive the objecting creditor of his standing to object to the other creditor's claim and moot the objection. Therefore, the court denies the settlement motion. *In re The C.P. Hall Co.*, 513 B.R. 540 (Bankr. N.D. Ill. 2014).

**6.1.b. Section 506(b) fee limitations apply to nonbankruptcy foreclosure sale following stay relief.** The secured lender's real property deed of trust authorized nonjudicial foreclosure and payment of trustee fees of 5% of the amount bid at the foreclosure sale and of the lender's attorneys' fees. The lender received stay relief to permit foreclosure under state law. The trustee conducted the foreclosure sale, realizing a surplus over the principal and interest owing and the fees. Section 506(b) allows to an oversecured creditor "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement … under which such claim arose." Stay relief does not constitute abandonment, so the real property remained property of the estate until sold, and the sale proceeds were property of the estate. Therefore, section 506(b) applies, even though the foreclosure sale occurred under nonbankruptcy law, and the bankruptcy court may determine whether the fees are reasonable and should be allowed. *Wells Fargo Bank, N.A. v. 804 Congress, L.L.C. (In re 804 Congress, L.L.C.)*, 756 F.3d 368 (5th Cir. 2014).

### 6.2 Priorities

**6.2.a. Section 510(a) trumps section 726(a)(3).** An agreement between the senior note indenture trustee and the junior note trustee subordinated the junior note claims to the senior note claims. The junior note trustee filed a claim before the bar date; the senior note trustee filed a claim long after the bar date. Section 726(a) specifies the priority of payments: timely filed allowed claims are paid before untimely filed claims. But section 510(a) requires the court to enforce a subordination agreement. Applicable nonbankruptcy law in this case enforces a waiver of a subordination agreement only if the waiver was knowing, voluntary, and intentional. Filing a claim after the bar date does not meet that standard. Section 726(a)(3) permits distribution on a late-filed claim, so it does not require subordination of a late-filed senior claim if the parties have agreed otherwise. Therefore, the trustee must pay the senior claim. *Bank of N.Y. Mellon Trust Co., N.A. v. Miller (In re Franklin Bank Corp.)*, ___ B.R. ___, 2014 U.S. Dist. LEXIS 98327 (D. Del. July 21, 2014).

**6.2.b. Claim for damages resulting from debtor's default in purchasing parent's unsecured bond is subordinated to unsecured claims against debtor.** The parent's broker-dealer subsidiary agreed to

purchase the parent's general unsecured bonds from an investor. Before settlement, the parent filed bankruptcy, and the broker-dealer did not complete the purchase. A SIPA proceeding for the broker-dealer was commenced days later. The investor filed a claim in the SIPA proceeding. Section 510(b) subordinates a claim "for damages arising from the purchase or sale" of such a security of the debtor or of an affiliate of the debtor "to all claims or interests that are senior to or equal to the claim or interest represented by such security." "Arising from" implies a causal relationship between the claim and a purchase or sale but does not require an actual purchase or sale, if the claim arises from a failed purchase or sale. Therefore, section 510(b) applies to the claim. The section separately refers to the underlying security and the claim or interest represented by the security. It does not tie subordination to a security within the debtor's capital structure, only to the level of a security within the capital structure. Here,the claim "represented by" the security is the bond claim against the parent, which is a general unsecured claim. Therefore, the investor's claim against the broker-dealer is subordinated to general unsecured claims against the broker-dealer. *In re Lehman Brothers Inc.*, ___ B.R. ___ (S.D.N.Y. Sept. 5, 2014).

**6.2.c. Securities of a debtor-sponsored securitization vehicle are not securities "of" the debtor under section 510(b).** The debtor created, funded, and marketed the certificates of a mortgage-backed securitization trust. Under the Securities Act of 1933, those functions make the debtor the "issuer." However, the prospectus for the certificates made clear that the trust and the mortgages it held were the sole payment source of the certificates, which did not represent any obligation of or interest in the debtor. A holder of trust certificates filed a claim against the debtor alleging misrepresentation under the Securities Act. Section 510(b) subordinates the claim of a creditor arising from the purchase or sale "of a security of the debtor or of an affiliate of the debtor." This provision prevents an investor who takes debt or equity risk of the debtor from elevating a claim above the level of the investor's security. The certificates here do not involve any debt or equity risk of the debtor or any part of the debtor's capital structure, only risk of the mortgage pool that backs the trust. Accordingly, they are not "securities of the debtor or of an affiliate of the debtor." Their status under the Securities Act and the "issuer" label the Securities Act places on the debtor are for regulatory purposes and do not change the bankruptcy law analysis. *In re Lehman Bros. Holdings Inc.*, 513 B.R. 624 (Bankr. S.D.N.Y. 2014).

