RECENT BANKRUPTCY CASE LAW UPDATES

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JURISDICTION

Exec. Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency), 702 F.3d 553 (9th Cir. 2012).

Issue: Does Article III of the Constitution permit bankruptcy courts to enter final judgments in "core" proceedings as defined in 28 U.S.C. § 157(b)?

Issue: Can bankruptcy courts exercise jurisdiction over litigants through their implied consent?

Nicholas Paleveda and Marjorie Ewing, a married couple, operated a series of companies, including Aegis Retirement Income Services, Inc. ("ARIS") and the Bellingham Insurance Agency, Inc. ("BIA"). In early 2006, BIA became insolvent and filed bankruptcy in the United States Bankruptcy Court for the Western District of Washington. In the meantime, BIA had irrevocably assigned the insurance commissions from its largest client to Peter Pearce, a long-time BIA and ARIS employee. Additionally, Paleveda had used BIA funds to incorporate the Executive Benefits Insurance Agency, Inc. ("EBIA"), and Pearce and EBIA deposited $373,291.28 of commission income into an account jointly held by ARIS and EBIA.

Peter Arkison, the Respondent and bankruptcy trustee, sued EBIA and ARIS to recover the commission deposited into the EBIA/ARIS account, claiming they were fraudulent transfers under Section 548 of the Bankruptcy Code and Washington's Uniform Fraudulent Transfer Act, Wash. Rev. Code § 19.40.041. The bankruptcy court granted summary judgment in favor of Arkison, and concluded that EBIA was liable for BIA's debts as a corporate successor. The district court affirmed. EBIA appealed the decision and also invoked *Stern v. Marshall* in a motion to vacate the bankruptcy court's judgment for lack of subject-matter jurisdiction.

The Ninth Circuit began its analysis by stating that under *Stern v. Mashall*, the United States Constitution does not empower bankruptcy courts to enter final orders and judgments in fraudulent-transfer actions. The Ninth Circuit held that fraudulent-conveyance claims are not matters of "public right," and cannot be decided outside the Article III courts. Rather, the Ninth Circuit held that under Section 157(b)(1), bankruptcy courts are only Constitutionally empowered to submit proposed findings of fact and conclusions of law to the United States district courts for review and approval and for entry of final judgment.

Despite this Constitutional limitation, the Ninth Circuit ruled that the EBIA had nevertheless consented to entry of a final judgment by the bankruptcy court because it had not challenged the bankruptcy court's power to enter final judgment soon enough in the process. The Court stated that *Stern* made clear that Section 157 does not implicate questions of subject matter jurisdiction. As a personal right, Article III's guarantee of an impartial and independent federal adjudication is subject to waiver.

EBIA petitioned for a writ of certiorari, which the Supreme Court granted on June 24, 2013. On January 14, 2014, the Supreme Court heard oral argument. At the time of publication of these materials, the Supreme Court had not yet issued its opinion.

The Fifth Circuit decided a similar issue in *In re BP RE, L.P.*, 2013 WL 5975030 (Nov. 11, 2013); however, in doing so, the Fifth Circuit reached the opposite conclusion. In *BP RE*, the Fifth Circuit held that the bankruptcy court had <u>statutory</u> but not <u>constitutional</u> authority to enter a final judgment on a non-core matter where the parties had consented. The Fifth Circuit concluded that consent could not cure the bankruptcy court's lack of constitutional authority. However, the Fifth Circuit did state that the bankruptcy courts could enter proposed findings of fact and conclusions of law.

CREDIT BIDDING

In re Fisker Automotive Holdings, Inc., 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014).

Issue: Whether a creditor's right to credit bid may be limited "for cause" under Section 363(k) to the amount it paid for its secured claim.

In November 2013, the Debtor filed bankruptcy with the intention of selling substantially all its assets to its principal secured lender, Hybrid Tech Holdings LLC ("Hybrid"). Prior to the Debtor's bankruptcy, Hybrid purchased $168.5 million of the senior secured debt owing by the Debtor to the U.S. Department of Energy. Hybrid purchased the debt for $25 million. Acquiring the debt gave Hybrid the same rights previously held by the U.S. Department of Energy, including the right to credit bid.

The asset purchase agreement between the Debtor and Hybrid provided that Hybrid would credit bid $75 million to purchase substantially all the Debtor's assets in a private sale. The Official Committee of Unsecured Creditors (the "Committee") opposed the private sale to Hybrid, arguing that an open auction should be held. Additionally, the Committee argued that Hybrid's credit bid should be capped at $25 million.

