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CR&B Alert

Commercial Restructuring & Bankruptcy News

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In This Issue:

SUPREME COURT WILL DECIDE STANDARD OF REVIEW ON APPEAL IN INSIDER DISPUTE

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To confirm a plan under the cram-down provisions of the Bankruptcy Code, unsecured claims held by insiders are not counted. But what happens when a person acquires a claim from an insider? Does that person become an insider? In *U.S. Bank NA v. The Village of Lakeridge LLC*, the debtor's general partner, in an attempt to deal with the insider cram-down problem, sold its $2.8 million unsecured claim for $5,000 to a close friend of one of the owners of the general partner. The bankruptcy court held that the buyer of the claim, while not a statutory insider, became one upon purchasing the claim from a statutory insider. The Ninth Circuit disagreed and held that a person does not become a statutory insider solely by acquiring a claim from a statutory insider. Each inquiry must be looked at on a case-by-case basis, taking into account the parties' conduct. In so holding, the Ninth Circuit said that the insider issue is subject to a clearly erroneous standard of review on appeal. The Supreme Court on March 27, 2017, agreed to consider the issue of whether determining statutory insider status for plan voting purposes is subject on appeal to review under the de novo standard followed by the Third, Seventh and Tenth Circuits (giving little or no deference to the decision of the trial court), or the clearly erroneous standard of review followed by the Ninth Circuit in this case (giving significant deference to the decision of the trial court). It appears that the Supreme Court's consideration will be limited to the standard of review issue, and not the ultimate issue of insider status.

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HOW MUCH POST-PETITION INTEREST IS TOO MUCH INTEREST FOR AN OVERSECURED CREDITOR?

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In re Manuel Mediavilla, Inc., Bankr. Case No. 13-2800 (MCF) 2016 WL 5360621 (Bankr. D.P.R. Sept. 23, 2016)

CASE SNAPSHOT

The secured creditor objected to the Debtors' amended joint plan of reorganization, arguing that the Debtors did not apply the correct post-petition interest rate to the creditor's claim. The Debtors applied the contractual rate, and the secured creditor sought the default rate.

FACTUAL BACKGROUND

The court previously determined that the individual and corporate debtors could provide treatment for the secured creditor's claim. Practically speaking, the secured creditor was oversecured. The secured creditor objected to the Debtors' amended joint plan of reorganization and argued that the Debtors applied the incorrect interest rate to the secured creditor's claim. The Debtors proposed the pre-default rate of 5 percent interest, and the secured credit sought 8 percent interest, which amount represented the contractual default interest rate.

COURT ANALYSIS

An over-secured creditor is entitled to receive post-petition interest up to the value of its equity cushion. Courts generally apply three rules when determining the applicable post-petition interest rate. First, the court may look to non-bankruptcy law to determine what rate applies. Second, the court may consider the default interest rate a charge, and not an interest rate at all. In such a scenario, charges under section 506(b) must be reasonable. Third, the majority of courts determine that they have the equitable power to address the facts of each case and determine what post-petition interest rate should apply.

The Bankruptcy Court for the District of Puerto Rico adopted the majority view and balanced the equities of the case. The equities favored the Debtors because the secured creditor never enforced the default rate of interest. Default rates of interest are intended to compensate parties for assumed risk regarding loan defaults. But the court was not persuaded that the secured creditor required such protection, as it never enforced the default rate of interest pre-petition.

One final argument weighed in favor of the Debtors: the higher interest rate would cost the Debtors an additional $290,000. The court expressed concern that the additional amount could harm junior creditors.

PRACTICAL CONSIDERATIONS

The secured creditor's failure to enforce the default rate of interest upon the Debtors' initial, pre-petition default, formed the foundation for the court's finding that the default rate of interest was not warranted. When facing a defaulting borrower, creditors should institute the default rate of interest or risk forfeiting the rate altogether.

AGRICULTURAL COOPERATIVE ASSOCIATIONS OWE 'SPECIAL CIRCUMSTANCES' DUTIES TO CREDITORS UPON INSOLVENCY, BANKRUPTCY COURT SAYS

Monique B. Howery
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Cox v. Smith (In re Cent. Ill. Energy Coop.), 561 B.R. 699 (Bankr. C.D. Ill. 2016)

CASE SNAPSHOT

In this chapter 7 case, defendant Michael W. Smith filed a motion to dismiss the First Amended Complaint filed by plaintiff A. Clay Cox, as chapter 7 Trustee for the estate of Central Illinois Energy Cooperative ("Co-op"). The seven-count complaint alleges breach of fiduciary duties owed at all times to the Co-op and, upon insolvency, to the Co-op's creditors. Smith moved to dismiss the complaint, alleging that the complaint failed to state viable claims because Smith did not owe fiduciary duties to Co-op's creditors; that the complaint failed to sufficiently allege Smith's breach; and that conduct complained of in the complaint pre-dates the contended insolvency date. The Bankruptcy Court denied the motion in its entirety, holding, among other things, that agricultural cooperative associations owe fiduciary duties to creditors upon insolvency.

FACTUAL BACKGROUND

In 2001, Co-op was formed under the Illinois Agricultural Cooperative Act (the "ACA") with the stated purpose to construct and operate an ethanol facility to process its members' corn into ethanol and other byproducts, and to purchase and deal in the corn produced by its members. Under Illinois law, an agricultural cooperative association is a form of nonprofit corporation. Smith was one of the Co-op's incorporators, and was a director from its inception until December 2007, in addition to serving as its president and general manager.

The Co-op's principals formed two additional entities in 2004 – Central Illinois Energy LLC ("Opco") and Central Illinois Holding Company, LLC ("Holdco). Opco undertook responsibility for constructing an ethanol plant, and Co-op undertook responsibility for constructing a grain-hauling facility. Co-op was the majority interest owner of Holdco, which was the sole member of Opco. Smith was general manager of both Opco and Holdco. The project never became operational because of financial difficulties. Opco filed a voluntary bankruptcy petition in December 2007, followed by the involuntary bankruptcy petition against Co-op in May 2009.

The seven-count First Amended Complaint alleges the same general theory of liability against Smith in each count – breach of fiduciary duty. Each count identifies a separate transaction or series of transactions engaged in by Smith in violation of his fiduciary duties, which resulted in quantified losses suffered by the Co-op and/or its creditors. In addition, the complaint alleges that Smith owed the same fiduciary duties to Opco and Holdco, which created a conflict of interest that impaired his ability to act in the best interests of Co-op.

Smith contends in his motion to dismiss that fiduciary duties owed to creditors upon insolvency (also known as "special circumstances" duties) have never been imposed by Illinois courts upon an officer or director of an agricultural cooperative association. He argues that special circumstances duties have only been imposed upon for-profit corporations, and never upon nonprofit corporations. Distinguishing between the duties owed to a corporation, Smith disputes that the Co-op's insolvency triggered an additional duty running in favor of the Co-op's creditors. In addition, Smith contends that the complaint should be dismissed for the Trustee's failure to adequately plead violations of section 6(d), and failure to negate statutory immunity. He also seeks dismissal of Count I because the allegations contained therein predate the Co-op's alleged insolvency.

COURT ANALYSIS

The Bankruptcy Court soundly rejected Smith's assertion that special circumstances duties do not apply to agricultural cooperative associations because of their statutory designations as nonprofit corporations. The court discussed the long-standing principle of Illinois common law that directors of a corporation occupy a fiduciary relationship toward the corporation's creditors when the corporation becomes insolvent. "Requiring officers and directors to consider the impact on creditors of a particular transaction or course of action when the entity is insolvent, is a normative rule tied to their position of authority, unrelated to the organizational nature of the entity on whose behalf they act." Stating that it was unaware of any precedent establishing that special circumstances duties do not apply to officers and directors of a nonprofit corporation upon insolvency, and noting that the Illinois Supreme Court had not yet resolved the issue, the Bankruptcy Court recognized that it must predict how the Illinois Supreme Court would decide the issue. Thus, the Bankruptcy Court held that it had little difficulty predicting that the Illinois Supreme Court would likely hold that directors and officers of an agricultural cooperative association owe the same fiduciary duties to creditors upon insolvency that they owe to the association at all times, without regard to solvency.

The Bankruptcy Court also rejected Smith's contention that the Trustee failed to state viable claims for breach of fiduciary duty based upon violations of section 6(d) of the ACA in Counts I through V of the complaint. Smith argues that section 6(i) contradicts section 6(d), and empowers the Co-op to undertake the actions purported to be in violation of section 6(d). Noting the apparent conflict between sections 6(d) and 6(i), the court held that Counts I through V state a recognized and plausible cause of action for breach of fiduciary duty, notwithstanding the allegation of violating section 6(d).

Smith next argues that the complaint fails to identify whether Smith's complained-of conduct was done in his capacity as director or general manager, and, therefore, should be dismissed pursuant to ACA section 15.8(a), which provides immunity to directors. Under Illinois law, statutory immunity accorded directors is an affirmative defense that must be pleaded and proved by the party seeking its protection. In federal cases, complaints need not anticipate defenses or plead around them, nor may the complaints be dismissed for that omission. The Bankruptcy Court concluded that Smith's basis for dismissal of the complaint because it fails to negate statutory immunity is without merit.

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RIGHT TO A JURY TRIAL IN A BANKRUPTCY PROCEEDING

Maura P. Nuño
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George L. Miller v. Sun Capital Partners, Inc., No. 13-1996-RGA, slip op. (D. Del. Sept. 15, 2016)

CASE SNAPSHOT

In a fraudulent transfer proceeding, the U.S. District Court for the District of Delaware (the "Court") held that a chapter 7 trustee was entitled to a jury trial even though defendants filed proofs of claim. Causes of action that fall within the process of allowance or disallowance of the proof of claim are not entitled to a jury trial, but the right to a jury trial is preserved where resolution of the claim would have no effect on the allowance or disallowance of the proofs of claim.