## 7. CRIMES

## 8. DISCHARGE

### 8.1 General

### 8.2 Third-Party Releases

### 8.3 Environmental and Mass Tort Liabilities

## 9. EXECUTORY CONTRACTS

## 10. INDIVIDUAL DEBTORS

### 10.1 Chapter 13

### 10.2 Dischargeability

### 10.3 Exemptions

### 10.4 Reaffirmation and Redemption

## 11. JURISDICTION AND POWERS OF THE COURT

### 11.1 Jurisdiction

**11.1.a. Litigation trustee is not entitled to a jury trial on avoiding power claim against creditor who filed a proof of claim.** The debtor's plan created a litigation trust to pursue avoiding power claims. The trustee sued a creditor who had filed proofs of claim on fraudulent transfers and other claims. Under section 502(d), the court must disallow the claim of a creditor who has received and not returned an avoidable transfer. The litigation is therefore part of the claims allowance process and of the restructuring of debtor-creditor relations, is equitable, and therefore does not give the creditor defendant a right to a jury trial. A debtor who invokes the bankruptcy court's jurisdiction to seek protection from creditors does not have a greater right. The litigation trustee is the representative of the estate in pursuing the avoiding power claims and therefore stands in the estate's shoes for purposes of determining a jury trial right. Because the estate does not have such a right where the creditor has filed a proof of claim, the litigation trustee does not either. *U.S. Bank N.A. v. Verizon Commc'ns, Inc.*, 761 F.3d 409 (5th Cir. 2014).

**11.1.b. Case dismissal deprives court of jurisdiction to award committee fees.** The court dismissed the chapter 11 case without condition or jurisdictional reservation and closed the case. A short time later, committee counsel filed a compensation application. Committee counsel compensation is payable only under section 330, and compensation payable under section 330 is payable only from the estate. Case dismissal revests property of the estate in the debtor, unless the court orders otherwise. Without an estate, the court cannot order payment of compensation from the estate. Any order would be only advisory. A federal court may not issue an advisory opinion. Therefore, the court may not consider the fee application. *In re Sweports, Ltd.*, 511 B.R. 522 (Bankr. N.D. Ill. 2014).

### 11.2 Sanctions

### 11.3 Appeals

**11.3.a. Missing a nonjurisdictional appeal deadline does not require dismissal of the appeal.** The appellant filed a motion for reconsideration under Civil Rule 59(e) 23 days after losing a bankruptcy appeal at the district court. The district court denied the motion. The appellant filed its notice of appeal to the court of appeals 51 days after the initial adverse district court ruling. The appellee did not object to the timeliness of the notice of appeal, but the court of appeals ordered briefing on the timeliness issue. The court of appeals must dismiss an appeal if the notice of appeal was filed after a jurisdictional deadline for filing a notice of appeal, but not if the deadline is only a claims processing rule. A deadline is jurisdictional if it is statutory, because only Congress may define a federal court's jurisdiction. A judge-made rule is not jurisdictional. Appellate Rule 6(b) applies Appellate Rule 4(a) to an appeal from a district court's decision in a bankruptcy appeal. Appellate Rule 4(a) is reflected in 28 U.S.C. § 2107, but Appellate Rule 6(b) is not statutory and therefore not jurisdictional. A motion for rehearing under Bankruptcy Rule 8015, which must be filed within 14 days after entry of judgment, suspends the time for filing a notice of appeal, but in a bankruptcy appeal, a motion for reconsideration under Civil Rule 59(e) does not, because Appellate Rule 6(b) makes Appellate Rule 4(a)(4) (which suspends the time for appeal after a Rule 59 motion) inapplicable in bankruptcy appeals. In this case, even if the appellant had filed its motion under Rule 8015, it would have been untimely and therefore would not have extended the time for the notice of appeal to the court of appeals. Because Appellate Rule 6(b) is not jurisdictional, any timeliness objection is forfeited if not timely raised. Appellee did not raise the issue, the objection is forfeited, and the court does not dismiss the appeal. *Tze Wung Consultants, Ltd. v. Bank of Baroda (In re Indu Craft, Inc.)*, 749 F.3d 107 (2d Cir. 2014).

