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In This Issue:

CAN A JUNIOR LIEN HOLDER OBTAIN DISCOVERY FROM A SENIOR LIEN HOLDER?

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We all know that under Section 510(a) of the Bankruptcy Code, subordination agreements between creditors are to be enforced in bankruptcy cases if they are enforceable under applicable state law. But what if the junior creditor wants to take discovery from the senior creditor regarding the senior creditor's claim? Is that allowed? Well, according to the United States Bankruptcy Court for the Northern District of Illinois, no. In that case, the subordination agreement was fairly typical and stated that "the Subordinated Lender shall not at any time or in any manner foreclose upon, take possession of, or attempt to realize on any Collateral, or proceed in any way to enforce any claims it has or may have against the Parent or any Obligor unless and until the Obligations to the Senior Lender have been fully and indefeasibly paid and satisfied in full." The Bankruptcy Court concluded that the discovery requests constituted an act to enforce claims, and that the subordination language was aimed at preventing such "obstructionist behavior" by the junior creditor and goes above and beyond the mere maintenance of the "hierarchy of lien priorities". The Bankruptcy Court did note that the junior creditor could attempt to bring an adversary proceeding or an action in a different court against the senior creditor contesting the enforceability of the subordination agreement and could seek discovery in such actions. *In re Argon Credit, LLC.* No. 16-39654 (Bankr. N. D. Ill January 10, 2019).

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Dine Brands Global, Inc. et. al v. RMH Franchise Holdings, Inc. (In re RMH Franchise Holdings, Inc.), Case No. 18-50481 (Bankr. D. Del. Sept. 25, 2018)

CASE SNAPSHOT

The Franchisor sought a declaratory judgment that it terminated the franchise agreements pre-petition; therefore, the franchisor could freely exercise its rights and remedies. The bankruptcy court ruled in the Debtors' favor, holding that the Franchisor's inconsistent pre-petition communications did not terminate the franchise agreements, and the franchise agreements remained property of the Debtors' estate.

FACTUAL BACKGROUND

The Debtors are the second-largest franchisee of Applebee's Neighborhood Grill & Bar restaurants. On the petition date (May 8, 2018), the Debtors operated over 160 franchises across 15 states. The franchise agreements granted the Franchisor the right to terminate the agreements upon written notice upon the occurrence of certain events of default.

In June 2017, the Debtors stopped making monthly royalty payments to the Franchisor. On September 20, 2017, the Franchisor sent a letter to the Debtors granting them 90 days to cure the default and stating affirmatively that the franchise agreements would automatically terminate on the 91st day if the Debtors did not cure the default.

In a series of subsequent letters, the Franchisor extended the date by which the Debtors had to cure the default. Notably, the subsequent communications did not include language that the franchise agreements would automatically terminate by a date certain. On April 25, 2018, the Franchisor signed a letter agreeing to delay exercising its rights under the franchise agreements until May 8, 2018. The Debtors filed for Chapter 11 bankruptcy protection on May 8th.

The Franchisor filed the declaratory judgment action seeking a ruling that the automatic termination provisions of the September 20, 2017 letter caused the termination of the franchise agreements prior to the petition date.

COURT ANALYSIS

In response to the Franchisor's lawsuit, the Debtors argued that the communications subsequent to the September 20, 2017 letter did not include automatic termination language, and if the automatic termination provision was deemed to carry through subsequent correspondence, the Franchisor's agreement to forbear until May 8, 2018 meant the franchise agreements could not terminate automatically.

The Court agreed with the Debtors. First, the court held that the September 20, 2017 letter expressly provided that the franchise agreements would terminate automatically on the 91st day. But the franchisor did not insert similar language into the subsequent communications, and it could not retroactively edit the communications. To terminate the franchise agreements upon expiration of continued cure periods, the franchisor had to provide

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TO AVOID MOOTNESS, REQUEST A STAY PENDING AN APPEAL

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Tanguy v. West (In re Davis),
No. 17-20655, 2018 WL 4232063
(5th Cir. Sept. 5, 2018)

CASE SNAPSHOT

In *In re: Davis*, the Fifth Circuit ruled that an appeal brought by a debtor was moot following the sale of property when the debtor did not request a stay pending the appeal, even when the debtor argued that the court rendering the underlying decision lacked jurisdiction on the matter.

FACTUAL BACKGROUND

On February 1, 2017, trustee-appellee William West ("**Appellee**") filed a motion in federal bankruptcy court under section 363(f) of the Bankruptcy Code to sell certain real property interests to Croix Custom Homes ("**Purchaser**"), which Appellee had recovered in collecting a judgment against the debtor ("**Debtor**"). The Debtor objected, and Appellee responded with an emergency motion to strike the objection because the Debtor's attorney had stated that the Debtor would not object to the sale of the property at a status conference attended by the parties.

The bankruptcy judge held a combined hearing on the emergency motion to strike and the underlying motion to sell. The bankruptcy judge struck the Debtor's objection and estopped Debtor from opposing the sale based on the representation made by counsel for the Debtor that his client did not object to the filing of a motion to sell and would not object to the sale. The bankruptcy judge then granted Appellee's motion to sell, and, notably, Debtor did not seek a stay of the sale pending appeal.

Appellee subsequently sold the property to Purchaser on February 17, 2017. Debtor filed its notice of appeal of the order of sale to the district court on February 23, 2017. Appellee then filed a motion to dismiss in the district court, arguing that, because Debtor had not requested a stay, section 363(m) removed jurisdiction from the district court on appeal by mooting any of Debtor's requests that would negate the sale of the property. Debtor then filed both an initial brief and an objection to the motion to dismiss, primarily arguing that the federal bankruptcy court did not have jurisdiction to order the property's sale. Debtor argued that the State had receivership over the property, and therefore, that State court had exclusive jurisdiction. The district court granted Appellee's motion to dismiss Debtor's appeal as moot, and Debtor appealed to the Fifth Circuit.

COURT ANALYSIS

Appellee argued that Debtor abandoned any argument contesting the district court's finding of mootness (regarding the bankruptcy court's determination of the legitimacy of the sale of the property to Purchaser) because it was not addressed in the initial briefing. The circuit court noted that Debtor did not cite to section 363(m), which deals with the sale of property to a good faith purchaser, in its opening brief. Debtor argued that its opening brief ***implicitly*** challenged the good faith of Purchaser in purchasing the property, which is a consideration in determining if section 363(m) applies, and therefore did preserve the argument for appeal.

The circuit court held that even if arguing good faith would preserve a section 363(m) mootness determination for appeal, Debtor did not argue good faith in its opening brief. While its citation to the opening brief contained an argument that *Appellee* and his counsel acted without good faith (as opposed to Purchaser) regarding disclosure to the bankruptcy court of a pending state court action, the circuit court noted that that inquiry is not relevant to the good faith of a *purchaser* under section 363(m). The circuit court, in other words, would not implicitly recognize Purchaser's bad faith through an argument of Appellee's bad faith, as would have been required to bring section 363(m) to the fore and potentially preserve the argument for appeal. Based upon this analysis, the circuit court held that Debtor abandoned its argument that the case in the district court was not moot.

The court then went one step further and noted that it would still have affirmed the district court's determination that the Debtor's claims was moot, reasoning that section 363(m) protects, from later modification on appeal, an authorized sale where the purchaser acted in good faith and the sale was not stayed pending appeal. This means, absent a lack of good faith, any appeal brought by a debtor is moot following the sale of property when there is no request for a stay pending appeal, and this is true even if the debtor argues that the bankruptcy court did not have jurisdiction to authorize the sale.

PRACTICAL CONSIDERATIONS

The case highlights some practical considerations for attorneys. First, to preserve a claim, a debtor must request a stay of a sale of property pending an appeal, even when it believes that the court lacks jurisdiction. Second, in its brief, attorneys should cite to the relevant statutory authority dealing with the sale of property to a good faith purchaser in order to preserve the argument for appeal. Finally, an attorney for a debtor or another party-in-interest should not rely on implicit arguments as to good faith, but rather should explicitly make clear the sections of the Bankruptcy Code relevant to their argument.

FIFTH CIRCUIT HOLDS THAT COURTS HAVE THE FLEXIBILITY TO SELECT THE VALUATION IN A CRAMDOWN SCENARIO

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Houston SportsNet Finance, L.L.C. v. Houston Astros, L.L.C. (In re Houston Regional Sports Network, L.P.), 886 F.3d 523 (5th Cir. 2018)

CASE SNAPSHOT

The Fifth Circuit held that when the court values collateral for a Chapter 11 "cramdown" plan, it has flexibility to choose the appropriate valuation date, and does not necessarily have to choose between the petition date and the effective date of plan, as long as the court takes into account the purpose of valuation and the proposed use or disposition of collateral at issue. The court remanded the matter to the bankruptcy court for a re-valuation of the collateral.

FACTUAL BACKGROUND

In September 2013, various Comcast Cable Communications, LLC ("Comcast") entities filed an involuntary Chapter 11 petition against the Houston Regional Sports Network, L.P. (the "Network") after it had defaulted on consecutive payments to the Houston Astros in connection with media-rights agreements the Network had entered into with the Houston Astros and the Houston Rockets (together, the "Teams"). The Network is a television network that was formed by the Teams to televise their respective games. Pursuant to the media-rights agreements, the Network was granted exclusive rights to broadcast the Teams' games in exchange for certain fees. In addition, the Network also entered into an Affiliation Agreement (the "Agreement") with Comcast pursuant to which Comcast would carry the Network through 2032, in exchange for a monthly fee. In 2010, a Comcast affiliate provided a $100 million loan to the Network, secured by a lien on substantially all of the Network's tangible and intangible assets, including the Agreement, but not including the Teams' media rights.