At the sale hearing, the bankruptcy court sustained the Committee's objection, relying heavily on the opinion from the Third Circuit Court of Appeals in *In re Philadelphia Newspapers* (wherein the Third Circuit denied a lender the right to credit bid in order to foster a more competitive bidding environment).

The bankruptcy court in *Fisker* held that the "for-cause" provision of Section 363(k) justified limiting Hybrid's credit bidding rights to $25 million. The court found "cause," in part, because the failure to limit Hybrid's credit bidding rights would not just chill bidding, it would eliminate an auction altogether. The bankruptcy court was also concerned about the extremely expedited nature of the sale process, which it believed to be "inconsistent with the notions of fairness in the bankruptcy process." Finally, the bankruptcy court also found "cause" to limit Hybrid's credit bidding rights because Hybrid's lien did not extend to all of the assets to be sold – rather, it included assets in which Hybrid either had no perfected lien or the perfection of the lien was in dispute.

POST-PETITION INTEREST

Prudential Ins. Co. of Am. v. SW Boston Hotel Venture, LLC (In re SW Boston Hotel Venture, LLC), 2014 U.S. App. LEXIS 6758 (1st Cir. Apr. 11, 2014).

Issue: Should a lender's claim for post-petition interest under Section 506(b) of the Bankruptcy Code accrue from the date of the sale of its collateral or from the petition date?

In January of 2008, Prudential Insurance Company of America ("Prudential") provided a construction loan of up to $192.2 million to the Debtor. Prudential took a mortgage and first-priority security interest in the Debtor's real and personal property, including a hotel and condominiums. In June 2010, the Debtor and four of its affiliates (collectively, the "Debtors") filed for Chapter 11 relief. During the case, Prudential filed a motion for relief from the automatic stay, arguing that it was undersecured.

After a three-day hearing, the bankruptcy court found that Prudential was marginally undersecured as to the Debtor's assets only, valuing its debt to Prudential at $154 million and its collateral at $153.6 million (valuing the hotel at $65.6 million and the condominiums at $88 million). However, with respect to the aggregate value of all of the Debtors' assets, the bankruptcy court found that Prudential had an equity cushion of more than $19 million. Further, the Debtor was continually reducing the amount of the outstanding debt through proceeds from condominium sales and the value of its secured claim was not declining. Therefore the bankruptcy court concluded that Prudential was adequately protected and denied its motion to lift the stay.

In 2011, the Debtor sought court approval to sell the hotel for $89.5 million. The purchase price was substantially higher than the $65.6 million value previously determined by the bankruptcy court. Because the sale price established that Prudential was oversecured, Prudential filed a claim seeking allowance and payment of postpetition interest (accruing from the petition date) under section 506(b) of the Bankruptcy Code. However, the plan of reorganization filed by the Debtors did not provide for Prudential to receive any postpetition interest.

Due to ongoing improvements to the hotel and other factors, the bankruptcy court noted that the sale price did not reflect the hotel's value on any date earlier than the sale date. The bankruptcy court held that the sale price, rather than the value assigned at the lift-stay hearing, was the best indicator of the hotel's value; therefore, the court ruled that Prudential only became oversecured at the time the hotel was sold. The bankruptcy court issued an order that Prudential should only receive non-compounded postpetition interest starting on the date of the sale. The Debtors modified the plan accordingly, which the bankruptcy court confirmed over Prudential's objection.

Prudential appealed the confirmation order to the Bankruptcy Appellate Panel for the First Circuit (the "BAP") and filed a motion to stay the confirmation order pending appeal. The BAP denied the stay motion and the plan became effective on December 1, 2011. On appeal, the BAP reversed, holding that Prudential was entitled to postpetition interest from the petition date. The BAP decision was then appealed to the First Circuit.

In its decision, the First Circuit first noted that courts were split on the issue of the appropriate timing and use of a valuation determination. Some courts adopted a "single-valuation" approach (such as the petition date) with others utilized a "flexible approach," affording the bankruptcy court discretion to set a date depending on the circumstances of the case. After evaluating the two approaches, the First Circuit concluded that "[w]e agree with the bankruptcy court and the BAP that, at least in the circumstances presented here, a bankruptcy court may, in its discretion, adopt a flexible approach." Accordingly, the First Circuit reversed the BAP decision and upheld the bankruptcy court decision, which granted Prudential postpetition interest only from the date of the hotel sale.