FACTUAL BACKGROUND

In February 2006, the Sun Capital Defendants finalized the acquisition of Indalex Holdings Finance, Inc., and its subsidiaries (collectively, "Indalex"), including Asia Aluminum Group ("AAG"). As part of the acquisition, Indalex acquired all the outstanding shares of Indalex Limited from Honeywell International Inc. Indalex partly financed the acquisition of Indalex Inc. and Indalex Limited with proceeds from Indalex's issuance of secured notes. In conjunction with the acquisition, Indalex entered into a Management Services Agreement ("MSA") with the Sun Capital Defendants, pursuant to which the Sun Capital Defendants agreed to provide Indalex management and consulting services for an annual fee.

In May 2007, Indalex sold its interests in AAG and paid its shareholders a dividend from the proceeds of the sale. Shortly thereafter, in March 2009, Indalex Holdings Finance, Inc., Indalex Holding Corp., and other Indalex subsidiaries (collectively, the "Debtors") filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. section 101 et seq. The chapter 11 proceeding was turned into a chapter 7 proceeding, and Mr. Miller (the "Plaintiff") was appointed the chapter 7 trustee for the Debtors. The Plaintiff brought the instant action against the Sun Capital Defendants alleging, among other things, that the dividend and fees paid pursuant to the MSA agreement constitute a fraudulent transfer. The Plaintiff sought a jury trial on this issue.

COURT ANALYSIS

In a bankruptcy proceeding, the test for determining whether a claim triggers a right to jury trial under the Seventh Amendment considers the following factors: (i) the historical characterization of the cause of action; (ii) the remedy sought; and (iii) whether Congress extinguished the jury trial right by assigning resolution of the claim to the bankruptcy court and, if it did, whether Congress had the power to do so.

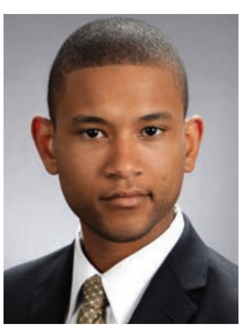
The Sun Capital Defendants conceded that the Plaintiff's fraudulent transfers claim and the remedy sought were legal in nature, but argued that the Plaintiff's right to a jury trial was extinguished as to the creditor-defendants that filed proofs of claim. The court cited case law indicating that Congress permissibly withdrew jurisdiction from courts of law over causes of action against a creditor that filed a proof of claim if the cause of action fell within the process of allowance or disallowance of the claim. The court then noted that a cause of action falls within the claims-allowance process if resolution of the dispute would affect the allowance of the creditor's claim. However, a cause of action that would augment the estate, but have no effect on the allowance of the creditor's claim, is not part of the claims-allowance process.

The court then considered each Defendant's proof of claim and determined that resolution of the fraudulent transfer claim would not affect the allowance or disallowance of the proofs of claim seeking (i) a share of the bankruptcy res; (ii) post-petition administrative expenses; or (iii) indemnification and contribution from the Debtors.

PRACTICAL CONSIDERATIONS

This holding illustrates that the estate's right to jury trial against a creditor is not extinguished by virtue of filing a proof of claim.

CLASS-ACTION WAIVERS IN ARBITRATION AGREEMENTS ARE NOT SO FRESH & EASY



Reginald Sainvil
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In re Fresh & Easy, LLC, No. 15-12220 (BLS), 2016 WL 5922292 (Bankr. D. Del. Oct. 11, 2016)

CASE SNAPSHOT

In a case of first impression for a court within the jurisdiction of the U.S. Court of Appeals for the Third Circuit, the Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") determined that: (i) a class-action waiver in an arbitration agreement violated substantive rights at the heart of the National Labor Relations Act; and (ii) the arbitration agreement was entirely invalid because the class-action waiver was a central tenet of the arbitration agreement.

FACTUAL BACKGROUND

Fresh & Easy, LLC operated a chain of grocery stores in the southwest United States. On November 29, 2013, Diana Chan ("Chan"), a Fresh & Easy employee, entered into an arbitration agreement with the company. Under the arbitration agreement, Chan agreed to resolve any employment-related disputes with Fresh & Easy through a final and binding arbitration by a single neutral arbitrator. The arbitration agreement provided that Chan could only bring claims against Fresh & Easy in her individual capacity, and she forfeited her rights to bring claims against Fresh & Easy as a plaintiff or class member in any purported class, representative or collective action. Chan, however, did have the right to revoke the agreement within 30 days of signing it.

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Agricultural Cooperative Associations Owe 'Special Circumstances' Duties to Creditors upon Insolvency, Bankruptcy Court Says—continued from page 3

Smith's final basis for dismissal asserts hat Count I pre-dates the Co-op's alleged insolvency. In analyzing the complaint, the Bankruptcy Court held that the Trustee's general allegation of insolvency was sufficient. In so holding, the court reasoned that the elements of a claim for a pre-insolvency breach of fiduciary duties are included within a claim for a post-insolvency breach. The nature of the claim is the same, with the difference being the addition of the allegation of insolvency. Explaining further, the court stated that at the pleading stage, it would not make sense to require a plaintiff to separate the claims based upon the timing of insolvency, given the difficulty of establishing exactly when insolvency occurred. Thus, the complaint placed Smith on notice of the asserted breach of fiduciary duties for pre-insolvency and post-insolvency conduct.

PRACTICAL CONSIDERATIONS

The Illinois Supreme Court has not affirmatively resolved the issue of whether special-circumstances duties apply to officers and directors of agricultural cooperative associations. However, the Cox decision provides persuasive guidance to officers and directors in terms of the duties owed to creditors upon insolvency of an agricultural cooperative association. Officers and directors of agricultural cooperative associations should, therefore, be mindful of exercising their business judgment cautiously in the fiduciary duties they may owe to creditors upon insolvency of the association.

Class-Action Waivers in Arbitration Agreements Are Not So Fresh & Easy—continued from page 4

On October 30, 2015, Fresh & Easy filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. section 101 et seq. (the "Bankruptcy Code"). Chan was terminated on the same day. On November 12, 2015, Chan filed a complaint against Fresh & Easy, alleging that Fresh & Easy, among other things, violated the Worker Adjustment and Retraining Notification Act and portions of the California Labor Code by failing to provide at least 60 days' advance notice of termination (the "WARN Claims"). Chan's complaint sought recovery for herself and a purported class of similarly situated former employees.

On January 25, 2016, Fresh & Easy moved to compel arbitration pursuant to the arbitration agreement, arguing that the Federal Arbitration Act ("FAA") requires the WARN Claims to be resolved by a single arbitrator pursuant to the parties' arbitration agreement. Fresh & Easy further argued that the arbitration agreement was enforceable because Chan could have opted out of the agreement. Chan countered by arguing that the arbitration agreement was unenforceable because the class-action waiver provision contained in the arbitration agreement violated the National Labor Relations Act ("NLRA").

COURT ANALYSIS

Judge Brendan L. Shannon agreed with Chan and denied Fresh & Easy's motion to compel arbitration because the class-action waiver contained in the arbitration agreement violated the NLRA. In reaching this conclusion, Judge Shannon addressed two issues: (i) whether the right to file a class action qualifies as concerted activities for mutual aid or protection under section 7 of the NLRA; and (ii) whether an illegal contractual provision that may be revoked still interferes with the exercise of an employee's rights under section 7 of the NLRA.

Judge Shannon determined that the right to file a class-action lawsuit qualifies as a concerted activity under section 7 of the NLRA because that section reflects Congress' unambiguous intent to create and protect an employee's right to pursue collective legal actions. Judge Shannon opined that the ordinary meaning of concerted activities within the context of section 7 of the NLRA protects class-action lawsuits, because such collective action is a planned arrangement among more than one employee for a work-related purpose, which is at the core of section 7's enactment and the NLRA's underlying policies. Addressing Fresh & Easy's argument based on the FAA, Judge Shannon noted that the FAA does not require enforcement of contractual provisions that are deemed illegal under other federal statutes. Consequently, because section 7 of the NLRA confers a substantive right to collective adjudication, and contractual provisions that violate that right are unenforceable, Judge Shannon held that the class-action waiver contained in the arbitration agreement violated Chan's rights and was, therefore, unenforceable.

Judge Shannon next addressed Fresh & Easy's argument that the arbitration agreement was still valid because it contained an opt-out provision. Finding that the statutory text was unclear, Judge Shannon deferred to the National Labor Relations Board's interpretation and held that an illegal contractual provision that may be revoked still interferes with the exercise of an employee's rights under section 7 of the NLRA. Accordingly, the fact that Chan had an opportunity to revoke the agreement did not alter Judge Shannon's determination that the arbitration clause was unenforceable.

Finally, Judge Shannon concluded that the arbitration agreement was completely unenforceable because the class-action waiver was a central tenet of the arbitration agreement, which could not be severed.

PRACTICAL CONSIDERATIONS

The Bankruptcy Court's opinion is contrary to opinions originating from courts within other jurisdictions, and further muddies the waters as to whether a class-action waiver is enforceable in an arbitration agreement. Until the courts provide greater clarity on this topic, it is important for practitioners to carefully consider whether to include and how to craft class-action waivers in arbitration agreements.

DELAWARE COURT APPROVES PLAN RELEASES FOR 'AGGRESSIVE' FIRST LIEN LENDERS FOLLOWING SECOND BANKRUPTCY FILING

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In re Hercules Offshore, Inc., No. 16-11385 (KJC), 2016 WL 8581685 (Bankr. D. Del. Nov. 1, 2016)

CASE SNAPSHOT

Less than six months after emerging from a first bankruptcy proceeding (the "2015 Bankruptcy"), Hercules Offshore, Inc. and its affiliates (together, the "Debtors") filed a second bankruptcy petition. Confirmation of the Debtors' plan (the "Plan"), which included comprehensive releases for the Debtors' first lien lenders and related parties (the "First Lien Lenders"), and the Debtors' directors and officers, was opposed by a committee of equity security holders (the "Equity Committee"). The Equity Committee alleged claims against the First Lien Lenders for violating the covenant of good faith and fair dealing as, following the Debtors' minor breaches of certain portions of the loan agreement, the First Lien Lenders aggressively negotiated forbearance agreements that denied the Debtors the use of $200 million in escrowed loan proceeds. However, in its opinion, the court found that while the First Lien Lenders had bargained hard, they had acted within their rights, and had further provided substantial benefit to the estate in exchange for the plan releases.[1] The plan was confirmed.