Post-petition, AT&T and DirecTV entered into an agreement with the Teams to acquire all of the equity in the Network and entered into separate agreements to pay the Network for the right to broadcast the Network's content. The sale agreement was included in the Network's plan of reorganization (the "Plan"), which was confirmed in October 2014. Under the Plan, the Teams agreed to waive their rights to approximately $107 million in media-rights fees owed by the Network that had accrued during the bankruptcy.

Prior to confirmation of the Plan, however, Comcast made a 11 U.S.C. § 1111(b) election to have its under-secured claim treated as fully, rather than partially, secured and as a result, Comcast was guaranteed the right to receive a stream of payments, the present value of which was equal to the value of the collateral as determined by the bankruptcy court. The parties stipulated to the value of the tangible collateral and to value the Network's intangible collateral, the bankruptcy court projected the Network's net income through 2032, discounting it to present value and then allocating that value among the intangible assets based on revenue generation. The bankruptcy court's valuation was as of the petition date, therefore, it apportioned income to agreements that did not exist as of the petition date based on the probability that such agreements would come to fruition. Comcast's expert and the Team's expert disagreed about whether and how the $107 million in waived media-rights fees should be included in the calculation. In the end, the bankruptcy court valued the Agreement as of the effective date of the Plan at $54.3 million, but deducted $107 million in media-rights fees from the Network's income in the period between the petition and the effective date, which rendered the value of the intangible assets to be zero. As a result, Comcast was unable to elect to have its claim treated as fully secured because a creditor cannot make a section 1111(b) election if the collateral is of "inconsequential value."

After the Plan was confirmed, Comcast appealed the bankruptcy court's valuation of the Agreement, specifically the valuation date utilized by the bankruptcy court, and sought a stay pending appeal. The district court denied the stay and affirmed the valuation, holding that the petition date was the proper date from which to value the Agreement and that expenses incurred by the Network were properly offset against the Agreement's value. Comcast appealed to the Fifth Circuit arguing that the effective date of the Plan should be the valuation date, while the Teams argued that the petition date should be the valuation date.

COURT ANALYSIS

In making it's determination, the Fifth Circuit considered 11 U.S.C. § 506 as well as *In re Stembridge*, 394 F. 3d 383 (5th Cir. 2004) relied upon by the bankruptcy court. The Teams alleged that *In re Stembridge* mandates valuation as of the petition date, while Comcast argued that the statutory text and case law dictated that the appropriate valuation date is the effective date of the Plan.

The Fifth Circuit found that the Bankruptcy Code itself does not dictate the appropriate valuation date for Chapter 11 bankruptcies. Under 11 U.S.C. § 506 (a)(1), the value of a secured claim "shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." section 506(a) is often used in conjunction with the cram-down provision in section 1129(b) of the Bankruptcy Code, which requires valuation of the collateral in the context

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Watch your Language.—continued from page 1

clear notice of its intent to terminate. The communications were not clear about termination.

Second, the court held that even if the communications were clear on the point of termination, the forbearance letter stated that the Franchisor would not exercise its rights or remedies until May 8, 2018. The Franchisor could not terminate the franchise agreements before May 8, 2018. Because the Debtors filed for bankruptcy protection on May 8, 2018, the franchise agreements were property of the estate.

PRACTICAL CONSIDERATIONS

Default notices must be clear and unambiguous as to the enforcing party's intent. Had the franchisor carried the automatic termination language throughout each subsequent correspondence and not sent the forbearance letter, the outcome would be different. The case makes clear that when a contract counterparty communicates with a defaulting counterparty, each communication should state exactly what the party is, or is not, doing. Former communications should not be relied on in subsequent communications.

Fifth Circuit Holds that Courts Have the Flexibility to Select the Valuation in a Cramdown Scenario—continued from page 3

of plan confirmation when the debtor retains possession of the collateral. The Fifth Circuit concluded that Section 1129(b)(2)(A)(i)(II)'s "fair and equitable" standard requires a discounting to present value, while section 506 provides guidance to calculate the initial value before discounting.

Rather than mandating a specific valuation date in the Chapter 11 cram-down context, the Fifth Circuit found that case law supports flexibility and section 506(a) requires consideration of the purpose of the valuation and the proposed use or disposition of the collateral at issue. On the other hand, the Third and Eighth Circuits have held that the confirmation or effective date of the plan is the appropriate valuation date for cram down, even though the Third Circuit recognized section 506(a) valuations may not always relate to plan confirmation.

The Fifth Circuit stated that its prior decision in *Stembridge* did not compel a fixed valuation as of the date of the petition for Chapter 11 cram-downs as its holding there was limited to section 1325 plan confirmations. The court declined to extend the per se valuation date to Chapter 11 cram-downs, stating that Congress implicitly rejected such an extension by enacting section 506(a)(2), which specifically refers to Chapter 7 and 13 bankruptcies but not Chapter 11. The Fifth Circuit also noted that a hard line need not be drawn for plan confirmation collateral valuation and a case-by-case analysis can be employed to determine the appropriate valuation date. The Fifth Circuit cited involuntary bankruptcies (as occurred here) as an example of where a plan may not be filed on the petition date and therefore the use and disposition of the property is not yet established.

In conclusion, the Fifth Circuit held that a court is not required to use either the petition date or the effective date for valuation purposes, courts have the flexibility to select the valuation dates so long as the bankruptcy court takes into account for the purpose of the valuation and the proposed use or disposition of the collateral at issue.

While the bankruptcy court had stated that under a flexible approach it would use the petition date to value the Agreement, the Fifth Circuit remanded for a re-valuation of the Agreement because it took issue with the bankruptcy court's full deduction of the media-rights fees. The Fifth Circuit found that the bankruptcy court improperly valued Comcast's collateral based on fees that would never be paid because the Teams agreed to waive such fees under the Plan. Additionally, subtracting the media-rights fees, which were an administrative expense, constituted an impermissible surcharge. The Fifth Circuit noted that while it had approved orders requiring payment of expenses incurred, it has never authorized charging a secured creditor for an expense that would never be paid under a reorganization plan.

PRACTICAL CONSIDERATIONS

The court's decision to follow a flexible approach to the timing of valuation should be taken into consideration by creditors before making a section 1111(b) election. In addition, with the Fifth Circuit's decision was made in the context of a Chapter 11 cramdown valuation, it may provide future support for courts to apply a flexible approach to other valuations as well, including valuations under section 506(a) of the Bankruptcy Code.

PATENTLY AMBIGUOUS – A LESSON IN CLARITY IN DRAFTING

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Somerset Trust Co. v. Mostoller (In re Somerset Regional Water Resources) 592 B.R. 38 (Bankr. W.D. Pa. 2018)

CASE SNAPSHOT

Interpreting an ambiguous collateral pledge of a 2015 tax refund in a debtor in possession (DIP) financing order, the court considers extrinsic evidence to find that a 2014 tax refund, which arose from the same amended carryback tax return as the 2015 refund, is included within the collateral pledge.

FACTUAL BACKGROUND

The debtor, the debtor's post-petition lender and the principals of the debtor entered into a consensual DIP financing order submitted to and approved by the bankruptcy court. An important component of the financing package was the principal's pledge to the lender of his right to a federal income tax refund attributable to losses incurred by the debtor in 2015 and imputed to the principal by virtue of the debtor's taxation as an S-corporation. Ultimately, the losses sustained by the debtor in 2015 resulted in a refund of federal income taxes in 2015 and, though carry-back provisions, also generated tax refunds for 2014. The refunds were processed in 2016.

The issue presented to the court was whether the pledge language in the consensual DIP order required the refunds attributable to tax year 2014 to be paid to the post-petition lender. The language in question states "[The principal] further agrees to assign to Lender any rights or interest in the 2015 federal tax refund due to him individually, but attributable to the operating losses of the Debtor…." The lender argued that this language is ambiguous and is intended to encompass all refund proceeds attributable to operating losses of the debtor that were incurred in tax year 2015. The debtor argued that the order is not ambiguous and only applies to "2015 Federal tax refund."

COURT ANALYSIS

The court first noted that relevant Third Circuit case law interprets consent orders in accordance with principles of contract construction. Absent ambiguity, a contract should be enforced according to its terms. When a contract is ambiguous, the court can go beyond the "four corners" of the document and consider evidence. A contract is ambiguous when it is reasonably susceptible to at least two different interpretations. A contract can be either patently ambiguous (ambiguous on its face) or latently ambiguous (ambiguous in light of extraneous or collateral facts). Issues of ambiguity are questions of law for the court to determine, and the court is not bound by stipulations of the parties regarding issues of law.

Applying these principles, the court found that the language in the consent order was patently ambiguous, despite the fact that the lender appeared to stipulate that the agreement was **not** patently ambiguous and focused its argument on latent ambiguity. In so holding, the court determined that the term "2015 Federal tax refund" could have three distinct connotations: (a) a refund actually paid during 2015 on account of any prior year, (b) a refund of taxes paid in all prior years but for which a refund is not due or has become due on account of year 2015 tax events, or (c) a refund of taxes paid in 2015 and not any other year. The court determined that the second and third possible connotations were reasonable readings of the language and, therefore, the language was patently ambiguous. The court further held that the language at issue was also latently ambiguous in light of the phrase "but attributable to the operating losses of the Debtor" in modification of the phrase "2015 Federal tax refund." Finally, the court considered other acceptable tools of construction, which the court also determined favored introduction of extrinsic evidence in these circumstances.