BREAK-UP FEES

<u>In re C & K Mkt</u>., 2014 Bankr. LEXIS 1510 (Bankr. D. Ore. Apr. 8, 2014)

<u>Issue</u>: Whether a DIP Lender's "break-up fee" claim arising from the Debtor's selection of an alternative DIP Lender was an administrative-expense claim.

Before the Debtor filed bankruptcy, it agreed to a proposed post-petition lending facility with Sunstone. The Debtor and Sunstone signed a Term Sheet on October 25, 2013, which stated that a "'Breakup Fee'" of $250,000, [would be] payable in the event the loan facility was not closed due to the Debtor's election to seek other financing." On November 19, 2013, the Debtor filed its Chapter 11 petition and moved for approval of a DIP financing facility from US Bank, which included considerably better loan terms than offered by Sunstone. A final order approving US Bank's DIP facility was entered on December 27, 2013, which triggered the Debtor's obligation to pay the break-up fee to Sunstone.

Accordingly, Sunstone filed a proof of claim for the $250,000 break-up fee and a motion for an order allowing its claim as an administrative expense under section 503(b) of the Bankruptcy Code. While the Debtor supported Sunstone's motion, the creditors' committee, US Bank, and the mezzanine lenders (collectively, Objectors) objected both to the administrative priority of the claim and the underlying claim itself. The Objectors argued that the proof of claim should be denied because: (i) the break-up fee was not in the best interest of the bankruptcy estate and greatly exceeded the typical break-up fee allowed in asset sale cases; (ii) the break-up fee should be avoided as a fraudulent transfer under Section 548(a)(1)(B); (iii) the amount of the DIP facility, which is a significant material term, was missing from the Term Sheet; and (iv) the Term Sheet was "vague and illusory."

In rendering its decision, the bankruptcy court first noted that the break-up fee was negotiated by the parties and that the evidence indicated that Sunstone would not have agreed to provide DIP financing without the break-up fee. Further, the bankruptcy court reasoned that Sunstone's willingness to lend on short notice served as consideration for the break-up fee. With respect to the second argument, the bankruptcy court ruled that because no evidence was presented as to what a reasonable break-up fee should be in these circumstances, it could not determine whether the $250,000 fee constituted reasonably equivalent value for the services provided by Sunstone. Accordingly, the court declined to avoid the break-up fee as a fraudulent transfer.

As to the third and fourth arguments, the bankruptcy court found that the Term Sheet provided sufficient information to quantify what DIP facility amount would be provided; therefore, it was not vague or illusory. While the Term Sheet did not contain a specific amount, it did specify a range along with the basic terms of the agreement, including events of default and remedies. In fact, the proposed Sunstone DIP Agreement completed the gaps left by the Term Sheet, as it made clear that the DIP facility was "up to $7,000,000," which the bankruptcy court held provided the requisite certainty.

With respect to the issue of administrative priority, the Court declined to give Sunstone's claim administrative-expense priority treatment. The Court explained that the alleged benefits that Sunstone provided to the Debtor (i.e., assurances that the Debtor would have access to funds after filing for bankruptcy, and providing leverage to the Debtor in its negotiations with US Bank) actually accrued to the Debtor prepetition and did not benefit the Debtor after it filed bankruptcy. The bankruptcy court ruled that holding the offer to lend open until the Court entered a final order approving US Bank's DIP financing was at most an incidental benefit to the estate. This was not the type of direct and substantial benefit necessary to transform a contingent prepetition claim into an administrative expense claim. Finally, the bankruptcy court held that the break-up fee was neither an actual expense of Sunstone nor any expense at all. Sunstone's actual expenditures were paid by the Debtor prepetition as required by the Term Sheet, which provided for payment of $5,000 to cover its out-of-pocket expenses.

PLAN VOTING

<u>Meridian Sunrise Vill., LLC v. NB Distressed Debt Inv. Fund Ltd.</u>, 2014 U.S. Dist. LEXIS 30833 (W.D. Wash. Mar. 6, 2014).

<u>Issue</u>: Whether two hedge funds were eligible assignees of the Debtor's loan obligations under the original loan agreement and, thus, were entitled to vote on the Debtor’s plan.