FACTUAL BACKGROUND

As part of the confirmed plan in the 2015 Bankruptcy, the First Lien Lenders provided the Debtors with $450 million in exit financing pursuant to a credit agreement (the "First Lien Credit Agreement"), with Jefferies Finance, LLC as the administrative and collateral agent (the "First Lien Agent"). Under the First Lien Credit Agreement, the Debtors were required, among other tasks, (i) to register a vessel mortgage in Nigeria within 60 days of closing that would secure an estimated $6 million to $25 million in collateral, and (ii) to use their best efforts to dissolve a Gibraltar subsidiary within 120 days of closing.

While the First Lien Agent had consented to the extension of the deadline to register the vessel mortgage several times, on March 31, 2016, the First Lien Agent informed the Debtors that the deadline would not be extended beyond April 15, 2016. The Debtors did not register the vessel mortgage by April 15, 2016. Additionally, the Debtors ceased efforts to dissolve the Gibraltar subsidiary as the Debtors believed that doing so would make it more difficult to collect an $11 million receivable. This cessation of the dissolution process was not discussed with the First Lien Agent. While the First Lien Lenders did not declare an event of default because of these failures, both the First Lien Lenders and the Debtors were aware that the Debtors failed to comply with these requirements of the First Lien Credit Agreement.

On top of these minor defaults, the Debtors continued to struggle financially, and predicted that they would default on the financial covenants of the First Lien Credit Agreement by early 2017. In early 2016, the Debtors formed a special committee (the "Special Committee") and began looking into how to address the Debtors' continuing financial distress. The Special Committees began marketing the Debtors, and also heard presentations from one of the First Lien Lenders who suggested a bankruptcy process. At the same time, the Debtors negotiated forbearance agreements to waive the claimed defaults. At the insistence of the First Lien Lenders, the forbearance agreements prevented the Debtors from accessing $200 million in loan proceeds that had been escrowed to pay for a new vessel. Unable to pay for the new vessel without the escrowed funds, the Debtors had to transfer their right to take delivery of it.

On May 26, 2016, the Debtors and First Lien Lenders entered into a restructuring support agreement (the "RSA"), based on a proposal previously put forward by one of the First Lien Lenders. The Debtors began pre-petition solicitation of a joint restructuring plan that would pay unsecured claims in full. While the original proposed plan was amended post-petition to allow for a $15 million guaranteed equity recovery – regardless of whether the First Lien Lenders recovered in full – the Equity Committee continued to oppose confirmation. Specifically, the Equity Committee opposed the releases for the First Lien Lenders and the Debtors' directors and officers. The Equity Committee alleged potential claims against the First Lien Lenders for violating the covenant of good faith and fair dealing by (i) asserting "baseless" events of default, (ii) declining to extend the deadline to register the vessel mortgage, and (iii) forcing entry into the forbearance agreement. The Equity Committee also alleged potential claims against the directors and officers for breach of the fiduciary duty, arising from the negotiation of the forbearance agreements, the restructuring support agreement and the plan.

COURT ANALYSIS

The Bankruptcy Court first addressed the releases to the directors and officers. Analyzing the actions of the directors and officers under the Delaware business judgment rule, the court held that "[t]he Special Committee's judgment must be upheld unless it cannot be attributed to any rational purpose."[2] The court held that the Special Committee, in consulting attorneys and financial advisors, meeting regularly and evaluating several avenues to address the Debtors' financial distress, acted in good faith. Specifically, the court noted that the Special Committee had, with the advice of its advisors, compared the solution proposed by one of the First Lien Lenders, which eventually shaped the RSA and plan, to the bids that the Debtors received through their independent marketing process. As a result of the Special Committee's informed evaluation of the various options, the court held that it was unlikely that any viable claims were to be brought against the directors and officers.

The court next addressed the releases for the First Lien Lenders. The court found that the First Lien Lenders had been "strategic" in their actions and had "bargain[ed] hard," but that "lenders are free to enforce contract rights and negotiate hard against borrowers at arms-length, particularly those that are in distress."[3] In holding so, the court found that while the breaches alleged by the First Lien Lenders were admittedly minor, the Debtors had in fact failed to complete acts required by the First Lien Credit Agreement, and that it was not inappropriate for the First Lien Lenders to leverage that fact in negotiating a forbearance agreement – especially where there was no evidence that the First Lien Lenders even threatened to declare a default, or in any way interfered with

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the Debtors' business. The court further found that it was not inappropriate for the First Lien Lenders to advocate for their preferred resolution of the Debtors' financial problems, even when "aggressive," "vocal," "persistent," and "annoying."[4] In the end, that court found it unlikely that any claim could be asserted against the First Lien Lenders and that, as the First Lien Lenders were agreeing to subordinate their claim in order to: (i) allow a 100 percent recovery to unsecured creditors, (ii) allow a $15 million distribution to equity, (iii) reduce their claim by $32.5 million, and (iv) allow use of cash collateral sufficient for an orderly wind down, the First Lien Lenders were entitled to a release of claims.

PRACTICAL CONSIDERATIONS

The *Hercules* decision shows that a lender may aggressively pursue its contractual rights and negotiate to its benefit, even against a bankrupt debtor, without violating the covenant of good faith and fair dealing. Further, such behavior will not prevent a lender from receiving a plan release in bankruptcy, so long as the lender has made a significant contribution to the case and has otherwise qualified for a plan release under the prevailing Delaware standard.

1 *In re Hercules Offshore, Inc.*, No. 16-11385 2016 WL 8581685 (Bankr. D. Del. Nov. 1, 2016).
2 Id. at *20.
3 Id. at *25.
4 Id. at *25

BANKRUPTCY COURT REJECTS DEBTORS' CLAIMS AGAINST LENDERS

Sarah K. Kam
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BH Sutton Mezz LLC v. Sutton 58 Assocs. LLC (In re BH Sutton Mezz LLC), No. 16-01187, 2016 Bankr. LEXIS 4113 (Bankr. S.D.N.Y. Dec. 1, 2016)

CASE SNAPSHOT

Based on all the evidence introduced at trial, the U.S. Bankruptcy Court for the Southern District of New York concluded that the debtors failed to establish a basis for relief on their claims against various lenders, including unconscionability, lender liability, and equitable subordination, and granted the lenders judgment on these counts. However, the bankruptcy court ruled in favor of the debtors on their claim for criminal usury because one of the loans at issue had an interest rate in excess of the New York statute.

FACTUAL BACKGROUND

The debtors commenced an adversary proceeding against various lenders who had provided secured financing for the debtors' proposed development of a 950-foot residential tower in Midtown Manhattan. The debtors sought to subordinate and reduce the amount they owed the lenders by alleging improper conduct by the lenders through their principals. The alleged improper conduct included more than a dozen specific claims, and allegations that the lenders breached the contracts between the parties, as well as non-contractual duties owed by the lenders to the debtors. The bankruptcy court divided the claims into categories, including unconscionability, lender liability, equitable subordination, and usury. The bankruptcy court held a trial during which 10 live witnesses testified. The debtors also submitted direct testimony for three additional witnesses.

COURT ANALYSIS

As to unconscionability, the debtors argued that certain terms of the financing, including the exit fees and maturity dates, were procedurally and substantively unconscionable under New York law. Based on the evidentiary record, the bankruptcy court rejected the debtors' argument that the terms were procedurally unconscionable because of the debtors' inadequate representation by counsel, and an inequitable bargaining position between the debtors and lenders. The bankruptcy court further rejected the debtors' argument that terms were substantively unconscionable, given the debtors' level of sophistication as real estate developers, as well as the benefits of the financing when compared with the debtors' other options.

As to lender liability, the bankruptcy court clarified that these claims refer to the debtors' claims against the lenders based upon their relationship, rather than upon the parties' contracts. Under New York law, a lender-borrower relationship will not normally create a fiduciary duty. Such a relationship may give rise to a fiduciary duty "where there exists a confidence reposed which invests the person trusted with an advantage in treating with the person so confiding, or an assumption of control and responsibility." However, the evidentiary record did not support the imposition of a fiduciary duty.

As to equitable subordination, the debtors argued that the lenders were insiders and that their claims should be equitably subordinated because of inequitable conduct. The bankruptcy court concluded that the lenders were not insiders and, further, that the debtors did not establish that the lenders engaged in inequitable conduct. The lenders did not breach the parties' written agreements, breach a fiduciary duty to the debtors, or become enriched through unconscionable, unjust, unfair, close or double-dealing, or foul conduct.

As to usury, the debtors argued that the building loan was criminally usurious under New York Penal Law. Because the effective annual interest rate on the building loan was 38 percent, this rate qualified as criminally usurious under New York law as it exceeded the statutory maximum rate of 25 percent.

PRACTICAL CONSIDERATIONS

Courts are inclined to enforce the contract between the parties, especially in the commercial context, and are hesitant to impose additional duties.

CHAPTER 7 TRUSTEE CAN 'STEP INTO THE SHOES' OF THE IRS AND AVOID TRANSFERS OCCURRING 10 YEARS BEFORE BANKRUPTCY FILING

Brian M. Schenker
Associate, Philadelphia

Mukamal v. CitiBank N.A. (In re Kipnis), Adv. No. 16-01044-RAM, Case No. 14-11370-RAM (Bankr. S.D. Fla. Aug. 31, 2016)

CASE SNAPSHOT

In this chapter 7 bankruptcy case, the bankruptcy court held that a chapter 7 trustee can avoid transfers made by the debtor up to 10 years before the bankruptcy filing by stepping into the shoes of the IRS via section 544(b) of the Bankruptcy Code. Under federal law, the IRS may pursue collection of taxes for 10 years from the assessment date, and its collection remedies include the right to avoid transfers under state law without being bound by state statutes of limitations. The bankruptcy court held that, when the IRS is an unsecured creditor of the debtor, section 544(b) of the Bankruptcy Code allows the chapter 7 trustee to pursue all avoidance remedies available to the IRS, and bring avoidance actions that would have otherwise been time-barred under applicable state law.