Accordingly, the court determined that consideration of extrinsic evidence was appropriate. To that end, the court first denied a motion *in limine* filed by the debtor to preclude use of affidavits drafted by lender's counsel, finding that it is common and acceptable practice for counsel to draft witness affidavits. Next, the court considered evidence presented, including affidavits, testimony, emails and terminology used by the parties when drafting and negotiating the final order. The court found that the evidence showed that the parties understood that the entirety of any refund to be generated on account of the 2015 operating losses was referred to by the parties as the "2015 refund," and therefore held that the lender's interpretation of the language was correct.

PRACTICAL CONSIDERATIONS

This case highlights the importance of clarity in drafting, and in particular ensuring that critical terms are explicitly defined and explained. While the court here ultimately determined that the parties' exchanges during negotiations confirmed that both parties (including the debtor) understood or should have understood the deal to include *any* tax refunds attributable to 2015 losses, the parties expended a great deal of time and expense in litigating the issue due to the lack of clarity in the consent order.

FIRST CIRCUIT ADDRESSES GENERAL CONTRACTORS' RIGHTS TO WITHHOLD PAYMENTS TO BANKRUPT SUBCONTRACTORS

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Insite Corporation v. Walsh Construction Company Puerto Rico (In re: Insite Corporation, Inc.), 906 F.3d 138 (1st Cir. 2018)

CASE SNAPSHOT

The United States Court of Appeals for the First Circuit recently reviewed the rights of general contractors to withhold payments to subcontractors after the bankruptcy filings of such subcontractors. The First Circuit confirmed that under a well-established principle, known as the Pearlman doctrine, funds withheld by a general contractor to cure a subcontractor's default and to complete a subcontractor's work are not property of the subcontractor or its bankruptcy estate. Therefore, a general contractor may withhold payments to subcontractors for such purposes without violating bankruptcy law. The First Circuit further confirmed that if the subcontract so provides, the general contractor may also withhold payment of "excess funds," *i.e.* amounts that absent the subcontractor's default would have been due to the subcontractor after deducting cure and completion expenses. However, the First Circuit allowed for the possibility of the subcontractor nevertheless having an equitable interest in such excess funds as a matter of state law, if the withholding of the same by the general contractor would amount to unjust enrichment. The First Circuit remanded the matter to the bankruptcy court to make such state law determination.

FACTUAL BACKGROUND

In September 2010, the Department of Veterans Affairs ("VA") awarded Walsh Construction Company Puerto Rico ("Walsh") a contract to build an addition to a VA facility in San Juan, Puerto Rico. Two months later, Walsh subcontracted with Insite Corporation, Inc. ("Insite") for certain concrete and masonry work. Insite in turn contracted with a number of sub-subcontractors and suppliers (collectively, "Suppliers") and began its work on the job site. Under the terms of the parties' subcontract, Insite was entitled to periodic progress payments for work performed, subject to certain conditions precedent. One condition precedent was that Insite had paid all of its Suppliers in connection with the work performed.

Prior to Insite filing for bankruptcy, Walsh did not approve and withheld several periodic progress payments requested by Insite on the basis that Insite had failed to pay its Suppliers. Such withholding of funds resulted in Insite filing for Chapter 11 bankruptcy protection. After the bankruptcy filing, Insite continued to perform some work on the project. However, Insite continued to fail to pay its Suppliers. Thus, Walsh continued to withhold progress payments from Insite and used certain withheld funds to pay cure and completion expenses related to the project.

Insite filed an adversary proceeding against Walsh, alleging that the unpaid progress payments were property of its bankruptcy estate and, therefore, Walsh was violating the automatic stay by withholding them. Walsh moved for summary judgment.

The bankruptcy court granted summary judgment in favor of Walsh on two bases. First, pursuant to the Supreme Court's decision in *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132, 141-42 (1962), it is a well-established principle that funds withheld by a general contractor to cure a subcontractor's default and to complete a subcontractor's work are not property of the subcontractor's bankruptcy estate and, therefore, may be withheld by a general contractor without violating the automatic stay. Second, because Insite never satisfied the conditions precedent to its entitlement to progress payments under the subcontract, it had no contractual rights to such payments, including payments of any "excess funds." On appeal, the district court affirmed. Insite appealed to the First Circuit.

COURT ANALYSIS

The First Circuit began its analysis by confirming the correctness of the lower courts' discussion and application of the Pearlman doctrine and the contractual provisions barring Insite's rights to any progress payments. However, the First Circuit concluded that the bankruptcy court's analysis was incomplete with respect to the issue of "excess funds," *i.e.* the difference between the progress payments that would have been due to Insite had it not been in default under the subcontract and the amount of Walsh's cure and completion expenses.

The First Circuit focused in particular on the progress payment owed to Insite for the post-petition work performed by Insite. The First Circuit held that the bankruptcy court erred by not developing a factual record as to whether the amount of such progress payment, together will all other prepetition progress payments owed to Insite, exceeded Walsh's cure and completion expenses related to the project. If so, excess funds may exist which would be outside the scope of the Pearlman doctrine.

The First Circuit then confirmed that Walsh was entitled to withhold any such excess funds under the terms of the subcontract. However, the First Circuit held that the bankruptcy court erred by not determining whether Insite nevertheless had an equitable interest in any such excess funds as a matter of state law, *e.g.*, if the withholding of the same by Walsh would amount to unjust enrichment.

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BANKRUPTCY COURT FINDS THAT DIP LENDER'S SUPER-PRIORITY CLAIMS TAKE PRIORITY OVER POST-CONVERSION ADMINISTRATIVE EXPENSE CLAIMS

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Matter of Happy Jack's Petroleum, Inc., 2018 WL 6192207 (Bankr. D. Neb. Nov. 7, 2018)

CASE SNAPSHOT

The Nebraska bankruptcy court held that a DIP lender's superpriority claims under Bankruptcy Code section 364(c)(1) take priority over post-conversion administrative expense claims of a Chapter 7 trustee under Bankruptcy Code section 503(b).

FACTUAL BACKGROUND

In the early stages of a voluntary Chapter 11 bankruptcy case filed by the Debtor, Happy Jack's, the court approved the Debtor's motion for approval of DIP financing and granted the Debtor's DIP Lender super-priority administrative expense claims under Bankruptcy Code section 364(c)(1).

Months later, the Debtor moved to convert the case to Chapter 7. After the conversion, the DIP lender filed an application for payment of its administrative expense claim. The Chapter 7 trustee and certain creditors objected, asserting that the Chapter 7 trustee's administrative expense claims took priority over the DIP lender's super-priority claims.

COURT ANALYSIS

At issue was the interplay between Bankruptcy Code section 364(c)(1), under which the DIP lender's super-priority claims were granted, and section 726(b), which governs post-conversion administrative expense priorities. Section 364(c)(1) allows a bankruptcy court to grant super-priority claims to a DIP lender such that the claims have "priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title . . ." However, upon conversion of a case to Chapter 7, Section 726(b) changes the priority scheme, providing that post-conversion claims under Section 503(b) take priority over pre-conversion claims under section 503(b).

The bankruptcy court determined that section 726(b) was silent on super-priority claims granted under section 364(c)(1), and only changed the priority with respect to pre and post-conversion 503(b) claims. The sourt ruled that "[s]ince super-priority claims granted under § 364(c)(1) are not administrative claims under § 503(b) - in fact, they are a special category of claims with priority over § 503(b) administrative claims - § 726(b) does not trump the super priority granted to § 364(c)(1) claims."

PRACTICAL CONSIDERATIONS

Courts are split on the relative priority of section 364(c)(1) superpriority claims and post-conversion section 503(b) priority claims. Bankruptcy courts in New Jersey, Illinois, Florida and Michigan, as well as the Bankruptcy Appellate Panel in the Eighth Circuit, have each similarly ruled that section 364(c)(1) claims take priority. Conversely, the Bankruptcy Appellate Panel for the Ninth Circuit and a bankruptcy court in Vermont have ruled that post-conversion fees may supersede a super-priority DIP lender's claims. DIP Lenders should take some comfort that the majority approach appears to honor the grant of super-priority claim status even after the conversion of a case to Chapter 7, but they should be wary that this is an issue of unsettled law and that certain jurisdictions may be more hostile to their super-priority claims than others.

First Circuit Addresses General Contractors' Rights to Withhold Payments to Bankrupt Subcontractors—continued from page 6

Thus, the First Circuit remanded the matter to the bankruptcy court to determine whether any such excess funds existed and, if so, whether Insite had any equitable rights to such funds under applicable state law, notwithstanding the terms of the subcontract.

PRACTICAL CONSIDERATIONS

By opening the door to equitable interests in "excess funds," the First Circuit has added uncertainty in an area of contractor law that had been relatively clear under the Pearlman doctrine and as a matter of contract. That said, if applicable state law does not recognize any such equitable interests, there will be no practical change. Going forward, contractors addressing this issue of "excess funds" will need to consult applicable state law prior to taking any action.

TERMINATION FEES: MAKING CLEAR WHEN, AND WHO, IS ENTITLED TO PAYMENT AT THE OUTSET

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In re: Energy Future Holdings Corp., et al. Case No. 14-10979 (CSS) (Bankr. D. Del.)

CASE SNAPSHOT

In *In re: Energy Future Holdings Corp., et al.*, the United States Bankruptcy Court for the District of Delaware (the "Court") retroactively struck a termination provision in a merger agreement based on a fundamental misunderstanding of the provision when it was first being considered, and the potential purchaser was then left clinging to much weaker arguments to recoup the fees lost in a cancelled transaction.