In 2008, the Debtor borrowed $75 million from U.S. Bank for the construction of a shopping center. The parties negotiated a loan agreement that, among other terms, only permitted U.S. Bank to assign the loan to an “Eligible Assignee.” The definition of “Eligible Assignee” included “any commercial bank, insurance company, financial institution or institutional lender and, so long as there was no Event of Default, approved by Borrower in writing." Soon after, U.S. Bank assigned portions of the loan to Bank of America, Citizens Bank, and Guaranty Bank and Trust. After the bankruptcy filing, Bank of America assigned its interests in the loan to BN Distressed Debt Limited Fund, which subsequently assigned half of the interests to two hedge funds (collectively, the “Funds”).

The Debtor objected to the Funds’ acquisition of the loans, and sought to enjoin the Funds from voting on the Debtor’s plan on the grounds that they did not qualify as “Eligible Assignees” under the loan agreement. After the bankruptcy court granted the injunction, the Funds appealed to the district court.

The district court affirmed, finding that the term “financial institution” did not contemplate hedge funds. The Funds argued that the court should look only to the dictionary definition of “financial institution” and not consider any extrinsic evidence. The court found the Funds’ interpretation too broad, noting that such a definition would have “no limiting effect at all," and could include a pawnbroker or an individual who created an online LLC "in thirty minutes." Applying the Funds' interpretation of "financial institutions" would also render superfluous other phrases in the definition of "Eligible Assignee" (*i.e.*, commercial bank, insurance company and institutional lender). Applying the principle of statutory construction, *noscitur a sociis*, the court held that the other words in the "Eligible-Assignee" definition demonstrated that the term "financial institution" should mean "entities that make loans."

The district court also noted that U.S. Bank's attempt to remove the "Eligible Assignee" limitations when a default first occurred served as "powerful evidence that the parties to the agreement meant to (and did) limit the list to lenders, and to exclude assignment to a distressed-asset hedge fund . . . ." Because the loan agreement permitted only "Eligible Assignees" to vote on the plan, the court concluded that the bankruptcy court properly barred the Funds from voting.

<u>In re J.C. Householder Land Trust #1</u>, 502 B.R. 602 (Bankr. M.D. Fla. 2013).

<u>Issue</u>: Whether a creditor had cause to change its plan vote when the sole purpose of buying the underlying claim was to block confirmation.

In this case, a secured creditor subject to a Chapter 11 cram-down plan purchased the claim of an unsecured creditor whose claim was sufficient to control the vote of the general unsecured class. However, because the unsecured creditor had already voted its claim in favor of the plan, the secured creditor had to file a motion to change the unsecured claim's vote.

In deciding the motion, the bankruptcy court focused its analysis on Bankruptcy Rule 3018, which requires a creditor to demonstrate "cause" before it is allowed to change a vote in favor or against a plan. Noting that Bankruptcy Rule 3018 does not define "cause," the bankruptcy court looked to the definition of "good cause" under Black's Law Dictionary, which is defined as a "legally sufficient reason." The bankruptcy court then found that "the reason for changing a vote is legally sufficient under Rule 3018 if it promotes consensual negotiation and fair bargaining. Changing a previously cast ballot to block confirmation does not promote consensual negotiation or fair bargaining. In fact, it does the opposite." Ultimately, the bankruptcy court held that the secured creditor had not demonstrated "cause" to change the unsecured claim's vote under Rule 3018 because the only purpose for doing so was to block confirmation.

PREPETITION DEFAULT INTEREST

<u>In re Shree Mahalaxmi, Inc.</u>, 505 B.R. 794 (Bankr. W.D. Tex. 2014).

<u>Issue</u>: Whether a lender is entitled to a claim for default interest for a non-monetary default without first providing notice to the Debtor that the note was being accelerated.

The Debtor was the owner and operator of a hotel property. In 1996, the Debtor received a loan from Merrill Lynch Credit Corporation ("Merrill Lynch") in the amount of $1,650,000 secured by the hotel. At some point after the loan was made, but prior to bankruptcy, the Debtor placed two junior liens on the hotel in favor of a third-party bank. After the Debtor filed bankruptcy, Merrill Lynch filed a proof of claim, which included prepetition default interest on the basis that the junior liens triggered a default under the loan documents.