FACTUAL BACKGROUND

In his 2000 and 2001 personal tax returns, the debtor claimed losses related to certain business transactions. The IRS timely notified the debtor that his 2000 and 2001 taxes were under investigation, which ultimately resulted in an examination report that determined the debtor's deficiency for tax year 2000 to be $701,113, and for tax year 2001 to be $346,495. The deficiencies were upheld by a Tax Court ruling. When the debtor subsequently filed for bankruptcy January 21, 2014, the IRS filed a $1,911,787.23 proof of claim, with $1,886,158.02 being secured and $25,629.51 being unsecured, but subject to priority treatment under section 507(a)(8) of the Bankruptcy Code.

The chapter 7 trustee sought to avoid certain transfers made by the debtor in 2005 – nine years before the bankruptcy filing. The debtor moved to dismiss the complaints based on the claims being time-barred under the Bankruptcy Code and applicable state law. The chapter 7 trustee responded that, since the IRS was an unsecured creditor in the case, he could "step into the shoes" of the IRS under section 544(b) of the Bankruptcy Code and not be bound by those limitations. The bankruptcy court agreed with the chapter 7 trustee and denied the debtor's motion to dismiss.

COURT ANALYSIS

The bankruptcy court began its analysis by explaining that section 544(b) of the Bankruptcy Code allowed the chapter 7 trustee to avoid any transfer "that is voidable under applicable law by a creditor holding an unsecured claim." The bankruptcy court noted that it was undisputed that the IRS held an allowable unsecured claim.

The bankruptcy court then explained that section 6502(a)(1) of the Internal Revenue Code establishes a 10-year deadline for the IRS to collect taxes, and section 6901(a)(1)(A) of the Internal Revenue Code provides the authority for the IRS to pursue avoidance actions against transferees of the taxpayers' property. The bankruptcy court noted that it was undisputed that the IRS could have sought to avoid the 2005 transfers based on the foregoing authority.

The bankruptcy court then acknowledged a split of authority as to whether a bankruptcy trustee can "step into the shoes" of the IRS via section 544(b) of the Bankruptcy Code. The bankruptcy court cited bankruptcy court cases from Pennsylvania, Illinois, District of Columbia, and Texas, holding that a bankruptcy trustee has the right to take advantage of the IRS' longer 10-year statute of limitations. The bankruptcy court also cited a single bankruptcy court case from New Mexico, holding that a bankruptcy trustee does not have the right to take advantage of the IRS' longer 10-year statute of limitations. In that single case, the court held that the IRS' longer 10-year statute of limitations was a "public right" that cannot be invoked by a bankruptcy trustee.

Because none of the cases cited was binding on the bankruptcy court, the bankruptcy court engaged in an independent review of the issue. The bankruptcy court considered the "public right" argument, but ultimately determined that it was required to enforce the "plain meaning" of section 544(b) of the Bankruptcy Code, which made no such distinction. The bankruptcy court explained that "the text of § 544(b) imposed no limitation on the meaning of 'applicable law' or on the type of unsecured creditor a trustee can choose as a triggering creditor." The bankruptcy court further explained that the IRS' "ability to trump the applicable state statute of limitations might derive from its sovereign immunity, but the estate representative's ability to override that same limitation derives from § 544(b)."

PRACTICAL CONSIDERATIONS

Ultimately, the Florida bankruptcy court joined the bankruptcy courts from Pennsylvania, Illinois, District of Columbia, and Texas in holding that, where the IRS is an unsecured creditor of a debtor, a bankruptcy trustee has the right to take advantage of the IRS' longer 10-year statute of limitations for avoidance actions. Notwithstanding the apparent emerging majority on this issue, as noted by the bankruptcy court in this case, there is not yet binding authority from any Supreme Court or Circuit Court decisions. Thus, while transferees of a debtor's property must take seriously the risk of avoidance actions going back 10 years, where the debtor has unpaid taxes owed to the IRS, results in particular cases may vary, given that the bankruptcy courts will most likely engage in a similar independent review of the issue.

NINTH CIRCUIT OVERRULES DECADES-OLD *ENTZ-WHITE* DECISION, FINDS THAT LENDERS ARE ENTITLED TO DEFAULT INTEREST UNDER PLAN OF REORGANIZATION

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Christopher O. Rivas
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In re New Inves., Inc. (Pacifica L 51 LLC v. New Inves., Inc.), 840 F.3d 1137 (9th Cir. 2016)

CASE SNAPSHOT

In a 2-1 decision, the Ninth Circuit overruled its nearly 30-year-old holding in *In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338 (9th Cir. 1988), ruling that 11 U.S.C. section 1123(d) requires that a debtor must pay contractually required default interest in order to cure breaches in a contract under a bankruptcy plan.

FACTUAL BACKGROUND

Debtor New Investments, Inc. borrowed approximately $3 million from lender Pacifica L 51, LLC. In 2009, Debtor defaulted on the promissory note, which provided for an increased interest rate of 5 percent upon default. In 2013, Debtor filed a petition under chapter 11 of the Bankruptcy Code. The Debtor filed a chapter 11 plan of reorganization, which sought to cure its defaults by paying Pacifica the entire accelerated balance of the loan, with interest paid at the non-default rate. Pacifica objected, arguing that interest should be paid at the contractual default rate, and that Pacifica was also entitled to contractual late fees. The Bankruptcy Court overruled Pacifica's objections, and confirmed the chapter 11 plan requiring that the Debtor pay only the non-default rate of interest to Pacifica. Pacifica appealed the decision directly to the Ninth Circuit.

COURT ANALYSIS

At issue was the continuing validity of the Ninth Circuit's long-standing ruling *In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338 (9th Cir. 1988), which held that a debtor who cures defaults under a plan "is entitled to avoid all consequences of the default – including higher post-default interest rates." Pacifica argued that 11 U.S.C. section 1123(d), which was enacted in 1994 – six years after *Entz-White* – effectively overruled the decision. Section 1123(d) provides that: "if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."

The Ninth Circuit held that on its face, section 1123(d) requires the bankruptcy court to apply the terms of the contract and applicable state law to determine the amount necessary to cure a default, thus effectively overruling *Entz-White*. Because, in this case, the promissory note required the Debtor to pay default interest and late fees, and because Washington law permitted the assessment of default interest and late fees, the Debtor was required to pay default interest and penalty fees in order to cure its defaults.

In a strongly worded dissent, Circuit Judge Berzon disagreed with the conclusion of the majority. The dissent explained that the burden was on Pacifica to establish that Congress, by enacting section 1123(d), intended to overrule the long-settled law reflected in *Entz-White.* The dissent observed that the legislative history showed otherwise. In enacting section 1123(d), Congress intended to overrule the Supreme Court's holding in *Rake v. Wade*, 508 U.S. 464 (1993), which provided a windfall to creditors by permitting them to recover non-contractual interest on interest and late fees, and not on the *Entz-White* holding. The legislative history also reflected that it was "the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred," which suggests that Congress specifically intended to leave *Entz-White* in its place. Given no clear indication that Congress intended to depart from long-standing precedent, Circuit Judge Berzon argued that *Entz-White* should remain good law.

PRACTICAL CONSIDERATIONS

The *Pacifica* decision has wide-ranging implications for debtors and creditors. Debtors may find it impractical, if not impossible, to reorganize if they are required to pay loans at their default rate. Debtors often use the removal of default interest as a strategic tool to bring junior lienholders "to the table" to support a plan – although first-lien holders will certainly benefit from the holding, and from the certainty it provides that senior secured lenders can recover their default interest. However, many lenders find themselves in junior lien positions, and the *Pacifica* ruling may take them completely "out of the money" in bankruptcy plans.

COURT FINDS THAT UTILITY REFUNDS ARE A GENERAL INTANGIBLE

Maura P. Nuño
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MPC Liquidation Trust v. Mississippi Phosphates Corporation, No. 14-51667-KMS, Adv. No. 16-06001-KMS, slip op. (Bankr. S.D. Miss. Jan. 3, 2017)

CASE SNAPSHOT

In a dispute between the unsecured creditors' committee and a liquidation trust that acquired all the debtor's assets – except those specifically excluded – the court finds that a large utility refund belongs to the trust.

FACTUAL BACKGROUND

On October 27, 2014, Mississippi Phosphates Corporation ("MS Phosphates") filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. section 101 et seq., in the U.S. Bankruptcy Court for the Southern District of Mississippi (the "Court"). The Court approved the creation of a liquidation trust (the "Trust") to liquidate and distribute certain assets for the benefit of the bankruptcy estate. In October 2015, the Court approved an asset purchase agreement (the "Agreement"), pursuant to which the Trust acquired all the assets of MS Phosphates, whether tangible or intangible, except for those specifically excluded. In January 2016, the Trust brought an adversary proceeding against MS Phosphates and Mississippi Power Company ("MS Power"), for a refund owed to MS Phosphates.

The refund stemmed from a rate increase proposed by MS Phosphates and approved by the Mississippi Public Service Commission (the "Commission"). MS Phosphates paid the increased rate until the Mississippi Supreme Court reversed the Commission's decision approving the rate increase. Pursuant to the Mississippi Supreme Court decision ("MSC Decision"), MS Power was ordered to refund to MS Phosphates the amounts attributable to the rate increase. In the adversary proceeding, the Trust argued it was entitled to the refund pursuant to the Agreement because the refund is a general intangible. Conversely, the unsecured creditor's committee (the "Committee") argued that the refund was the proceeds of a constitutional tort, which was specifically excluded from the Agreement.

COURT ANALYSIS

The Court began by finding that the proceeds of a constitutional tort would constitute proceeds of commercial tort. The Court then applied Mississippi's doctrine of collateral estoppel to the MSC Decision to determine whether it awarded money based on a constitutional tort. Collateral estoppel would preclude the Court from finding that the money that was ordered to be repaid is a refund, rather than the proceeds of a constitutional tort, if the issue was litigated and essential to the MSC Decision.

The Court found that the Mississippi Supreme Court determined that the Commission exceeded its statutory authority, and ordered the Commission to refund money attributed to the rate increase, prior to reaching the constitutional questions. Because the Mississippi Supreme Court ordered repayment prior to reaching the constitutional issues, the Court concluded that the money ordered to be repaid was a refund, not the proceeds of a constitutional tort.