FACTUAL BACKGROUND

In April 2016, after a marketing process and various other efforts, the Debtors engaged in discussions with NextEra Energy, Inc. ("**NextEra**") for the sale of the Debtors' approximately 80% economic interest in Oncor Electric Delivery Company LLC ("**Oncor**"). Thereafter, the parties executed definitive documentation to govern the transaction, including an Agreement and Plan of Merger (the "**Merger Agreement**"). Included in the Merger Agreement was a termination fee in the amount of $275 million in favor of NextEra. On October 31, 2016, NextEra and Oncor submitted their joint change of control application for the Public Utility Commission of Texas ("**PUCT**") approval. The application asked that the PUCT drop two key features of a "ring-fence" the regulator had erected around Oncor, which NextEra coined deal killers. The PUCT subsequently denied the application due to NextEra's refusal to drop its terms. NextEra took no action to terminate the Merger Agreement, and the Debtors, viewing the deal as dead, terminated the Merger Agreement with the attendant risk of triggering the termination fee. The Debtors terminated the Merger Agreement based on both NextEra's failure to obtain regulatory approval and breach of the Merger Agreement, while reserving their rights to assert other grounds for termination.

On July 29, 2017, various affiliates of Elliott Associates, L.P. ("**Elliott**") filed a motion seeking a denial of NextEra's termination fee (the "**Motion to Reconsider**"). The court, in its reconsideration decision, stated that it had a fundamental misunderstanding of the critical facts when it approved the termination fee. Specifically, the Court did not understand that if the PUCT declined to approve the NextEra transaction and the Debtors (as opposed to NextEra) terminated the Merger Agreement, the Termination Fee would be payable to NextEra. The Court stated that it had asked questions as to whether the fee would be payable if the PUCT declined to approve the transaction, but, according to the court, the record was confusing as to this fundamental point. As a result, the court determined that the termination fee would not be awarded to the Debtors.

COURT ANALYSIS

Upon its Motion to Reconsider, NextEra attempted to recoup its fees based on an expense reimbursement provision in the Merger Agreement. In determining whether to award expenses that NextEra incurred in relation to the Merger Agreement, the Court analyzed the language in section 6.7 of the Merger Agreement, which provided that:

> The Surviving Company shall pay all charges and expenses, including those of the Exchange Agent, in connection with the transactions contemplated in Article IV. Except as otherwise provided in Section 6.3, Section 6.18, Section 6.19, Section 6.20 and Section 6.22 or any administrative expenses of the Debtors' estates addressed in the Plan of Reorganization, whether or not the Merger is consummated, all costs and expenses incurred in connection with this Agreement and the Closing Date Transactions and the other transactions contemplated by this Agreement shall be paid by the party incurring such expense.

The court found that the Debtors never agreed to pay NextEra's expenses that related to obtaining regulatory approval before the PUCT; and held that the Merger Agreement expressly provided that each party must carry its own expenses in connection with the merger transaction. While the plain language of section 6.7 of the Merger Agreement created two exceptions: (i) specifically enumerated sections of the Merger Agreement or (ii) administrative expenses of the Debtors, the court held that NextEra's administrative expense claim did not fall into either of these exceptions. In citing to the language of the Merger Agreement, the court held that all costs and expenses incurred in connection with the Merger Agreement *shall* be paid by the party incurring such expenses. As a result, NextEra was barred by the terms of Merger Agreement from seeking a section 503(b) claim in connection with NextEra's efforts to obtain approval of the Merger Agreement.

NextEra contended that if the court determined that section 6.7 required parties to otherwise bear their own expenses, then NextEra should not be bound by the expense limitation because of the Court's reconsideration of the termination fee provisions in the reconsideration decision. The crux of NextEra's argument

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was that the court's retroactive disapproval of the termination fee was inconsistent with the legal and economic effect of the Merger Agreement as entered into by the parties. The court held, however, that the reconsideration decision did not eviscerate the Merger Agreement, but rather the court simply carved out one specific instance where, if the record had been clear, the court would not approve the termination fee in the Merger Agreement.

The court further held that NextEra's expenses did not qualify as administrative expenses under section 503(b)(1) of the Bankruptcy Code. Pursuant to established case law, NextEra carried the burden of demonstrating that the costs and fees for which it sought payment provided an actual benefit to the estate, and that such costs and expenses were necessary to preserve the value of the estate assets. In differentiating cases where courts have granted administrative expenses under 503(b)(1), the court noted that here, NextEra was unable (due to lack of regulatory approval) to consummate the transaction contemplated in the Merger Agreement and, additionally, there was no competitive bidding process and the Debtors eventually closed an alternative transaction for substantially less value, and thus, there was no benefit to the estate.

NextEra asserted, in the alternative, that it was entitled to an administrative claim under section 503(b)(3)(D) for making a substantial contribution to the Debtors' chapter 11 cases. NextEra stated that, through one of its subsidiaries, it was a creditor of EFIH from the time it entered into the Merger Agreement through the end of the period for which NextEra sought allowance of its expenses. Section 503(b)(3)(D) provides that services engaged by creditors, creditor committees and other parties interested in a reorganization are presumed to be incurred for the benefit of the engaging party and are reimbursable if the services directly and materially contributed to the reorganization. The court held that in this case, NextEra was not undertaking regulatory approval of the Merger Agreement as a creditor, but rather it was undertaking the potential merger as the purchaser. NextEra's actions were wholly related to its desire to own the Oncor assets..

PRACTICAL CONSIDERATIONS

This case highlights the importance of making sure termination fee provisions make clear when the payment mechanism is triggered, and, if a court appears to be confused by a fundamental provision, parties should be aware of that fact and make it abundantly clear what the expectations of the provisions are. Once this fundamental provision was struck, NextEra was left with much weaker arguments. Here, the Merger Agreement in section 6.7 made clear that NextEra was not entitled to expense reimbursements for their efforts made in connection with the potential merger. Furthermore, with respect to any claims for administrative expenses based on substantial contribution, parties must be aware that any attempt to recoup an administrative expense claim on this theory will only be awarded if, as a result of a party's actions, the Debtors received more value than they would have without that party's contribution. In the instance where a creditor or other party-in-interest is playing multiple roles in the case, courts will also only look to that constituent's role as it applies to that which it is advocating for.

FIFTH CIRCUIT HOLDS THAT A PATENT LICENSE ALLEGEDLY PURCHASED BY A COMPANY IN A BANKRUPTCY SALE WAS IN FACT A REJECTED EXECUTORY CONTRACT AND COULD NOT HAVE BEEN TRANSFERRED IN THE SALE.

Chrystal P. Mauro
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RPD Holdings, LLC v. Tech Pharmacy Services (In re Providers Meds, LLC), 907 F.3d 845 (5th Cir. 2018)

CASE SNAPSHOT

On appeal from the United States Bankruptcy Court, Northern District of Texas, the Fifth Circuit concluded that the non-exclusive patent licenses at issue were executory contracts that were deemed rejected by operation of law 60 days after conversion of the Onsite Debtors' bankruptcy cases from Chapter 11 cases to Chapter 7 cases, therefore, the purchaser of a significant portion of the Debtors' assets, RPD Holdings, LLC ("RPD"), failed to acquire any rights to the Debtors' IP licenses under certain asset purchase agreements.

FACTUAL BACKGROUND

In 2012 and 2013, 10 OnSite parties with a joint corporate parent, OnSite Rx, (collectively, the "OnSite Debtors") filed separate Chapter 11 bankruptcy cases in the United States Bankruptcy Court, Northern District of Texas (the "Bankruptcy Court"). The cases were later converted to cases under Chapter 7 of the Bankruptcy Code. Five of the OnSite Debtors were parties to a License Agreement with Tech Pharmacy Services ("Tech Pharm"). Tech Pharm holds a patent on a system, software, and related methods of remote pharmaceutical dispensing. The License Agreement granted a "non-exclusive perpetual license" to the five OnSite Debtors "so long as the Patent or Patents are valid and enforceable" for a one-time licensing fee for each OnSite machine placed into operation after the Licensing Agreement, and required that the certain OnSite Debtors provide quarterly reports reflecting new machines placed into service. Despite the bankruptcy requirement that debtors schedule all assets and creditors, none of the OnSite Debtors listed the License Agreement as an executory contract, or Tech Pharm as a creditor, on their respective bankruptcy schedules.

RPD had a security interest in the OnSite Debtors' collateral and agreed to purchase collateral from three of the OnSite Debtors' bankruptcy estates pursuant to individual Asset Purchase Agreements (the "APAs"). Specifically, the APAs stated that to the extent that any of the subject property in the APA was an executory contract, it was "hereby assumed by the estate and immediately assigned to RPD under the applicable provisions of section 365 of the Bankruptcy Code." However, none of the APAs explicitly reference the License Agreements. In fact, RPD was not aware of the License Agreements until after all three sale motions and APAs were filed with the Bankruptcy Court. Although it did become aware of the License Agreements prior to entry of the third sale order approving one of the APAs. After that time, RPD and CERx, a competing secured party, entered into a global agreement dividing up the OnSite Debtors' assets, and providing that two on the OnSite Debtors' Tech Pharm licenses were to go to CERx, with RPD entitled to all remaining available Tech Pharm licenses.