The Debtor objected to Merrill Lynch's proof of claim, and the bankruptcy court considered whether the claim for default interest was matured and earned as of the petition date pursuant to Section 502. The bankruptcy court found that there was a default under the loan documents because of the provisions prohibiting the debtor from further encumbering the collateral and from incurring additional debt (other than trade debt). The bankruptcy court further noted that acceleration of the note would have to be triggered by the nonpayment default to support the claim for default interest. Pursuant to the loan documents, however, Merrill Lynch had discretion to accelerate after an event of default, which meant that acceleration did not automatically occur. Thus, to trigger default interest for a nonpayment event of default, the bankruptcy court held that Merrill Lynch first had to exercise its option to accelerate the loan. Under applicable state law, acceleration required two notices: (1) notice of intent to accelerate and (2) notice of acceleration. Since acceleration was viewed as a harsh remedy, the notices were required to be "clear and unequivocal."

The bankruptcy court then noted that although parties can choose to waive notice requirements, the waiver must also be clear and unequivocal. According to the Supreme Court, waivers "must state specifically and separately the rights surrendered." A waiver of "notice" or "notice of acceleration" would be sufficient to waive notice of acceleration, but not of the intent to accelerate. Similarly, a general waiver of all notices would be insufficient to specifically waive the two separate rights.

In this case, the bankruptcy court found that Merrill Lynch did not accelerate since it wasn't even aware of the default prior to bankruptcy. The only way it could prevail was if the waiver provision was sufficient. The note contained a standard waiver provision, including: "Maker hereby expressly waives the right to receive any notice from holder with respect to any matter for which this note does not specifically and expressly provide for the giving of notice by holder to maker." The bankruptcy court concluded that, at best, this waived the notice of acceleration, but was not sufficient to waive the notice of intent to accelerate. Accordingly, the bankruptcy court held that the loan documents did not provide for automatic default interest upon occurrence of an event of default; and the bankruptcy court declined to rewrite the contracts and instead enforced the terms as agreed.

NEW-VALUE DEFENSE

Stoebner v. San Diego Gas & Electric Co. (In re LGI Energy Solutions, Inc.), 746 F.3d 350 (8th Cir. 2014).

Issue: Whether two utilities could each offset subsequent new value that the utilities paid to the Debtor for that utility's services, regardless of when those services were provided.

Prior to bankruptcy, the Debtor performed bill-payment services for large utility customers. During the ninety days prior to bankruptcy, the Debtor made transfers totaling $75,053.85 to San Diego Gas & Electronic Company ("SDGE") and transfers totaling $183,512.74 to Southern California Edison Company ("SCE").

The trustee then sued SDGE and SCE after the Debtor filed bankruptcy to recover the payments. SDGE and SCE asserted that the payments were insulated from avoidance by the "subsequent-new-value" defense. However, SDGE and SCE did not contend that they provided any new value to the Debtor. Instead, they argued that the payments that the Debtor continued to receive from *its clients* (the customers of the utility companies and the beneficiaries of the allegedly preferential payments) after the Debtor made the allegedly preferential transfers should constitute new value to defeat the trustee's clawback action. The trustee contended that for the new-value defense to apply, the new value must be provided by the creditor that received the alleged preference payment.

In separate decisions, the bankruptcy court ruled in favor of the utility companies, in part, allowing SDGE and SCE to offset payments received by the Debtor from the utility customers. The Eighth Circuit Bankruptcy Panel reversed the bankruptcy court in part and allowed each utility a larger offset for all payments by the utility customers that were made after a preference payment. The trustee appealed to the Eighth Circuit.

The Eighth Circuit began its analysis by affirming the lower courts' findings that the purpose of the new-value defense can be served in three-party relationships where the debtor's preferential transfer to a third party (i.e. SDGE and SCE) benefits the debtor's primary creditor (i.e. the Debtor's clients), even if the third party is the only defendant of the preference action. The Eight Circuit examined the economic realities of the business arrangement between the Debtor, SDGE, SCE, and the Debtor's clients and observed that even though SDGE, SCE, and the Debtor's clients could have stopped using the Debtor's bill-paying services at any time, they both continued to work with the Debtor right up to the date of the bankruptcy filing in spite of the Debtor's financial struggles. The Eight Circuit noted that this commitment to a struggling business is precisely the type of behavior that the new-value defense seeks to safeguard. Accordingly, the Court ruled that the new value provided to the Debtor by its clients could be used by the utility companies in defense of the trustee's preference action.