Lastly, the Court considered whether the refund is a general intangible. The Committee argued a refund must be "self-executing," meaning the refund is effective without court action, in order to be considered a general intangible. The Court was unpersuaded by the argument and found that the general intangible category is meant to be a catchall category, and that excluding the refund from it would lead to an absurd result. Accordingly, the Court found that the Trust was entitled to the refund under the Agreement.

PRACTICAL CONSIDERATIONS

This opinion cautions against broad asset purchase agreements that include general intangibles.

THE INVOLUNTARY BANKRUPTCY PETITION SWORD

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Yucaipa American Alliance Fund I, et al. v. Ehrlich, Civ. Case No. 15-373 (D. Del. Sept. 2, 2016)

CASE SNAPSHOT

The district court dismissed the complaint because plaintiffs failed to state a claim under RICO, and the court declined to exercise supplemental jurisdiction over the state law claims

FACTUAL BACKGROUND

The case arose out of the involuntary bankruptcy of Allied Systems Holdings, a provider of distribution and transportation services to the automotive industry. Certain of Allied's lenders, including the defendants in the district court case, filed involuntary bankruptcy petitions. The bankruptcy court ultimately supervised a sale of substantially all of the debtor's assets.

The plaintiffs, who owned the debtor, filed the instant case alleging that the defendants developed and implemented a racketeering scheme to force Allied into bankruptcy, and equitably subordinate the plaintiffs' claims. The plaintiffs further alleged, among other state law claims, that the defendants conspired and acted to prevent plaintiffs from orchestrating a sale of the debtor's assets prior to a bankruptcy filing, and that the involuntary petitions filed by the defendants contained material omissions and false statements.

Defendants filed motions to dismiss the district court litigation.

COURT ANALYSIS

The RICO Act imposes criminal and civil liability upon those who engage in certain "prohibited activities," which may include a pattern of racketeering activity. Plaintiffs alleged that defendants: (i) made a false oath in regard to the bankruptcy proceeding; (ii) made false declarations in relation to the bankruptcy proceeding; and (iii) committed wire and mail fraud.

The district court first analyzed two distinct requirements to confer standing in RICO claims: (i) that the plaintiff suffered an injury to business or property; and (ii) that the plaintiffs' injury was proximately caused by the defendants. The complaint of injury must be specific or quantifiable, and must have resulted in tangible financial loss. The court determined that the plaintiffs' damages were speculative because it was unknown if the plaintiffs' claims would be equitably subordinated. Speculative losses do not confer RICO standing.

Plaintiffs also alleged damages of more than $175 million in their complaint (including loss of profit and attorneys' fees and costs), but the court held that none of these damages conferred RICO jurisdiction because plaintiffs could not prove that defendants' actions proximately caused plaintiffs' losses. There were too many contingencies for the court to find the causal connection.

The court also held that plaintiffs failed to plead a pattern of racketeering activity. Plaintiffs' complaint did satisfy the requirement that the predicate acts are related, but the acts did not pose a continuous threat. The court found that the alleged pattern of racketeering activity occurred for, at most, nine months; there was no close-ended continuity. The court also held that defendants' alleged scheme, equitably subordinating plaintiffs' claims in the bankruptcy case, did not satisfy open-ended continuity because the scheme had a definite termination.

The court's original jurisdiction was based solely on the federal RICO claims. After dismissing the RICO claims, the court could not exercise supplemental jurisdiction because the claims that conferred original jurisdiction no longer existed.

PRACTICAL CONSIDERATIONS

The petitioning creditors used the involuntary bankruptcy as a sword to align their interests in the bankruptcy case.

BANKRUPTCY COURT REJECTS YIELD CAPITALIZATION METHOD IN DETERMINING THE FMV OF AN UNBRANDED EXTENDED-STAY HOTEL

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In re TIAT Corporation, No. 16-10764, 2017 BL 11540 (Bankr. D. Kan. Jan. 13, 2017)

CASE SNAPSHOT

In a recent decision on a secured creditor's motion for valuation of collateral under Fed. R. Bankr. P. 3012, the Kansas Bankruptcy Court rejected both the debtor's and creditor's proposed valuations. The Bankruptcy Court concluded that neither of the proposed values adhered to the statutory requirement that the value of the estate's interest in the property be determined "in light of the purpose of the valuation and of the proposed use or disposition of the property" as set forth in section 506(a)(1). In its analysis, the court accorded weight to portions of each appraisal and disregarded those portions of the appraisals it found less persuasive. In doing so, the court adopted the direct capitalization method as the best indicator of the fair market value of the property.

FACTUAL BACKGROUND

TIAT Corporation ("TIAT") operates the Inn at Tallgrass (the "Inn"), a hotel property that is encumbered by a mortgage securing a non-recourse note held by SBNV ITG LLC ("SBNV"). Built in 1985, the Inn is a campus-style, limited-service, extended-stay hotel located in northeast Wichita, Kansas. The property consists of several buildings with 88 total units with exterior door entrances and stairwells. It is an independent hotel, unaffiliated with any brand or franchise, and disconnected from any national reservation system. The Inn's typical customers are corporations that provide extended-stay lodging for their employees.

TIAT borrowed $5 million from U.S. Bank on a non-recourse note secured by, among other things, a mortgage on the property and an assignment of room rents. After a substantial decline in revenues in 2015, TIAT filed a voluntary petition under chapter 11. Post-petition, U.S. Bank auctioned TIAT's note and mortgage, and SBNV, the current holder, acquired it for $1.82 million. TIAT filed a plan proposing to value the Inn at $2,161,761, and SBNV filed a motion under section 506(a) for determination of the value of the collateral.

The Bankruptcy Court considered three valuation reports that were offered and admitted into evidence. TIAT offered two opinions, one from James Korroch (later amended), and one authored by CBRE procured by U.S. Bank in preparation for the auction. SBNV offered the opinion of James Askew. The appraisals indicate values for the Inn ranging from approximately $1.3 million to $5.2 million. The variance in values is largely a function of the appraisers' valuation methods.

Korroch's appraisal and the CBRE appraisal both employed the "direct capitalization" method. TIAT's plan proposed a value of $2,161,761, which it later revised to $1,289,384 in response to a "rebuttal" report filed by SBNV's appraiser, James Askew. CBRE estimated the value at $2.2 million. Askew's appraisal of $5.3 million is derived from the "yield capitalization" method.

COURT ANALYSIS

The Bankruptcy Court began its analysis by noting that when a debtor intends to retain and operate a property using its operating income to fund its plan for reorganization, section 506(a)(1) requires that the value of the property be determined as of the hearing date and as it currently exists ("as is").

Analyzing the appraisal reports, the court noted the range of opinions regarding the value of the Inn, and discussed that it is not required to simply adopt one opinion over the other competing opinion. Rather, the court "can give such weight to those portions of each appraisal that enable [it] to reach a determination of the Inn's fair market value while disregarding those portions that are less persuasive." The court went on to discuss that section 506(a) imposes no specific standard or method of valuation, noting that the court in *In re 210 Ludlow Street Corp.*, 455 B.R. 443 (Bankr. W.D. Pa. 2011) held that the income capitalization method was appropriate for approximating the value of a hotel.

The court next evaluated the two methods of income capitalization—direct and yield. Each is a method used to stabilize the rate of income. The court rejected the yield-capitalization method advocated by SBNV because the analysis relies upon assumptions and trends that do not reflect the current hotel market in Wichita. Reasoning that section 506's focus is on the present, not on speculative factors into the future, the court held that the direct capitalization of the Inn's net operating income ("NOI") is the best indicator of its fair market value as an income-producing asset today.

Turning next to consideration of the appropriate income stream, the court evaluated the appraisers' calculations of NOI. The variance in the appraisers' direct capitalization values can be explained by the method the appraisers used to calculate operating expenses. For example, SBNV's appraisal used industry averages for operating expenses in its calculations. The court found Askew's projected future operating expenses to be substantially lower than the Inn's actual operating expenses, and was unpersuaded by Askew's suggestion that operating expenses could be substantially reduced over the next year without negatively impacting gross revenues. Alternatively, TIAT's appraisal reflects the hotel's historical performance. The court found TIAT's historical-performance approach more compelling, and it adopted the capitalization rate advocated by TIAT in its revised valuation.

Ultimately, the court declined to adopt either of the value opinions because neither proposal "values the Inn in light of its anticipated use or disposition given its condition, historical performance, its competitive disadvantages, and the current local hotel market." In making its determination of value, the court held that the valuation method that best reflects the requirements of section 506(a) is a direct capitalization of the trailing 12 months' NOI , as adjusted for average historical operating expenses, at a capitalization rate advocated by TIAT's appraiser.

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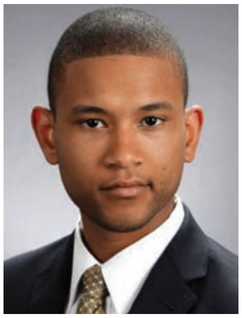
SECOND CIRCUIT ADDRESSES LIMITED SCOPE OF CHAPTER 15 OF THE BANKRUPTCY CODE



Reginald Sainvil
Associate, Pittsburgh

Trikona Advisers Ltd. v. Chugh, 846 F.3d 22 (2d Cir. 2017)

CASE SNAPSHOT

The U.S. Court of Appeals for the Second Circuit recently considered the scope of chapter 15 of title 11 of the United States Code, 11 U.S.C. section 101 et seq. (the "Bankruptcy Code") and determined that chapter 15 of the Bankruptcy Code does not apply where a U.S. District Court provides preclusive effect to factual findings from an otherwise unrelated foreign insolvency proceeding.

FACTUAL BACKGROUND

Trikona Advisors, Ltd. ("TAL") was an investment advisory company formed in 2006 by Rakshitt Chugh and Aashish Kalra. Chugh and Kalra each held a 50 percent equity stake in TAL through entities they owned. Chugh owned TAL through ARC Capital LLC ("ARC") and Haida Investments ("Haida"), and Kalra owned TAL through Asia Pacific Investments, Ltd. ("Asia Pacific"). TAL imploded because of the 2008 financial crisis, and Chugh's and Kalra's relationship soured because of pressure from shareholders to sell TAL's assets, a series of failed transactions with a German fund manager, and Chugh's eventual ouster from TAL.