Almost a year after the bankruptcy court approved the global agreement, Tech Pharm filed a petition in Texas State Court against several parties, including two of the OnSite Debtors, alleging that the defendants had failed to comply with their obligations under the License Agreements to provide quarterly reports and pay licensing fees for new machines. RPD intervened in the state action and removed the proceedings to the Bankruptcy Court arguing that the License Agreements had been transferred to RPD. The Bankruptcy Court held that RPD did not have rights under the License Agreements for either of two reasons: RPD had not purchased the License Agreements under any of the OnSite APAs, and, regardless of the terms of the APAs, the License Agreements were executory contracts that were rejected by operation of law prior to any alleged transfer. The Bankruptcy Court also determined that RPD had not gained rights under the License Agreements by purchasing OnSite machines from the OnSite Debtors. RPD appealed to the United States District Court, Eastern District of Texas (the "District Court") which concluded that the License Agreements were rejected executory contracts and affirmed the Bankruptcy Court's decision. RPD appealed the district court decision claiming that its rights under the License Agreements were established by final and non-appealed Bankruptcy Court sale orders, so any determination to the contrary would constitute an impermissible collateral attack. It also argued that the Bankruptcy Court and the District Court erred on the merits when determining that RPD has no rights under the License Agreements.

COURT ANALYSIS

The first issue that the Fifth Circuit grappled with was whether the License Agreements were executory contracts. Recognizing that an executory contract is one that requires ongoing performance by both parties, the court held that the License Agreements qualified as executory contracts because material, reciprocal obligations remained outstanding on both sides. Tech Pharm, the patent holder, had a continuing contractual obligation to refrain from suing licensees for patent infringement stemming from their introduction of new machines. The relevant OnSite Debtors, in turn, had corresponding material obligations under the License Agreements to file quarterly reports. The fact that the license was "perpetual"

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DELAWARE DISTRICT COURT FINDS THAT A CRAMDOWN PLAN CAN MODIFY A CREDITORS' EXPECTED RECOVERIES PURSUANT TO PREPETITION SUBORDINATION AGREEMENTS

Meghan Byrnes
Associate, Philadelphia

Law Debenture Trust Co. of New York & Deutsch Bank Trust Company Americas v. Tribune Media Co. et al. (In re Tribune Media Co.), Case No. 08-13141 (Bankr. D. Del.)

CASE SNAPSHOT

This case produced two key takeaways. First, it is clear that section 1129(b) permits nonenforcement, or only partial enforcement, of prepetition subordination agreements, so long as doing so would not amount to unfair discrimination. Second, whether discrimination is material (rendering it unfair) depends on the *percentage points* by which the claim was reduced, not the actual dollar amount of the haircut.

FACTUAL BACKGROUND

On remand from the Third Circuit, the District of Delaware analyzed whether a cramdown plan's failure to strictly enforce prepetition subordination agreements constituted unfair discrimination against senior noteholders.

The cramdown plan for Tribune Media Company was approved by the Bankruptcy Court in 2012. Several parties appealed confirmation; however, the Third Circuit in 2015 struck down all but two claims on appeal as equitably moot.

The two surviving claims belonged to the trustees of the senior noteholders (the "Senior Noteholders"). The genesis of their objection began prepetition, where the senior noteholders and certain other noteholders of Tribune Media Company entered into two subordination agreements. The subordination agreements provided that if Tribune went bankrupt, any recovery owed to the subordinated noteholders would be payable to the Senior Noteholders.

Eventually, Tribune filed for bankruptcy following the completion of a leveraged buyout (LBO). In contravention of the subordination agreements, the Bankruptcy Court confirmed a plan of reorganization which required that any recovery by the subordinated noteholders be split pro rata between (1) the Senior Noteholders in one class; and (2) another class of general unsecured individual and small business trade creditors with claims at Tribune's parent company (the "Parent Claims"). The Bankruptcy Court determined that the sharing was justified, in part, because the subordination agreements treated the majority of the value of the Parent Claims as senior indebtedness.

The effect of the plan's "sharing" of the subordinated noteholders' recoveries—over the Senior Noteholders' objections—decreased the Senior Noteholders' initial recoveries from 35.9% to 33.6%—a difference representing approximately $30 million.

COURT ANALYSIS

Dissatisfied with the haircut, the Senior Noteholders made the following primary arguments on appeal: first, that section 510 of the Bankruptcy Code, which requires full implementation and enforcement of subordination agreements, overrides the cramdown powers in section 1129(b)(1); and second, that the plan discriminated unfairly against the senior noteholders.

The District Court agreed with the bankruptcy court's analysis and affirmed the plan's confirmation, addressing both of the Senior Noteholders' arguments.

First, it found that section 1129(b)(1) clearly permits a plan to modify subordination agreements because its plain language provides that the court "shall confirm" a plan over the objection of an impaired dissenting class "*[n]otwithstanding* section 510(a)." On this point, the District Court rejected the Senior Noteholders' arguments that the bankruptcy court misinterpreted the meaning of the term "notwithstanding" as creating an exception to 510(a)'s strict enforcement of subordination agreements. The District Court adopted the bankruptcy court's textual analysis that "notwithstanding" as used in other sections of the Bankruptcy Code means "in spite of" or "without prevention or obstruction from or by." Thus, section 1129(b) plainly permits modification of subordination agreements that would have otherwise been protected by 510(a).

Second, the District Court found that the $30 million haircut did not unfairly discriminate against the Senior Noteholders.

In its analysis, the District Court noted that there is no definition of "unfair discrimination" nor does legislative history shed light on its interpretation. Rather, the District Court, following certain other decisions, agreed that rebuttable presumption of unfair discrimination arises when there is: (1) a dissenting class; (2) another class of the same priority; and (3) *a different in the plan's treatment of the two classes* that results in either (a) *a materially lower percentage recovery* for the dissenting class (measured in terms of the net present value of all payments) or (b) regardless of the percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

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Fifth Circuit holds that a patent license allegedly purchased by a company in a bankruptcy sale was in fact a rejected executory contract and could not have been transferred in the sale.—continued from page 10

for so long as the patent was valid and enforceable did not render the OnSite Debtors' obligations immaterial, the court found.

Next, the Fifth Circuit held that the License Agreements were rejected by operation of law prior to the bankruptcy sales in question. Pursuant to section 365(d)(1) of the Bankruptcy Code, an executory contract not assumed within 60 days of conversion is deemed rejected. Here, because the License Agreements were not assumed prior to the expiration of the applicable 60-day period, they was deemed rejected. RPD, the purchaser, attempted to argue that because the OnSite Debtors had failed to list the License Agreements in their bankruptcy schedules, the deadline imposed by section 365(d)(1) should not apply because the Trustee was unaware of the License Agreements' existence. However, the Court declined to read such an exception into the statute, noting that the Bankruptcy Code obligates a Trustee to investigate a debtor's financial affairs.

Finally, the Fifth Circuit rejected RPD's argument that setting aside the sale amounted to a collateral attack on the sale-approval order. By the time the sale orders were finalized, the 60-day deadline had passed for each estate and the License Agreement, being deemed rejected, had exited the bankruptcy estates, such that it was outside the power of the trustees to include the License Agreement within the assets sold to the purchaser. "This is not a matter of collateral attack, but merely an interpretation of the bankruptcy court's orders," the Court stated.

The Fifth Circuit affirmed the lower courts, concluding that the License Agreements were executory contracts that were deemed rejected by operation of law prior to the bankruptcy sale in which the purchaser RFD allegedly acquired the License Agreements. Because the License Agreements were not part of the bankruptcy estates at the time of the relevant sales, the Bankruptcy's Court's final orders did not effect a transfer of the License Agreements from the OnSite Debtors to RPD.

PRACTICAL CONSIDERATIONS

Purchasers in a bankruptcy sale should be diligent about what assets are included in a sale. It is also imperative that a debtor file correct and exhaustive schedules that include any and all assets that may be included in a sale or executory contracts that are to be assumed.

Delaware District Court Finds that a Cramdown Plan Can Modify a Creditors' Expected Recoveries Pursuant to Prepetition Subordination Agreements—continued from page 11

In analyzing the above factors, the District Court noted that minor or immaterial differences in plan treatment do not rise to the level of unfair discrimination. Applying this general rule, the District Court concluded that even though the "actual amount of money at issue is large" the percentage difference of "at most" 2.3% was immaterial, especially in light of other courts rejecting plans based on disproportionate treatment of 50% or more.

PRACTICAL CONSIDERATIONS

This case confirms the power of the cramdown provisions in section 1129(b) to modify prepetition contractual rights (such as those created by the subordination agreements in this case) so long as such modification does not amount to unfair treatment. In determining the "materiality" of alleged unfair treatment, it is not the actual dollar amount (however large) of the money lost that governs—it is the percentage difference that controls.

PICKING UP THE PIECES AFTER THE PONZI SCHEME

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In re Woodbridge Grp. of Cos., LLC, No. 17-12560, 2018 Bankr. LEXIS 3315 (Bankr. D. Del. Oct. 26, 2018)

CASE SNAPSHOT

In a Ponzi bankruptcy case involving hundreds of affiliated debtors, the court approves a "quick exit" plan supported by the vast majority of creditors. The plan: (i) substantively consolidates the debtors , (ii) in settlement, applies a 27.5% discount to a class of claims that might be recharacterizable as equity (iii) in settlement, allows claims in "net" amounts by reducing the otherwise-allowable amount of claims by the distributions the creditor received from the Ponzi scheme and (iv) in settlement, cancels intercompany claims and liens (affecting putative lien claims of some creditors).

FACTUAL BACKGROUND

Over 300 debtors commenced bankruptcy cases that arose out of a massive, multi-year Ponzi scheme from 2012-2017. During that time, the debtors raised over $1 billion from approximately 10,000 investors – as either "Noteholders" or "Unitholders" – and used nearly half of those funds to repay existing investors. While the bankruptcy cases were pending, the SEC filed a complaint against the debtors' principal and the debtors, which resulted in a settlement approved in the bankruptcy court that involved, among other things, appointment of a new board, formation of official committees of noteholders and unitholders.