PREPAYMENT PREMIUMS

Bank of N.Y. Mellon v. GC Merchandise Mart, L.L.C. (In re Denver Merchandise Mart, Inc.), 740 F.3d 1052 (5th Cir. 2014)

Issue: Whether a prepayment premium is triggered upon the mere acceleration of a note rather than actual prepayment.

On September 30, 1997, GC Merchandise Mart ("GCMM") signed a $30 million promissory note ("Note") in favor of Dynex Commercial, Inc., who was later succeeded by Bank of New York Mellon ("Mellon"). In October 2010, GCMM defaulted on its loan from Mellon, resulting in the acceleration the Note. After defaulting, GCMM made two more partial payments, but ceased making payments after December 2010. GCMM filed for bankruptcy in March 2011; at which time, it still owed $24 million on the Note. Mellon filed a proof of claim seeking a $25 million secured claim owing under the Note, along with a $1.8 million prepayment premium owing per the terms of the Note.

The bankruptcy court disallowed the $1.8 million prepayment premium. The district court affirmed the bankruptcy court's decision, and Mellon appealed to the Fifth Circuit.

The Fifth Circuit analyzed whether a lender is entitled to prepayment premiums upon the pre-bankruptcy acceleration of a promissory note. In doing so, the Fifth Circuit reviewed the governing law under the Note (Colorado law). Under Colorado law, unless specifically provided for by contract, a lender may not assess a prepayment premium when the note is accelerated at the lender's option. In addition, a lender's choice to accelerate the note acts as a waiver of the right to a prepayment premium.

The Fifth Circuit then analyzed the exact language in the note governing acceleration and prepayment premiums. With respect to prepayment premiums, several conditions were required to trigger the obligation to pay prepayment premiums but none required the borrower to pay such premiums absent an actual prepayment. Article 6(A)(1) stated that the borrower was obligated to pay the prepayment premium in the event of a Default Prepayment, which was defined as a prepayment occurring during a default or acceleration "under any circumstances." Further Article 6(A)(3) provided that "Borrower shall pay the Prepayment Consideration due hereunder whether the payment is voluntary or involuntary (including without limitation in connection with Lender's acceleration of the unpaid principal balance of the Note) . . . ."

The Fifth Circuit found that the language plainly provided that no prepayment premiums were owed unless there was an actual prepayment. Therefore, the Fifth Circuit held that, pursuant to Colorado law, absent a clear contractual provision to the contrary or evidence of the borrower's bad faith in defaulting to avoid a penalty, the lender's decision to accelerate acts as a waiver of a prepayment premium.

ABSOLUTE-PRIORITY RULE

In re Castleton Plaza, LP, 707 F.3d 821 (7th Cir. 2013)

Issue: Whether an equity investor could evade a competitive-marketing process by arranging for the new value to be contributed by an "insider," in this case his wife.

In *Castleton Plaza*, 100 percent of the equity in the Debtor was owned by George Broadbent, who was also CEO of a company that managed the Debtor. The Debtor proposed a plan of reorganization in which 100 percent of the Debtor's new equity would go to Mary Clare Broadbent, George Broadbent's wife, on account of a $375,000 investment in the reorganized company. EL-SNPR Note Holdings, the Debtor's only secured creditor, objected, arguing that the Debtor's assets had been undervalued, and offered to pay $600,000 for the new equity, as well as paying the unsecured creditors in full. EL-SNPR also asked the bankruptcy court to require that Mary Clare Broadbent's offer to purchase the new equity be subject to a competitive-auction process.

EL-SNPR's request was denied, and the plan was approved as proposed. The bankruptcy court held that competition wasn't necessary because section 1129(b)(2)(B)(ii) of the Bankruptcy Code deals only with "the holder of any claim [or interest]" that is junior to the impaired creditor's claim, and Mary Clare Broadbent did not hold an interest in the debtor. EL-SNPR appealed this holding and the bankruptcy judge certified the question for direct appeal to the Seventh Circuit under 28 U.S.C. § 158(d)(2)(A), which the Circuit Court accepted.

In reversing the bankruptcy court, the Seventh Circuit ruled that the Debtor's plan of reorganization should be submitted to competitive bidding under the Supreme Court's *203 North LaSalle* decision. The Seventh Circuit reasoned that a "new-value" plan that channeled new equity to an insider of an old equity investor, here the investor's spouse, would potentially circumvent the absolute-priority rule just as effectively as conferring new equity on the investor himself. The Seventh Circuit explained that George Broadbent would receive value from his wife's investment in the reorganized Debtor, which was retention of his $500,000 salary as CEO of Broadbent Company and an increase in his family's wealth due to Mary Clare Broadbent's new ownership of the Debtor.