On February 13, 2012, ARC and Haida filed a petition in the Grand Court of the Cayman Islands (the "Grand Court"), seeking to wind up TAL under the Cayman Islands Companies Law. The court granted the petition to liquidate, and the decision was affirmed. Separately, on December 28, 2011, Asia Pacific filed a complaint against ARC and Haida in the U.S. District Court for the District of Connecticut. The claims against ARC and Haida were nearly identical to the affirmative defenses that were asserted by Asia Pacific in the wind-up proceedings before the Grand Court. ARC and Haida moved for summary judgment following the Grand Court's ruling, and argued that Asia Pacific was collaterally estopped from re-litigating the factual disputes already decided by the Grand Court. The District Court agreed and granted the motion for summary judgment. The decision was subsequently appealed.

COURT ANALYSIS

In an opinion authored by Judge John M. Walker, Jr., the Court of Appeals rejected Asia Pacific's argument that the judgment from the Grand Court could not have preclusive effect because there was no chapter 15 recognition given to the Cayman Island liquidation proceeding. In reaching its conclusion, the court set forth the specific circumstances where chapter 15 applies, and explained that these requirements did not apply to the facts presented. Moreover, according to the court, chapter 15 did not apply because the lawsuit commenced in the District Court was a non-bankruptcy action that was unconnected to any foreign or domestic bankruptcy proceeding. Thus, in a narrow holding, the court determined that chapter 15 of the Bankruptcy Code does not apply when a United States court simply gives preclusive effect to factual findings from an otherwise unrelated foreign liquidation proceeding.

Though chapter 15 does not apply where a party contends that a foreign court's finding of facts should be given preclusive effect, the court noted that chapter 15 of the Bankruptcy Code could apply where a party seeks to enforce in a United States court, an order entered by a foreign court in an insolvency proceeding.

PRACTICAL CONSIDERATIONS

Parties involved in cross-border insolvencies should pay close attention to the threshold requirements for commencing and maintaining a chapter 15 case, because the Second Circuit's opinion demonstrates that courts are likely to adhere to a strict interpretation of the language contained in chapter 15 of the Bankruptcy Code. In particular, practitioners should pay careful attention to situations where a party to a proceeding in a United States court seeks to enforce an order entered by a foreign court presiding over an insolvency proceeding, because chapter 15 of the Bankruptcy Code could apply.

Bankruptcy Court Rejects Yield Capitalization Method in Determining the FMV of an Unbranded Extended-Stay Hotel— continued from page 12

PRACTICAL CONSIDERATIONS

Because of the subjective nature of the appraisal process, a bankruptcy court has wide latitude in determining the value of property after consideration of an expert's testimony. When obtaining expert opinions on value, practitioners should be wary of wildly speculative assumptions that may lead a court to conclude that the proposal fails to estimate value in light of the anticipated use or disposition of the property. In its efforts to persuade a judge to adopt its proposed valuation, a party is well served by demonstrating that the proposed value reasonably considers the condition of the property, historical performance, competitive disadvantages, market conditions, or any other factors that may impact the value of the property at the time of the valuation.

DELAWARE WEIGHS IN ON SPLIT IN AUTHORITY REGARDING AMOUNT OF SEVERANCE PAY ENTITLED TO PRIORITY STATUS

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In re ADI Liquidation, Inc., 560 B.R. 105 (Bankr. D. Del. 2016)

CASE SNAPSHOT

In an opinion issued in the case of ADI Liquidation, Inc. (f/k/a AWI Delaware, Inc.)[1], Judge Kevin Carey addressed a split in authority regarding the amount of severance pay entitled to priority status as wages earned "within 180 days before the date of filing of the petition" under 11 U.S.C. section 507(a)(4). In its opinion, the Bankruptcy Court held that the entirety of a former employee's severance pay – and not just the portion attributable to the 180 days before the petition date – was entitled to priority status, as the severance pay was not actually earned until the employee was terminated.

FACTUAL BACKGROUND

Mark R. Managan was an employee of Associated Wholesalers, Inc. ("AWI"), one of the debtor entities, from June 1999 to his termination August 1, 2014. AWI provided full-time, non-union employees who had at least five years of service, with one week of severance benefits for every year of completed service, up to 20 weeks. It was undisputed by the parties that Mr. Managan was entitled to 15 weeks of severance payments. From the time of Mr. Managan's termination to September 9, 2014, when the Debtors filed bankruptcy, Mr. Managan received nine weeks of severance payments, leaving $8,693.70 unpaid. From August 2, 2014 to October 16, 2014, Mr. Managan responded to requests from the Debtors and their representatives for information and advice, despite his termination.

Mr. Managan filed a claim for the unpaid $8,693.70 and asserted that his claim was entitled to priority under section 507(a)(4). After confirmation of a plan, the Debtors objected to the priority status of Mr. Managan's claim. Mr. Managan, acting pro se, responded to the objection and asserted that his claim was a priority claim under section 507(a)(4), or, in the alternative, an administrative expense claim.[2]

COURT ANALYSIS

The Bankruptcy Court noted a split in authority regarding what portion of an employee's severance pay is entitled to priority under section 507(a)(4) as "wages, salaries, or commissions, including vacation, severance, and sick leave pay earned…" "within 180 days before the date of the filing of the petition."[3] The split revolves around when severance pay is "earned." Many courts have held that severance paid is "earned" when severance is accrued. Under that line of reasoning, only one week of Mr. Managan's severance pay, accrued on his 15th anniversary in June 2014, would be entitled to priority.

However, Judge Carey, referencing his own prior decision in *In re Garden Ridge Corp.*[4] and the Fourth Circuit's decision in *Matson v. Alarcon*[5], held that severance pay is not "earned" until the employee's termination, when payment is triggered. As a result, the Bankruptcy Court found that the entirety of Mr. Managan's 15-week severance payment was "earned" on August 1, 2014. The Bankruptcy Court distinguished the holding of the Third Circuit Court of Appeals in *In re Roth Am., Inc.*[6], which found that employees were only entitled to administrative expense claims for severance and vacation pay to the extent that such pay was attributable to their period of post-petition employment. The entire $8,693.70 was deemed to be entitled to priority status.

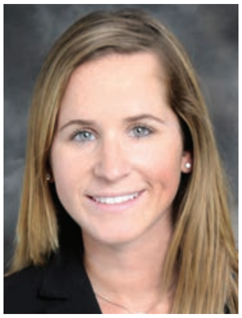
The Bankruptcy Court quickly dismissed the idea that the severance pay was entitled to administrative priority based on Mr. Managan's post-petition and post-termination advice and assistance to the Debtors. The court found that there was no evidence of an agreement by the Debtor to pay the severance payments or to make any payment to Mr. Managan in exchange for his post-petition assistance.

PRACTICAL CONSIDERATIONS

The *ADI Liquidation, Inc.* opinion highlights continuing uncertainty regarding how claims for severance arising from termination in the 180 days pre-petition will be treated in the busy Delaware Bankruptcy Court. In contrast, the *Roth Am., Inc.* opinion provides clarity regarding the portion of severance pay entitled to administrative expense priority to the extent severance claims arise after the petition date. As a result, debtors planning to file in Delaware should give careful consideration to their timing of the termination of employees entitled to severance or paid time off.

1 No. 14-12092 (Bankr. D. Del. Oct. 19, 2016)
2 Mr. Managan also alleged that his claim was secured, but provided no basis for this allegation.
3 11 U.S.C. § 507(a)(4).
4 2006 WL 521914, at *1-2 (Bankr. D. Del. Mar. 2, 2006).
5 651 F.3d 404 (4th Cir. 2011).
6 975 F.2d 949 (3d Cir. 1992).

DEAD MEAT: BANKRUPTCY COURT IN DELAWARE CONSIDERS ABILITY TO SET OFF AN ADMINISTRATIVE EXPENSE CLAIM AGAINST PREFERENCE LIABILITY



Lauren S. Zabel
Associate, Philadelphia

In re Quantum Foods LLC, 554 B.R. 729 (Bankr. D. Del. 2016)

CASE SNAPSHOT

The Creditors' Committee sued various Tyson Foods entities (the "Tyson Entities") for recovery of preferential transfers of approximately $3.75 million and for disallowance of the Tyson Entities' claims under section 502(d), pending return of alleged preferential transfers. The Tyson Entities asserted various defenses, claimed a right to set off a previously allowed post-petition administrative expense claim, and asserted that any section 502(d) disallowance should exclude the Tyson Entities' administrative expense claim. The court denied the Committee's motion for judgment on the pleadings, finding that the requirements for setoff were met.

FACTUAL BACKGROUND

The Tyson Entities supplied meat products to the debtors post-petition, and for which the Tyson Entities were allowed an administrative expense claim of approximately $2.6 million. Thereafter, the Committee initiated an adversary proceeding to avoid and recover allegedly preferential transfers under sections 547, 548 and 550 of the Bankruptcy Code. The Tyson Entities asserted various defenses and asserted various counterclaim and third-party claims against the Debtors. Specifically, the Tyson Entities asserted that the Committee's claims constituted post-petition claims, and that the Tyson Entities were entitled to set off any recovery by the amount of its administrative expense claim. The Tyson Entities also sought declaratory judgment that disallowance under section 502(d) was limited to pre-petition claims, and would not interfere with recovery on administrative claim. The Committee moved for judgment on the pleadings regarding the Tyson Entities counterclaim.

COURT ANALYSIS

The court first considered the Tyson Entities' setoff argument. The court noted that under the *In re Friedman's* decision rendered by the Third Circuit, post-petition new value may not factor into a preference calculation for purposes of the new value defense. The court rejected the Committee's argument that the Tyson Entities' setoff claim was merely a disguised new value defense because it would have the effect of reducing the amount of preferential transfers returned to the estate. In rejecting that argument, the court noted that a setoff claim does not affect the preference calculation, but rather only the amount paid to the estate. Instead, the court noted that the Tyson Entities' administrative expense claim – which is an independent, pre-existing and wholly unrelated claim – fit squarely into the definition of a setoff claim. The court then noted that a setoff claim is only proper where both obligations arise on the same side of the petition date, and continued to find that a preference claim – though involving pre-petition facts – necessarily arises post-petition. Finally, the court determined that an administrative expense claim is not subject to disallowance under section 502(d). Thus, the court denied the Committee's motion for judgment on the pleadings.