Following the settlement, the various constitutions worked toward quickly and consensually resolving the Chapter 11 cases. Ultimately, a plan was proposed that contemplated liquidation of each of the Debtors and substantive consolidation of various debtors. The plan also incorporated certain settlements, including resolution of disputes about whether the "Units" are debt or equity and whether the "Notes" were validly secured by certain real estate, and reflected a 27.5% discount to Unitholders as a result of such compromises. Impaired creditors overwhelmingly supported the plan.

COURT ANALYSIS

The "Dissenting Creditors" assert that they have claims secured by specific property and should receive 100% of their claims from proceeds of the sale of that real property. As a result, the Dissenting Creditors object to the Plan for: (a) relying on an unsupported assumption that the debtors operated a Ponzi scheme, (b) including settlements that are not fair or reasonable, and (c) improperly seeking to substantively consolidate the debtors.

In casting aside the Dissenting Creditors' argument that a Ponzi scheme had not been evidenced, the court cited to the substantial evidence presented by the Debtors and the SEC regarding the debtors' Ponzi scheme. The court then found that the plan settlements are reasonable and "provide an arm's –length negotiated resolution of the complex, uncertain issues that strikes a fair balance between the potential range of litigated outcomes." The court further found that the plan's negotiated extinguishment of disputed inter-company liens was reasonable and permissible under relevant law in light of the pre-petition fraud and the complexities of the case and negotiations.

Next, the court held that substantive consolidation was permissible under Third Circuit law, particularly in light of the substantial evidence that the debtors were run as a Ponzi scheme, the hopeless comingling of the assets of the various debtors and the testimony of the debtors' chief restructuring officer that "it would be exceptionally difficult, if not literally impossible, to trace, reconcile, and reconstruct a reliable and compete allocation of assets and liabilities across [the debtors]." Finally, the court concluded that the requirements of sections 1129(a) and (b) were met and confirmed the plan.

PRACTICAL CONSIDERATIONS

The various settlements and negotiated plan in this bankruptcy case was clearly the result of tremendous amounts of negotiating on complex issues among the various constituents with the aim of providing the best result for those harmed by the Ponzi scheme. In confirming the plan, the court recognized the efforts of all involved and the unique-ness of this case.

SIXTH CIRCUIT CLARIFIES TRIGGER FOR DETERMINING APPEAL DEADLINES

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Ritzen Group, Inc. v. Jackson Masonry, LLC (In re Jackson Masonry, LLC), 906 F.3d 494 (6th Cir. 2018)

CASE SNAPSHOT

In a recent decision, the Sixth Circuit addressed the vagueness of existing tests for determining the finality of bankruptcy orders for the purposes of appeal.

FACTUAL BACKGROUND

Pre-petition, Appellant Ritzen Group ("Ritzen"), entered into a contract with Appellee Jackson Masonry ("Jackson") to purchase a piece of property. However, the sale of the property never went through, and each party claimed the other breached.

After the deal fell through, Ritzen sued Jackson for breach of contract. During the pendency of the breach of contract action, Jackson filed for bankruptcy. Therefore, the breach of contract action was automatically stayed. Ritzen filed a motion to lift the automatic stay which the bankruptcy court denied. Ritzen did not appeal, choosing instead to vindicate its rights in the bankruptcy court by bringing a claim against the bankruptcy estate. Ritzen was unsuccessful in that effort, too, because the bankruptcy court found that Ritzen, not Jackson, breached the contract.

Ritzen appealed both the order denying relief from the automatic stay as well as the breach-of-contract determination. The district court found the automatic-stay appeal untimely and rejected the appeal of the breach-of-contract determination.

COURT ANALYSIS

The Sixth Circuit began its evaluation of Ritzen's appeal of the order denying stay relief by reviewing the text of the bankruptcy appeals statute. Under the statute, a bankruptcy court's order may be immediately appealed if it is (1) "entered in [a] . . . proceeding[ ]" and (2) "final"—terminating that proceeding. 28 U.S.C. § 158 (a). A party must appeal a final order within 14 days of the court's ruling. The court held that Ritzen's appeal of the stay-relief denial was untimely because he failed to appeal within fourteen days. In so holding, the court stated that an order denying stay relief terminates a proceeding and is therefore final.

In its decision, the Court compared appeals in ordinary civil litigation to those in a bankruptcy proceeding. In ordinary litigation, parties may generally only appeal "final decisions." 28 U.S.C. § 1291. In contrast, in bankruptcy cases, orders may be immediately appealed if they finally dispose of discrete disputes within the larger case. *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686, 1692 (2015).

The Court noted that "finality" has been loosely interpreted by many courts which has resulted in "a series of vague tests that are impossible to apply consistently," particularly in the context of bankruptcy cases where courts have had difficulty determining what is a final order. Consequently, parties must constantly guess whether an order is final because courts have simply treated the finality of a specific order before them as a case-by-case question rather than articulating principles that can be applied to other types of orders.

The Sixth Circuit then articulated a two-step finality analysis for determining whether a bankruptcy court's order may be immediately appealed:

> First: Identify the appropriate "judicial unit" which establishes the relevant "proceeding" or "discrete dispute"; and
>
> Second: Determine whether the order is "final" which is established by determining whether the "order is both procedurally complete and determinative of substantive rights."

Applying this test, the Sixth Circuit affirmed the district court's decision that Ritzen's appeal of the denial of stay relief was untimely. In doing so, the Court first found that the motion for stay relief and its determination was a "proceeding" within the bankruptcy case ("akin to a case within a case"). Next, the Court determined that the order denying stay relief was a final order because it was procedurally complete (the stay-relief proceeding was complete upon entry of the denial order). Accordingly, the denial of stay relief was a final order, and its entry commenced the appeal period which rendered untimely Ritzen's appeal filed more than fourteen days after denial of stay relief. The Court also affirmed the bankruptcy court's denial of Ritzen's breach of contract claim on the grounds that the bankruptcy court's conclusions were not clearly erroneous.

PRACTICAL CONSIDERATIONS

This case provides clarity as to what constitutes a final order for the purposes of appeal in the bankruptcy context. Thus, practitioners should be mindful that stay relief orders are immediately appealable. In addition, when a question of appealability arises in bankruptcy cases, the conservative approach favors an immediate appeal rather than waiting for the underlying claim to fully resolve.

ILLINOIS DEPARTMENT OF REVENUE NOT ENTITLED TO ADEQUATE PROTECTION UPON SALE OF PROPERTIES SUBJECT TO TAX LIENS

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Ill. Dep't of Revenue v. Hanmi Bank, 895 F.3d 465 (7th Cir. 2018)

CASE SNAPSHOT

The Seventh Circuit affirmed the bankruptcy court's ruling that the Illinois Department of Revenue was not entitled to adequate protection liens on the proceeds of property sales because the Department of Revenue failed to provide sufficient evidence of the value of its liens on the properties.

FACTUAL BACKGROUND

Debtors in two consolidated bankruptcy cases obtained approval of the bankruptcy court to sell the majority of their assets, comprised of several gas stations, a movie theater, and a café, free and clear of all liens and encumbrances under section 363(f) of the Bankruptcy Code. The properties were subject to first-priority liens of the Debtor's secured lenders that were far in excess of the value of the real property.

The Illinois Department of Revenue (IDOR) objected to the "free and clear" sale on the basis that the IDOR has a unique right under Illinois law to pursue purchasers in bulk sales for the tax liability of the sellers under a successor liability theory. The IDOR argued that even though its liens were junior to the secured creditors liens, that the bankruptcy court's removal of the IDOR's unique rights to pursue successor liability claims against purchasers enhanced the marketability of the property and its purchase price. The IDOR argued its tax liens should be paid in full from the sale. However, the Bankruptcy Courts in both cases overruled the IDOR's objections and valued the IDOR's interests at $0 and ordered the proceeds to be turned over, in full, to the senior secured lenders.

COURT ANALYSIS

On appeal, the Seventh Circuit affirmed on the basis that the IDOR had provided insufficient evidence of the value of its junior interest. The Seventh Circuit agreed, for the sake of argument, that the IDOR had the authority to impose successor liability for unpaid taxes on the purchasers. The IDOR's "interest" was being removed from the property pursuant to a "free and clear" sale under Bankruptcy Code section 363(f), and thus the IDOR was entitled to adequate protection commensurate with the value of its interest. However, the Seventh Circuit agreed with the Bankruptcy Courts' decision that the value of IDOR's interests were effectively $0.

The Seventh Circuit agreed that the "successor liability" right held by the IDOR is a "unique and powerful weapon", and that the removal of this liability could potentially enhance the sale value of a property and make such property more marketable to purchasers. As such, the IDOR could conceivably be entitled to adequate protection for its claim. But the Seventh Circuit was "dubious" of the IDOR's position that it was entitled to 100% of the value of its successor liability claims, particularly when it would effectively permit the IDOR to jump ahead of the senior secured lenders even though the IDOR was actually out of the money. The Seventh Circuit criticized the IDOR's "go-for-broke" position, as well as its failure to provide meaningful evidence of the practical value of its successor liability claims on these particular sales. For example, there was no valuation of the increase in property value based upon the removal of successor liability claims. Additionally, the purchasers of the property were special-purpose entities with no assets other than the property they were acquiring, which therefore rendered the successor-liability claims less certain. Because of the lack of evidence of the value of IDOR's successor liability claims, the Seventh Circuit affirmed the bankruptcy court's valuations of $0 for such claims.