**11.3.b. Order denying stay relief is not necessarily a final order.** The debtor's counterparty sued the debtor in Virginia. The debtor sued the counterparty in Puerto Rico. Each counterclaimed, and the counterparty asked the Virginia court to stay the Puerto Rico litigation under the "first to file" rule. Before the court ruled, the debtor filed a chapter 7 case in Puerto Rico. The bankruptcy court granted stay relief to allow the Puerto Rico action—claim and counterclaim—to proceed to judgment. The counterparty sought stay relief to allow the Virginia court to decide the first to file issue. The bankruptcy court denied stay relief without prejudice, and the counterparty appealed. Section 158(d)(1) gives the court of appeals jurisdiction over "final decisions, judgments, orders, and decrees." In bankruptcy, courts treat finality flexibly, because of the multiple "proceedings within a proceeding" nature of a case. Thus, an order

granting stay relief is final and appealable, because it resolves a discrete dispute within the case. Nothing more need be done on the stay. However, an order denying stay relief, especially one without prejudice, might not resolve a discrete, fully-developed issue that is not reviewable elsewhere. Here, the discrete issue was the first to file issue. The bankruptcy court did not resolve that issue by denying stay relief but deferred to the Puerto Rico court to address it. Once it does, the counterparty might seek stay relief again, on a more fully developed record. Therefore, the denial was not a final order. The court dismisses the appeal, over a strong dissent and the different views of seven other circuits. *Pinpoint IT Servs., LLC v. Landrau Rivera (In re Atlas IT Export Corp.)*, 761 F.3d 177 (1st Cir. 2014).

**11.3.c. Adversary defendant is not a "person aggrieved" by an order that requires him to defend litigation.** The debtor's confirmed plan established a litigation trust and imposed a deadline on actions it could bring. After the deadline, the debtor modified the plan to extend the deadline. Because the plan had not been substantially consummated, the court permitted the modification and confirmed the modified plan. A former creditor (one who had withdrawn his proof of claim) appealed. Only a "person aggrieved" may appeal a bankruptcy court order. A person aggrieved is one whom the order directly, adversely, and pecuniarily affects by diminishing his property, increasing his burdens, or impairing rights that the Bankruptcy Code seeks to protect or regulate. An order subjecting a party to litigation causes a party only indirect harm, because the party may still exercise the right to defend the litigation. Here, the only right the defendant sought to protect was to prevent being sued, based on a provision of the superseded plan, not the Bankruptcy Code. Therefore, he is not a person aggrieved. *Atkinson v. Ernie Haire Ford, Inc. (In re Ernie Haire Ford, Inc.)*, 764 F.3d 1321 (11th Cir. 2014).