PRACTICAL CONSIDERATIONS

Although a setoff claim would not be considered a preference defense, it would have the impact of reducing any net payment to the estate on account of preference liability. Thus, creditors should keep this argument in their arsenal when considering preference cases. Debtors should likewise be mindful of preference-defendants' administrative expense claims when analyzing the strengths of preference cases.

NEITHER EXPIRED COMMERCIAL LEASE NOR HOLDOVER TENANCY IS PROPERTY OF BANKRUPTCY ESTATE

Brian M. Schenker
Associate, Philadelphia

Truong v. 325 Broadway Associates LLC (In re Truong), Adv. No. 16-1380-VFP, Case No. 16-19929-VFP (Bankr. D.N.J. Aug. 30, 2016)

CASE SNAPSHOT

In this chapter 7 bankruptcy case, the bankruptcy court held that, when a commercial lease is terminated pre-bankruptcy as a matter of state law, neither it nor any holdover tenancy of the tenant is property of the bankruptcy estate. Therefore, the landlord is not barred by the automatic stay from proceeding to evict the holdover tenant in a state court proceeding.

FACTUAL BACKGROUND

The debtor entered into a lease of commercial real property with its landlord. The term of the lease expired December 31, 2014, after which the debtor remained on the property as a month-to-month tenant. The debtor then sublet a portion of the property to a subtenant.

By prior written notice, the landlord terminated the debtor's month-to-month tenancy effective as of March 31, 2016. The debtor ceased paying rent, did not vacate the premises, and continued to collect rent from the subtenant. The landlord sought to evict the debtor as a holdover tenant in a state court proceeding.

The debtor filed for bankruptcy May 23, 2016, and filed a notice with the state court that its eviction proceeding was stayed. The landlord disagreed and argued in state court that the termination of the debtor's tenancy was effective pre-bankruptcy and, therefore, the eviction proceeding was not stayed. The state court agreed with the landlord and proceeded with the eviction, which decision was upheld on appeal.

The debtor then commenced an adversary proceeding in the bankruptcy court seeking an injunction staying the eviction. The debtor argued that it maintained an interest in the property and, therefore, the eviction was barred by the automatic stay of section 362 of the Bankruptcy Code.

COURT ANALYSIS

The bankruptcy court disagreed, and concluded that the Bankruptcy Code excludes a commercial lease that expired pre-bankruptcy under state law, from being property of the debtor's estate and enjoying the protection of the automatic stay.

The bankruptcy court first cited section 541(b)(2) of the Bankruptcy Code, which provides that "property of the estate does not include … any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease …." The bankruptcy court then cited section 362(b)(10) of the Bankruptcy Code, which provides that "the filing of a petition … does not operate as a stay … under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of … a case under this title to obtain possession of such property …." The bankruptcy court finally cited section 365(c)(3) of the Bankruptcy Code, which provides that the "trustee may not assume or assign any … unexpired lease of the debtor … if … such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief."

The bankruptcy court then noted that the state court had determined that the landlord's termination notice cut off all of the debtor's interests in the property effective as of March 31, 2016, as a matter of state law without the need for further judicial action – a decision that the bankruptcy court was required to give preclusive effect. Thus, the bankruptcy court found, as it was required to do, that the debtor's tenancy terminated when the time under the notice expired because no further act of the landlord was required to effect the termination as a matter of state law – all of which occurred pre-bankruptcy.

With respect to the debtor's holdover tenancy, the bankruptcy court reasoned that "if a commercial holdover tenant's equitable possessory interests were protected by the automatic stay, that would effectively nullify section 362(b)(10), which was purposely placed into the Bankruptcy Code to deal with situations such as this." Thus, the bankruptcy court held that the eviction proceedings were not stayed.

PRACTICAL CONSIDERATIONS

As this case makes clear, when evaluating the effect of a bankruptcy filing on the termination of a commercial lease and eviction proceeding, the key inquiry is the status of the termination of the debtor's tenancy under state law. This case presents the "easy" facts, where the lease had expired pursuant to its terms pre-bankruptcy, the month-to-month tenancy had been effectively terminated pre-bankruptcy, and a state court had ruled on both issues and determined that the tenant only had holdover tenancy rights. The landlord (and bankruptcy court) may have faced a "tougher" decision as to whether to the state court proceedings were free to continue had the tenant filed for bankruptcy prior to March 31, 2016 – the effective date of the termination letter – or if the termination had been default-based and "early," i.e., prior to the expiration of the stated term of lease.

TEXAS BANKRUPTCY COURT HOLDS THAT REVERSE VEIL PIERCING IS NOT AN INDEPENDENT CLAIM UNDER TEXAS LAW. RATHER, IT IS A REMEDY THAT MAY BE GRANTED IN A SUCCESSFULLY ESTABLISHED INDEPENDENT CLAIM.

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In re Ward, 558 B.R. 771 (Bankr. N.D. Tex. 2016)

CASE SNAPSHOT

The U.S. Bankruptcy Court for the Northern District of Texas, Dallas Division (the "Court") held that reverse veil piercing is not an independent cause of action under Texas law. Rather, reverse veil piercing is a remedy that courts may impose in connection with a successfully prosecuted stand-alone claim. Moreover, the Court rejected the Trustee's argument that he could rely on the stand-alone claims asserted by the Debtor's creditors during pre-bankruptcy litigation as a mechanism for invoking the remedy of reverse veil piercing. The Court, therefore, granted the defendants' Motion for Summary Judgment on the Trustee's reverse veil piercing claim.

FACTUAL BACKGROUND

Lloyd Eugene Ward (the "Debtor") filed a voluntary petition for relief under chapter 7 of the Bankruptcy Court on May 1, 2014 (the "Petition Date"). His wife, Amanda Ward ("Amanda"), did not file a joint petition in connection with the Debtor's bankruptcy. Rob Yaquinto (the "Trustee") was appointed as the duly authorized chapter 7 Trustee of the Debtor's bankruptcy estate, and conducted an investigation into the Debtor's assets and financial affairs in the course of discharging his fiduciary duties. In his investigation, the Trustee discovered the existence of Glen Properties Corp. ("GPC"), and Best Account Receivables Management Solutions, LLC ("BRM"), which Amanda claimed to be her sole and separate property.

GPC was formed approximately 16 years before the Petition Date, and the evidence presented to the Court demonstrated that Amanda was its only shareholder. GPC was formed for the purpose of purchasing and owning a condominium (the "Condominium") in order to protect Amanda for any liability associated with leasing the Condominium to third-parties. Approximately four years prior to the Petition Date, GPC acquired a single-family residence that the Debtor and Amanda occupied as their homestead (the "Homestead"). The Homestead had been purchased with the proceeds from the sale of Amanda's previous home, which was sold in connection with her divorce from her previous husband, and a loan from her father. The evidence presented to the Court, however, demonstrated that the Debtor's and Amanda's community property was used to renovate the Homestead. As a result, some comingling had occurred between the Debtor's and GPC's assets. Moreover, the evidence also demonstrated that the Debtor: (i) exercised substantial control over GPC; (ii) signed at least one document in which he represented that he was an officer of GPC; and (iii) conducted several transactions in which he moved funds in and out of GPC's bank accounts. Nevertheless, on the Petition Date, GPC's only assets were the Condominium and the Homestead.

BRM was in the business of providing billing and collection services to health care companies, and had no assets other than the revenues produced from the services it provided. On the other hand, the evidence presented to the Court demonstrated that: (i) the bookkeeper for the Debtor's law practice ("LWA") also kept BRM's books, and occasionally cut checks from LWA's account to cover BRM's expenses; (ii) LWA paid BRM's employees' payroll and health insurance premiums; (iii) LWA and BRM had the same IT Director, shared the same phone system, and had the same address; (iv) BRM leased space from the Debtor / LWA, but almost never paid LWA the required rent; and (v) BRM's collection letters were sent on LWA letterhead.

The Trustee, as a result of the finding from his investigation, filed a complaint (the "Complaint") against the Debtor, Amanda, GPC, and BRM (collectively, the "Defendants") asserting claims for, among other things: (i) reverse veil piercing against the Debtor, which sought a declaration that GPC's and BRM's assets are property of the Debtor's bankruptcy estate; and (ii) reverse veil piercing against Amanda, which sought a declaration that GPC's and BRM's are Amanda's property. The Trustee, however, did not assert separate affirmative damages claims (i.e., claims for fraud, fraudulent transfer, or other misconduct) against any of the Defendants.

The Defendants subsequently filed a Motion for Summary Judgment (the "MSJ") asserting, among other things, that reverse veil piercing is not an independent claim and/or cause of action under Texas law, and that they are entitled to judgment as a matter of law because the Trustee had failed to plead an independent claim for damages against them for which the remedy of equitable veil piercing could be imposed. The Trustee responded by asserting that: (i) reverse veil piercing constitutes an independent claim under Texas law, and (ii) even if reverse veil piercing is just a remedy under Texas law, he could rely on pre-petition claims asserted against the Debtor by its creditors to support the imposition of the veil piercing remedy. The Court proceeded to analyze these arguments in connection with ruling on the MSJ.

COURT ANALYSIS

In reaching its ultimate holding that reverse veil piercing is not a stand-alone independent claim or cause of action under Texas law, the Court began its analysis by distinguishing the cases cited by the Trustee that have referred to reverse veil piercing theory as a "claim or cause of action." Specifically, the Court noted that such cases do not analyze the controlling issue presented in the case – i.e., whether reverse veil piercing is a "stand-alone" claim or cause of action under Texas law. The Court then specifically noted that courts that have addressed the controlling issue, including the Texas Supreme Court (*Matthews Const. Co., Inc. v. Rosen*, 796 S.W.2d 692, 693 n.1) (Tex. 1990)) and the United States Court of Appeals for the Fifth Circuit (*U.S. Nat'l Assn. v. Verizon Comms., Inc.*, 761 F.3d 409, 415 (5th Cir. 2014)), have specifically held that reverse veil piercing is not a stand-alone claim or cause of action under Texas law.