PRACTICAL CONSIDERATIONS

This decision should provide some comfort to secured lenders and to purchasers in bankruptcy sales. However, this decision should not be interpreted to mean that the IDOR's successor liability claims will always be valued at $0. Here, the IDOR's refusal to consider any compromise to the value of its successor liability claims was ultimately its downfall, but had it provided evidence of the value of its interests, it may have been entitled to some portion of the proceeds. In other words, secured lenders in a similar situation should consider reaching a compromise.

THIRD CIRCUIT HOLDS SHARES IN DEBTOR ARE SUBJECT TO TERMS OF CONFIRMED PLAN

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Zardinovsky v. Arctic Glacier Income Fund (In re Arctic Glacier International, Inc.), 901 F.3d 162 (3d Cir. 2018)

CASE SNAPSHOT

The United States Court of Appeals for the Third Circuit (the "Third Circuit") affirmed the Delaware bankruptcy and district courts' holdings that a post-confirmation purchaser of shares in the debtor is bound by the terms of the confirmed plan (including the releases contained therein) and the *res judicata* effect of the order confirming the plan, where the purchasing party had notice of the debtor's bankruptcy proceedings and the plan, and the selling parties had notice of and were represented in the bankruptcy proceedings.

FACTUAL BACKGROUND

The Debtor, a Canadian income trust, filed for bankruptcy protection in 2012 under the Canadian analog to Chapter 11 of the U.S. Bankruptcy Code. Because the Debtor operated in both Canada and the U.S., it sought and received recognition under Chapter 15 of the Bankruptcy Code. This recognition extended to the Debtor's confirmed reorganization plan ("Plan") and gave same full effect in the U.S. Pursuant to the Plan, the Debtor was to sell its assets and distribute the proceeds to, first, its creditors and, then, if sufficient proceeds existed, its shareholders. One of the few limits placed on the Monitor's (analogous to a Chapter 11 Trustee) discretion was that it must provide 21 days' notice of any distributions to shareholders. The Plan also contains releases, which provide, in pertinent part, that the Debtor and its officers are released from claims "in any way related to, arising out of or in connection with" the bankruptcy.

The Monitor sold the Debtor's assets from which it was able to pay the creditors in full. Accordingly, as contemplated by the Plan, the Monitor gave notice on December 11, 2014 of its intention to make at some future date a distribution in an unspecified amount to shareholders of record as of December 18th. Notably, the Plan was silent on the dividend rules established by the Financial Industry Regulatory Authority ("FINRA"). FINRA is a self-regulating organization that, among other things, regulates distributions including establishing rules for which dates count for receiving dividends and which dates control for being entitled to retain dividends. Moreover, the Debtor did not inform FINRA of its contemplated distribution to shareholders.

Plaintiff/appellants purchased more than 12,600,000 shares in the Debtor between December 16, 2014 and January 22, 2015. On January 21st, 2015, the monitor announced that it would make a distribution that would amount to roughly 75% of the share price to "shareholders as of December 18." Plaintiffs did not receive a distribution on account of their shares and subsequently brought suit in the Delaware bankruptcy court against Arctic Glacier Income Fund ("Arctic Glacier") and four of its officers claiming that Plaintiffs were entitled to a distribution and asserting, among other things, claims for negligence, breach of fiduciary duties, and securities fraud. Plaintiffs also argued that, under the applicable FINRA rules, they would have been entitled to a distribution. The bankruptcy court granted Arctic Glacier's motion to dismiss the complaint and held that the releases in the Plan and *res judicata* barred the claims. The district court affirmed and Plaintiffs appealed.

COURT ANALYSIS

Plaintiffs' advanced three arguments. First, relying on the Supreme Court's decision in *Holywell Corp. v. Smith*, 503 U.S. 47 (1992), they argued that a plan can never insulate a debtor from post-confirmation conduct. Second, Plaintiffs asserted that they are not subject to the Plan's releases because buying shares of the Debtor's stock did not make them transferees within the meaning of the Plan. Finally, Plaintiffs argued that subjecting them to the Plan's releases violates due process. The Third Circuit rejected each of these arguments.

As to the first argument, the Third Circuit noted that when a court enters an order confirming a bankruptcy plan it is entering a final judgment, which is *res judicata*, and bars any challenges to the plan that were or could have been raised. Therefore, the Debtor's Plan, including the releases is *res judicata*. The court found unavailing the Plaintiffs' reliance on *Holywell*, and in particular the single sentence from the end of that opinion on which Plaintiffs rely: "[W]e do not see how [a confirmed plan] can bind the United States or any other creditor with respect to post[-] confirmation claims." *Holywell*, 503 U.S. at 58. The Third Circuit distinguished *Holywell*, noting that, in that case, the government sought to collect taxes on income generated from the post-confirmation liquidation of the debtor's assets (i.e., the tax obligation arose post-confirmation). Unlike the instant case, the government was not seeking to challenge the implementation of the plan. The Third Circuit also found that the Plaintiffs' interpretation of the *Holywell* decision defied logic. The court noted that, by definition, a debtor can only implement a plan after it has been confirmed at which time it is a binding plan. Plaintiffs' "overreading of a single sentence in *Holywell* would nullify the *res judicata* effect of confirmed plans and, with it, much of Chapter 11."

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EQUITABLE MOOTNESS REMAINS ALIVE AND WELL

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Dropbox, Inc. v. Thru, Inc. et al. (In re Dropbox, Inc.), No. 3:17-CV-1958-G (N.D. Tex. Oct. 19, 2018)

CASE SNAPSHOT

If the requested relief on appeal would require a substantially consummated (but allegedly imperfect) chapter 11 plan to be completely unraveled—courts will apply equitable mootness to protect third parties who have relied on and benefited from the plan.

FACTUAL BACKGROUND

The origin of this bankruptcy appeal began over a messy prepetition trademark dispute between debtor Thru, a provider of cloud-based data-sharing file systems, and Dropbox, a provider of online management and collaboration services. Dropbox ultimately prevailed and was granted rights to the trademark. Thereafter, Thru was ordered to pay $2.3 million in attorneys' fees to Dropbox for bad faith conduct in litigation.

Unable to pay the award or to obtain a bond to prevent collection pending appeal, Thru filed for bankruptcy. Within two weeks of its petition, Thru filed its initial plan and disclosure statement, which was met with several objections from Dropbox disputing, among other issues, unfair discrimination and feasibility of the plan. For good measure, Dropbox additionally requested conversion, or, alternatively, the appointment of a Chapter 11 trustee.

Thru amended its filings twice to address many of Dropbox's objections. The plan's final version kept Dropbox in a separate class from other unsecured creditors, and purported to pay $2.3 million over a 10-year period at the federal judgment rate of 1.22%. In addition, the plan subordinated the right of repayment of the debtor's secured creditors to Dropbox, requiring that Thru's 1 million exit facility loan be *parri passu* with Dropbox's right to repayment of its fee award.

All creditors except for Dropbox voted in favor of the modified plan. Over Dropbox's objections, the Bankruptcy Court denied Dropbox's motion to convert or appoint a Chapter 11 trustee and approved the plan.

On appeal to the District Court, Dropbox advanced the following nine claims:

(1) The plan was not filed in good faith as it was essentially a two-party dispute and filed to obtain a litigation advantage, and the Bankruptcy Court erred by failing to fully address its bad faith arguments;

(2) The plan was not feasible due to inadequacies in Thru's earning power, capital structure, management, and current economic conditions;

(3) The plan was not fair and equitable as it failed to provide a high enough interest rate to ensure that Dropbox would receive the present value of its claims.

(4) Classes were improperly gerrymandered and the Bankruptcy Court erred in finding that Dropbox was a competitor of Thru to justify placing it in a separate class;

(5) The plan was unfairly discriminatory in that it allowed prepetition lenders to perfect a previously unperfected lien and provided payment to other unsecured creditors over a shorter period than Dropbox's 10-year payment schedule;

(6) In violation of established Fifth Circuit precedent, the plan contained impermissible third-party exculpations and releases of non-debtor directors, officers, and debtor's parent company;

(7) The plan was not in the best interest of creditors because debtor failed to show that creditors would receive more under the plan they would in a liquidation scenario;

(8) The Bankruptcy Court should have appointed a Chapter 11 Trustee; and

(9) The Bankruptcy Court erred in excluding testimony from a witness.

In response to the litany of objections, Thru filed a motion to dismiss the appeal for equitable mootness.

COURT ANALYSIS

The District Court began its analysis by identifying that the following events had occurred since the appeal was taken: (1) Thru had assumed executory contracts and unexpired leases, including 180 customer contracts; (2) Thru had received a $1 million exit facility loan which was already used on operations and initial distributions; (3) Dropbox, other unsecured creditors, and Thru's bankruptcy professionals had already received significant distributions under the plan; and (4) Thru had entered into multiple large third-party contracts, including a two-year $1.2 million service agreement for the replacement of Thru's main hardware.

The court recognized that the doctrine of equitable mootness authorizes an appellate court to decline review of an otherwise viable appeal of a Chapter 11 plan where reorganization has progressed too far for the requested relief to be practicably or fairly granted. However, it was careful to note that equitable mootness should be applied narrowly to specific claims instead of entire appeals and that partial relief should be granted to appellant when feasible and appropriate.

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Equitable Mootness Remains Alive and Well—continued from page 17

To frame its analysis, the court restated the following three factors used by courts in the Fifth Circuit in determining whether an appeal should be dismissed for equitable mootness: (1) whether a stay was obtained; (2) whether the plan has been 'substantially consummated'; and (3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.

Dropbox conceded that it did not obtain a stay pending appeal and that the plan was substantially consummated—eliminating the need to consider the first two factors of the three-factor test. Accordingly, the court analyzed each of the nine claims through the third factor, whether the requested relief would affect third parties and/or the success of the plan.