**11.3.d. Section 364(e) statutory mootness does not apply to non-estate collateral.** Vantage sued Su for fraud to impose a constructive trust on and recover Vantage shares that it had issued to Su and that Su had transferred to his wholly-owned corporation F3. While the litigation was pending, Su caused other wholly-owned corporations to file chapter 11 cases. The bankruptcy court ordered that Su deposit the Vantage shares *in custodia legis* to secure compliance by the debtors in possession with bankruptcy court orders and to secure DIP financing. The order did not transfer title to the estates and permitted F3 to retain all voting rights in the shares. The DIPs then sought financing secured by the Vantage shares, which the bankruptcy court approved over Vantage's objection. Vantage appealed. Section 364(e) provides, "The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity" of the debt or lien "to an entity that extended such credit in good faith" unless the order were stayed pending appeal. "Good faith" requires giving value, in good faith, and without notice of adverse claims and the absence of fraud, collusion, and any attempt to take grossly unfair advantage of other bidders. Here, the DIP lender knew of Vantage's adverse claim to the Vantage shares, defeating the lender's good faith, so the appeal may affect its lien on the Vantage shares and is therefore not moot. The bankruptcy court has "related to" jurisdiction over a proceeding that could conceivably have an effect on the estate or property of the estate. Section 541(a)(7) includes as property of the estate "[a]ny interest in property that the estate acquires after the commencement of the case." However, its reach is limited to property that is traceable to property of the estate or generated in the ordinary course of the debtor's business. Here, the Vantage shares remained F3's property, were not derived from property of the estate, and did not, by reason of the deposit order, become property of the estate. Otherwise, the bankruptcy court could create "bootstrap jurisdiction" simply by ordering non-estate property to be deposited with the court. Therefore, the bankruptcy court did not have subject matter jurisdiction to order a lien on the Vantage shares for the DIP lender. Finally, the prepetition Vantage litigation could not have any conceivable effect on the estate, because it did not affect any property of the estate or any debtor, only the debtors' shareholder. Therefore, the bankruptcy court could not resolve the dispute over ownership of the Vantage shares. *TMT Procurement Corp. v. Vantage Drilling Co. (In re TMT Procurement Corp.)*, 764 F.3d 512 (5th Cir. 2014).

### 11.4 Sovereign Immunity

## 12. PROPERTY OF THE ESTATE

### 12.1 Property of the Estate

### 12.2 Turnover

### 12.3 Sales

**12.3.a. Trustee may sell fully encumbered property only under an approved carve-out agreement.** The trustee determined that the secured lender's lien was valid and proposed to abandon the collateral. The lender asked the trustee to sell the collateral under section 363 in exchange for half the proceeds. The trustee agreed and sought bankruptcy court approval. Generally, a trustee should not sell fully encumbered property, because there is no benefit to the estate, and there is a risk that the estate could incur unnecessary expense or that a trustee would sell only to increase her fees, not unsecured creditor recoveries. However, a carve-out agreement is permissible if it will result in a meaningful distribution on unsecured claims. The court must review such an agreement under a heightened scrutiny standard, because of the risk of abuse, and there is a presumption against approval. A trustee may overcome the presumption if the trustee fulfilled her basic duties, there is a prospect for meaningful recovery on unsecured claims, and the trustee makes full disclosure. Here, the trustee fulfilled her duties by determining the validity of the creditor's lien and fully disclosed the proposed agreement to the bankruptcy court. The BAP remands for the bankruptcy court to determine whether the agreement will result in meaningful recoveries on unsecured claims. *In re KVN Corp., Inc.*, 514 B.R. 1 (9th Cir. B.A.P. 2014).

**12.3.b. Counterclaim against secured lender is not grounds to disallow credit bidding.** The debtor in possession moved for authority to sell property of the estate that was encumbered by a valid lien securing an allowed claim. In connection with the sale motion, the DIP brought a counterclaim against the lender on issues not related to the claim's allowability but which could give rise to a setoff against the claim. Section 363(k) permits the holder of an allowed secured claim to credit bid at a sale of property of the estate, "unless the court for cause orders otherwise." A bona fide dispute over the claim's allowability might provide a ground to deny credit bidding, because a successful credit bid might result in the creditor's recovering property of the estate without a valid secured claim. Here, the claim was allowed, and the only dispute was over unrelated counterclaims. Therefore, the court permits the lender to credit bid at the sale. *In re Charles St. African Methodist Episcopal Church of Boston*, 510 B.R. 453 (Bankr. D. Mass. 2014).

## 13. TRUSTEES, COMMITTEES, AND PROFESSIONALS

### 13.1 Trustees

**13.1.a. *Barton* doctrine does not apply to counterclaim against the trustee in the appointing court.** The defendants in an action by the trustee filed a counterclaim against the trustee for breach of duty and willful misconduct. *Barton v. Barbour*, 104 U.S. 126 (1881), deprives a court of jurisdiction over an action against a bankruptcy trustee brought without leave of the appointing court. By its terms, *Barton* applies to an action in a different court. Where the action is brought in the appointing court, the appointing court can exercise adequate supervision over the action to protect the trustee and the estate to the extent appropriate. Finally, it would be a waste of judicial resources to require a separate motion for leave to bring the action. Therefore, *Barton* does not prohibit the action here. *CERx Pharmacy P'ners, LP v. RPD Holdings, LLC (In re Provider Meds, LP)*, 514 B.R. 473 (Bankr. N.D. Tex. 2014).