The Court continued its analysis by addressing the Trustee's argument that the cases holding that reverse veil piercing is not an independent stand-alone

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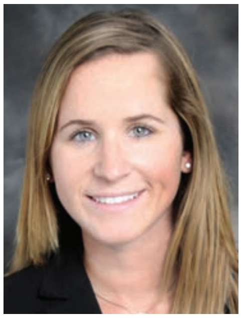
CROPPED OUT: BANKRUPTCY COURT CONSTRUES ALLEGED BAILMENT AGREEMENT AS DISGUISED FINANCING



Lauren S. Zabel
Associate, Philadelphia

In re Jeff Benfield Nursery Inc., No. 16-40375, 2017 WL 358591 (Bankr. W.D.N.C. Jan. 24, 2017)

CASE SNAPSHOT

Debtor (operator of a nursery) entered into a pre-petition growing contract with SiteOne. SiteOne alleged that such agreement constituted a bailment agreement and, therefore, that SiteOne owned full title to the trees subject to such agreement. SiteOne moved for relief from the automatic stay. The Bankruptcy Court construed the agreement, instead, as a disguised financing agreement, and found that stay relief was not necessary because any security interest of SiteOne was adequately protected.

FACTUAL BACKGROUND

Debtor operates a commercial nursery in western North Carolina. PNC asserted a $6.1 million secured claim, secured by substantially all of the Debtors' assets. Century asserted a $540,000 secured claim, which it claimed to be secured by a first-priority lien on all of the Debtors' assets. Prior to the petition date, the Debtor entered into certain "grow agreements" governed by North Carolina law, pursuant to which the Debtor was to plant and grow certain varieties and quantities of trees on land leased by the debtor, in exchange for various fees and payments. Pursuant to the grow agreements, title to the trees was to remain in the name of the non-debtor contract counterparty (SiteOne), and SiteOne was granted authority to file any financing statements necessary to protect its claim of title to the trees. The grow agreements do not reference the intent to create a security interest.

SiteOne filed three financing statements with the North Carolina Secretary of State, each stating that it was a "non-UCC Filing" concerning a bailee/bailor relationship. SiteOne sought relief from the automatic stay. PNC objected, disputing SiteOne's assertion of title, arguing that the grow agreements are financing arrangements rather than bailment agreements, and arguing that any interest of SiteOne is adequately protected.

COURT ANALYSIS

The court first rejected SiteOne's argument that the Debtor waived the protections of the automatic stay in the grow agreements, finding such provisions unenforceable as a matter of public policy. The court next addressed whether SiteOne was otherwise entitled to relief from the automatic stay, noting that the nature of the moving party's interest in the property at issue must first be determined. The court determined that the grow agreements did not constitute bailment agreements because SiteOne retained significant control rights regarding the trees, which is contrary to North Carolina bailment law, which requires the bailee to retain exclusive possession and control over the goods at issue.

Instead, the court held that the grow agreements were disguised finance arrangements because SiteOne financed the Debtor's operation by supplying material, rather than money with which to buy materials. Based upon such finding, the court determined that whether SiteOne had a perfected security interest in the trees must be analyzed under Article 9 of the Uniform Commercial Code, but noted that the respective rights of the various parties would be determined in an adversary proceeding pursuant to Federal Rule of Bankruptcy Procedure 7001. For purposes of SiteOne's stay relief motion, however, the court determined that it was sufficient to conclude that SiteOne is not the owner and bailor of the goods in question, but may be the holder of a perfected security interest therein. Therefore, the court held that while SiteOne had a plausible interest in the trees, such interest was adequately protected. Therefore, the court concluded that there was no cause for stay relief.

PRACTICAL CONSIDERATIONS

If parties to a contract do not intend to enter into a financing transaction, the parties should be very specific when drafting such contracts so as to avoid a situation where the agreement could be construed otherwise, and should consider other steps to protect the transaction in the event it is construed as a financing arrangement.

BALLOON PAYMENT WILL NOT POP CHAPTER 13 PLAN

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In re Cochran, 555 B.R. 892 (Bankr. M.D. Ga. 2016)

CASE SNAPSHOT

A Georgia bankruptcy judge rejected the majority view and concluded that a plan that calls for monthly payments followed by a balloon payment to a secured creditor complies with section 1325(a)(5)(B)(iii)(I) of the Bankruptcy Code.

FACTUAL BACKGROUND

The debtor's plan provided for the repayment in full of a creditor's claim secured by real estate, through the making of periodic payments in equal amounts, followed by a single, final, larger balloon payment. The balloon payment was to be funded by the debtor's wife refinancing the secured debt. The wife's ability to refinance the debt was based on a recently increased salary paid to her by the debtor-owned business, and the debtor admitted there was no approval, term sheet or commitment letter for such refinancing. Despite the potential uncertainty of the refinancing, the court reasoned that the plain language and purpose of 1325 do not support the majority view. Thus, after analyzing feasibility, the court approved the debtor's plan.

COURT ANALYSIS

In analyzing whether section 1325(a)(5)(B)(iii)(I) of the Bankruptcy Code permits periodic equal monthly payments followed by a final larger balloon payment, the court employed the "plain language" canon of statutory construction. In doing so, the court first analyzed the language of the statute and then assessed whether the language was absurd or contrary to congressional intent. The court determined that balloon payments are not within the plain language of section 1325(a)(5)(B)(iii)(I) of the Bankruptcy Code and, therefore, need not be equal to other periodic payments that would repay a secure claim. The court noted that, unlike a periodic payment, a balloon payment is not recurring and is not "'property to be distributed ... in the form of periodic payments' and, consequently, are outside the scope of [section symbol] 1325(a)(5)(B)(iii)(I)." Accordingly, the court concluded that only the periodic payments prior to the final balloon payment are subject to the "equal monthly amounts" requirement in section 1325(a)(5)(B)(iii)(I) of the Bankruptcy Code.

The court's conclusion is contrary to the majority view that a balloon payment is a periodic payment under 1325, and therefore must be equal to other periodic payments for a plan to be confirmable. In doing so, the Georgia bankruptcy court suggests that the reasoning of courts adopting the majority view suffers from two errors. First, such courts ignore the "if" in the statutory language, "*if* property to be distributed ... is in the form of periodic payments." Second, those courts also err on the apparent assumption that a claim must be satisfied by only one type of property or payment.

Next, the court the analyzed whether the plain language is absurd or demonstrably at odds with congressional intent. Again, the court broke with the majority view, and noted such view is contrary to the underlying purpose of chapter 13, which is to provide the debtor with "a flexible means for the debtor to protect his assets, most importantly those assets necessary to pay his creditors by completing his plan, such as a house to live in or car to drive to work" (citation omitted).

Since it concluded the plain language was not absurd or demonstrably at odds with Congress' intent, the court then analyzed the plan's feasibility. Although the refinancing was not imminent and required the wife to demonstrate six months of income at the increased salary, the court accepted the uncontroverted testimony of the debtor, who testified that the refinancing lender's loan officer advised the refinancing would be "no problem" once debtor's wife could demonstrate six months of income at her new salary. Absent contrary testimony that the debtor's wife would be able to refinance, or testimony that the debtor would not be able to make the other plan payments – and in light of the fact that the secured creditor was oversecured and there was no evidence the property was depreciating in value – the court found the plan to be feasible.

PRACTICAL CONSIDERATIONS

There is a split of authority as to whether balloon payments are permitted in chapter 13 plans. Lenders should be mindful of this when evaluating how to negotiate the repayment of a chapter 13 debtor's secured claim. Lenders may also want to counsel their loan officers that oral representations concerning refinancing of debt may be admissible to prove feasibility in a chapter 13 plan confirmation hearing.

claim or cause of action are distinguishable. Specifically, the Trustee argued that such cases are distinguishable because the "alter ego" theory discussed in the adverse cases arises under section 21.223 of the Texas Business and Organizations Code. Reverse veil piercing theory, on the other hand, arises under Texas common law. As a result, the Trustee argued that alter ego and reverse veil piercing are two separate claims or causes of action under Texas law. The Court rejected the Trustee's argument and held that reverse veil piercing under Texas law is accomplished through an application of Texas common law alter ego theory. Moreover, because the applicable factors that a court must consider in deciding whether to impose an alter ego or reverse veil piercing remedy are nearly identical, the Court concluded that there is no reason to consider alter ego and reverse veil piercing as separate theories. Based on the above analysis, the Court concluded that reverse veil piercing is not an independent claim under Texas law, but merely a remedy that may be imposed by the Court in connection with the successful prosecution of a stand-alone claim.

After announcing its initial holding, the Court proceeded to address the Trustee's alternative argument that he could rely on the stand-alone claims and causes of action asserted in a pre-petition lawsuit by a group of the Debtor's creditors. The Court held that the Trustee could not rely on the creditors' claims, or on the judgment obtained by the creditors on their claims, because such claims and judgment were not property of the bankruptcy estate. A trustee, therefore, was required to either have a judgment in hand or hold stand-alone independent damage claims against the Defendants that are property of the estate before he could seek to invoke the remedy of reverse veil piercing. Because the Trustee had failed to plead an affirmative stand-alone damages claim against the Defendants, the Court granted judgment in favor of the Debtor and Amanda on the Trustee's reverse veil piercing claims.

PRACTICAL CONSIDERATIONS

Reverse veil piercing can serve the valuable purpose of bringing additional assets into a bankruptcy estate when a debtor seeks to deprive its creditors of the opportunity to obtain a recovery on their claims from the liquidation of such assets. In order to benefit from this powerful remedy, however, trustees, authorized committees or other authorized parties-in-interest should assert a series of affirmative stand-alone claims and causes of action that seek pecuniary damages in order for a bankruptcy court to be able to invoke the remedy of reverse veil piercing. Asserting such affirmative stand-alone claims will assist in limiting a debtor's ability to conceal assets that should be used to satisfy legitimate creditor claims.

COUNSEL'S CORNER: NEWS FROM REED SMITH

Jennifer Knox was a panelist on "60 Cases in 90 minutes" at the Eastern District of Pennsylvania Bankruptcy Conference, 28th Annual Forum, in Atlantic City on January 19, 2017.

Jane Sarma moderated a panel for the 11th Annual Capital Link International Shipping Forum entitled, "Restructuring as a Business & Investment Opportunity," March 20, 2017, in New York.

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