The District Court easily dismissed seven out of nine claims on appeal as equitably moot. The dismissed claims were Dropbox's arguments that the plan was filed bad faith, infeasible, not in the best interests of creditors, unfairly discriminatory, and gerrymandered. The District Court also dismissed Dropbox's contentions that a Chapter 11 trustee should have been appointed and that the Bankruptcy Court should have permitted Dropbox's expert testimony.

These seven claims were all dismissed for one simple reason: partial relief for Dropbox was impossible. Instead, the relief requested by Dropbox for each of these claims would require the entire plan to be unraveled and for Thru to start from scratch. An inevitable consequence of the plan's undoing would cause, in the court's opinion, significant harm to third parties not before the court. Importantly, third party creditors and professionals would be forced to return significant distributions, and postpetition contractors and vendors were dependent on Thru exiting Chapter 11. In light of the fact that Dropbox failed to seek a stay pending appeal and the plan was substantially consummated, the third party harm caused by unraveling the plan justified dismissal of these seven claims on the grounds of equitable mootness.

Only two claims remained. First, with respect to Dropbox's third objection against its 1.22% interest rate—the court found that it could provide Dropbox a higher interest rate without completely unraveling the plan. On the merits, Dropbox was still unsuccessful because the court was satisfied that the 1.22% federal judgment rate was objective and would provide Dropbox with what they would receive outside of the bankruptcy process.

However, not all hope for relief to Dropbox was lost. On the sole remaining claim—that the plan contained improper releases and exculpation of non-debtor third parties—the court first found that it could reverse these provisions (and provide Dropbox its requested relief) without completely unraveling the payment provisions of the plan harmful to other third parties. On the merits, the court agreed with Dropbox and concluded that it was clear error for the Bankruptcy Court to approve the plan's releases and exculpations as written because it ignored clear Fifth Circuit precedent prohibiting nondebtor releases.

PRACTICAL CONSIDERATIONS

This case demonstrates that equitable mootness remains a powerful tool. The District Court used this doctrine to knock out the vast majority of Dropbox's objections, despite the fact that they were based on fundamental bankruptcy principles. Even though the plan may have violated these principles, such considerations do not outweigh the harm that would befall third parties if a substantially consummated plan were unwound. However, as seen above, not all hope is lost. The District Court found that partial relief on Dropbox's challenge to interest rates and releases could be available without completely unraveling the plan. On remand, if a court were to increase interest rates or strike down releases, such changes would provide an otherwise-frustrated appellant with significant economic relief.

Third Circuit Holds Shares In Debtor Are Subject To Terms Of Confirmed Plan—continued from page 16

The court also rejected the argument that Plaintiffs were not transferees that are subject to the releases. As buyers of the stock, the court found that Plaintiffs are clearly transferees and took those shares "with both the Plan's benefits and its burdens," including the releases. Finally, the Third Circuit rejected the due process argument noting that the sellers of the shares were represented in the Debtor's bankruptcy proceeding and the Plaintiffs had notice of the Plan and its terms by way of the public notice given by the monitor.

PRACTICAL CONSIDERATIONS

The Third Circuit's decision underscores generally the *res judicata* effect of plan confirmation orders. More specifically, it highlights the need to carefully review the terms of confirmed plan as same may impact the rights of holders of claims against and interest (shares) in the debtor. Here, for example, had the Plan incorporated FINRA's distribution rules explicitly or by reference, Plaintiffs would likely have been entitled to the distribution. In the absence of such reference the distribution scheme set forth in the plan will likely govern and should be considered by parties that may be interested in purchasing claims against or interests in the debtor.

DERIVATIVE STANDING FOR CREDITORS AVAILABLE IN CHAPTER 7 CASES

Brian M. Schenker
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Claridge Associates, LLC v. Schepis (In re: Pursuit Capital Management, LLC), Adv. Proc. No. 16-50083 (LSS), Bankr. Case No. 14-10601 (LSS) (Bankr. D. Del. Nov. 2, 2018)

CASE SNAPSHOT

The United States Bankruptcy Court for the District of Delaware held that, under certain circumstances, an individual creditor may be granted derivative standing to pursue litigation claims held by a Chapter 7 trustee in a Chapter 7 bankruptcy proceeding. In so holding, the Bankruptcy Court extended a decision of the United States Court of Appeals for the Third Circuit, holding that an official committee of unsecured creditors may be granted derivative standing to pursue litigation claims held by a Chapter 11 trustee in a Chapter 11 bankruptcy proceeding. The Bankruptcy Court concluded that the Third Circuit's rationale for permitting derivative standing in a Chapter 11 case for a creditors' committee was equally applicable in a Chapter 7 case for an individual creditor.

FACTUAL BACKGROUND

An investment fund entity filed for Chapter 7 bankruptcy without any assets, other than certain litigation claims. Because the bankruptcy estate had no funds to use to pursue the claims, the Chapter 7 trustee concluded it was in the best interests of the estate to sell the claims at an auction to a party with the resources to pursue them.

At the auction, the Chapter 7 trustee sold all interests that the debtor, the estate, and the Chapter 7 trustee had in the debtor's litigation claims and the trustee's fraudulent transfer claims under state and federal law to a particular motivated creditor of the debtor. Under the terms of the sale, the Bankruptcy Court retained jurisdiction over the claims, and the creditor was required to share proceeds of the claims with the bankruptcy estate and seek Bankruptcy Court approval of any settlement thereof.

When the creditor ultimately brought the claims by initiating an adversary proceeding with the Bankruptcy Court, the defendants moved to dismiss the fraudulent transfer claims on the basis that the creditor lacked standing to bring such claims. The defendants argued that, under the Bankruptcy Code, only the Chapter 7 trustee has standing to bring fraudulent transfer claims in a Chapter 7 case.

COURT ANALYSIS

The Bankruptcy Court focused its analysis, and based its holding, on the decision of the Third Circuit in *Official Committee of Unsecured Creditors of Cybergenics Corporation v. Chinery*, 330 F.3d 548 (3d Cir. 2003) (*en banc*) ("*Cybergenics II*").

In *Cybergenics II*, the Third Circuit addressed the issue of whether the Bankruptcy Code prevented any person, other than a trustee, from bringing state and federal fraudulent transfer claims in a Chapter 11 case. The Third Circuit held that, under the Bankruptcy Code, a non-trustee does not have the unilateral right to bring such claims but that it is within a bankruptcy court's equitable powers to grant a non-trustee derivative standing to bring such claims. The Third Circuit reasoned that Congress intended that fraudulent transfers be recovered in bankruptcy cases to maximize the value of the estate and, thus, granting derivative standing to pursue such claims is appropriate when necessary to further that goal.

In such case, the trustee was refusing to bring certain fraudulent transfer claims. As a result, the Third Circuit held that it was appropriate under those circumstances, where the Bankruptcy Code's envisioned scheme had broken down, for the bankruptcy court to grant the official committee of unsecured creditors derivative standing to bring the claims. Otherwise, to the detriment of the estate, the claims would never be brought as Congress intended.

Against that backdrop, the Bankruptcy Court concluded that the holding of *Cybergenics II* could be extended to Chapter 7 cases. The Bankruptcy Court explained that, in its view, the import of *Cybergenics II* is that there is not a per se constraint on the ability of a non-trustee to act in instances where the Bankruptcy Code identifies the trustee as the actor as long as the non-trustee does not act unilaterally. Instead, *Cybergenics II* recognizes the ability of the bankruptcy court to permit a third party to employ the trustee's avoidance powers in appropriate circumstances. The Bankruptcy Court found such rationale equally applicable to a Chapter 7 case, where the Chapter 7 trustee would otherwise decline to pursue the claims due to a lack of available liquid assets.

The Bankruptcy Court emphasized that this was not a situation where an individual creditor was seeking to "hijack" the Chapter 7 trustee's rights. Nor was this a situation where the Chapter 7 trustee was seeking to avoid its obligations and duties to the estate. Instead, the Chapter 7 trustee discharged its obligations and duties to the estate by selling the claims at auction to a high bidder, who was motivated to bring the claims for the benefit of the estate. All of which was and would be under the supervision of the Bankruptcy Court.

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In sum, the Bankruptcy Court held that if a Chapter 7 trustee has no funds to pursue a cause of action and a creditor is willing to do so, the court should be able to determine, on a case-by-case basis, whether to permit it using the court's equitable powers. As a result, the Bankruptcy Court denied the defendant's motion to dismiss the fraudulent transfer claims. .

PRACTICAL CONSIDERATIONS

An interesting aspect of the case is that the creditor who purchased the litigation claims from the Chapter 7 trustee had been embroiled in non-bankruptcy litigation with the same defendants for years. Presumably, the creditor purchased the claims from the Chapter 7 trustee to gain additional advantage over the defendants, who may have otherwise been hopeful for a quick and cheap settlement of such claims with the Chapter 7 trustee. Though well aware of this aspect of the case, the Bankruptcy Court appeared untroubled by the fact that the purchase of the claims was part of an overall litigation strategy and an apparent risk existed that the creditor would not necessarily prosecute the claims in the same manner as an independent fiduciary for the estate and all of its creditors but would be primarily seeking to advance its own interests.

COUNSEL'S CORNER: NEWS FROM REED SMITH

Derek Baker presented on Recent Commercial Cases at PBI 23rd Annual Bankruptcy Institute.

Bob Simons served as chairperson at the 41st Annual Platts Coal Marketing Days and also moderated a panel.

Derek Baker presented: A Day on Contracts 2018 - Work-out Agreements for the Pennsylvania Bar Institute.

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