### 13.2 Attorneys

**13.2.a. Attorney directed by state court to prepare show cause order against debtor's counsel is not entitled to absolute quasi-judicial immunity.** The debtor obtained a personal injury settlement, which his attorney placed in his client trust account. The attorney withdrew his own fees but held the balance for distribution to lien claimants to the funds. One of the lien claimants filed an interpleader action in state court but did not name the debtor or his attorney in the action. The debtor soon filed a chapter 7 case. The state court judge initially determined that a state law precedent required the debtor's attorney to deposit the funds in the state court and at a hearing asked which attorney would prepare an order to show cause to bring the debtor's attorney before the state court. The interpleader plaintiff's attorney volunteered, and the state court ordered him to do so. The debtor's attorney brought an action to hold the plaintiff's attorney in contempt for violating the automatic stay. Absolute judicial immunity insulates a court, and absolute quasi-judicial immunity its officers, from liability for judicial actions. It applies where an

exercise of judicial or quasi-judicial discretion is required. Based on this functional approach, the plaintiff's attorney is not entitled to absolute quasi-judicial immunity, because preparing a draft order has no judicial effect; the judge exercises the necessary discretion in determining whether to sign the order at all and whether to revise it. Therefore, the attorney is not entitled to immunity and is subject to sanctions for violating the stay. *Burton v. Infinity Cap. Mgmt.*, 753 F.3d 954 (9th Cir. 2014).

### 13.3 Committees

### 13.4 Other Professionals

### 13.5 United States Trustees

## 14. TAXES

**14.1.a. Section 505 does not apply to a liquidating trustee appointed under a plan.** The liquidating trustee appointed under the confirmed plan sought a refund from the U.S. of prepetition taxes by way of a counterclaim to the government's administrative expense claim. Neither the debtor in possession nor the liquidating trustee had previously filed a refund request with the IRS. A federal court lacks subject matter jurisdiction over an action against the government unless the government has waived sovereign immunity. Section 505 permits the bankruptcy court to determine the amount and legality of any tax refund claim, but only if the trustee has properly requested the refund from the government and the government has either determined the request or 120 days has elapsed. Sections 106 and 505 provide an immunity waiver, but as a jurisdictional statute, section 505 must be strictly construed. Its reference to the "trustee" includes only a trustee appointed during the case, whose rights and powers are determined by the Code, not under a plan, which determines a liquidating trustee's rights and powers independent of the Code. Therefore, section 505's immunity waiver is not available to a liquidating trustee, and the bankruptcy court is without jurisdiction to hear the refund claim, which the liquidating trustee must pursue in district court. *U.S. v. Bond*, 762 F.3d 255 (2d Cir. 2014).

## 15. CHAPTER 15—CROSS-BORDER INSOLVENCIES

**15.1.a. Section 363 applies in a chapter 15 case to a foreign representative's sale of a claim against a U.S. bankruptcy estate.** The foreign representative agreed to sell an allowed claim against a New York SIPA estate. The sale agreement was governed by New York law and was subject to the approval of the foreign court and of the bankruptcy court in the chapter 15 case. Section 1520(a)(2) provides "sections 363 … apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate." Section 1502(8) defines "within the territorial jurisdiction of the United States" to include "intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States." Under New York law, property that can be assigned or transferred is subject to attachment. The location of intangible property whose subject is a legal obligation to perform is the location of the party who is obligated to perform, here, the SIPA trustee in New York. Therefore, the SIPA claim is located in New York, and section 363 applies. Chapter 15 requires the bankruptcy court to consider comity, but the requirement is not absolute. Section 1520(a)(2)'s requirement that section 363 apply to U.S. property to the same extent as it would apply in a domestic case creates a comity exception, requiring the bankruptcy court to conduct an ordinary section 363 review of the sale agreement without deference to the foreign court. *Krys v. Farnum Place, LLC (In re Fairfield Sentry Ltd.)*, ___ F.3d ___, 2014 U.S. App. LEXIS 18427 (2d Cir. Sept. 26, 2014).