Further, the Seventh Circuit stated that George Broadbent would receive an indirect benefit from transfer of new equity under the Internal Revenue Code because it would qualify as income and thus would qualify as "value" for purposes of the absolute-priority rule. Specifically, the proposed plan of reorganization provided a valuable opportunity for his wife to purchase the Debtor on the cheap. The Seventh Circuit held that this outcome could not be squared with *203 North LaSalle's* competition requirement, which "helps prevent the funneling of value from lenders to insiders . . . ." The Seventh Circuit recognized that the need for competitive bidding was particularly compelling where, as here, the secured lender believed the debtor's assets were undervalued and its secured claim was being substantially impaired.

INVOLUNTARY PETITIONS

<u>Credit Union Liquidity Servs., L.L.C. v. Green Hills Dev. Co., L.L.C. (In re Green Hills Dev. Co., L.L.C.)</u>, 741 F.3d 651 (5th Cir. 2014).

<u>Issue</u>: Whether a creditor lacked standing under Section 303(b) to file an involuntary bankruptcy petition against the Debtor when extensive litigation provided that the creditor's claim was subject to a bona fide dispute.

Credit Union Liquidity Services, L.L.C. ("CULS") entered into a construction loan agreement with the Debtor. The lending relationship between CULS and Greens Hills deteriorated, and Green Hills had an outstanding balance on the loan of more than $8 million at that time. Green Hills then filed suit against CULS in Texas state court seeking legal and equitable remedies such as damages for fraud claims and equitable subordination. In response, CULS filed a counterclaim for the outstanding amount it claimed to be owed under the loan agreement. While the Texas state-court litigation was still pending, CULS filed an involuntary bankruptcy proceeding against Green Hills in the Bankruptcy Court for the Southern District of Mississippi. The bankruptcy court dismissed the bankruptcy petition and held that (1) CULS failed to demonstrate that Green Hills was failing to pay its debts when due and (2) the claim was subject to a *bona fide* dispute. The district court affirmed, and CULS appealed to the Fifth Circuit.

The Fifth Circuit found that CULS lacked standing under section 303(b) of the Bankruptcy Code to file an involuntary bankruptcy proceeding, because the creditor's debt was subject to a '*bona fide* dispute.' The

Court observed that 2005 amendments to the Code defined a *bona fide* dispute as one "to liability or amount," a change that questioned earlier authority that focused only on liability.

In considering whether a claim is subject to a *bona fide* dispute, the Fifth Circuit reviewed the standard it developed in *Subway Equipment Leasing Corp. v. Sims (In re Sims)*, 994 F.2d 210, 221 (5th Cir. 1993), in which it held that a "bankruptcy court must determine whether there is an objective basis for either a factual or legal dispute." The Fifth Circuit supported the bankruptcy court's "thorough and independent" review of the evidence in the Texas state-court proceedings in determining whether a *bona fide* dispute existed under the facts. In reaching its conclusion, the Court noted that the claim had been subject to "unresolved, multiyear litigation." Therefore, the Fifth Circuit found that the CULS claim was subject to a *bona fide* dispute in regard to the Texas litigation.

EXEMPTIONS

<u>Law v. Siegel</u>, __ U.S. __, 134 S. Ct. 1188 (2014).

<u>Issue</u>: Whether statutory exemptions can be revoked as punishment for the debtor's misconduct during bankruptcy proceedings.

When the Debtor filed a petition for relief under Chapter 7 of the Bankruptcy Code, his primary asset was his home, which was valued at just over $360,000. Under the California Code of Civil Procedure, a debtor filing for bankruptcy can file a "homestead exemption" for up to a particular amount. The Chapter 7 Trustee submitted two motions to "surcharge" the Debtor's homestead exemption because of the Debtor's behavior throughout the bankruptcy process. Although the first motion was dismissed because the court found no misconduct beyond litigiousness, the court granted the second motion to surcharge the exemption.

The bankruptcy court relied on case precedent establishing equitable authority to surcharge an exemption when a debtor's misconduct results in fraud on the court or creditors. Following the same reasoning, the Bankruptcy Panel of the Ninth Circuit affirmed the bankruptcy court's order. The Debtor then filed a petition for a petition for a writ of certiorari with the Supreme Court, which was granted on June 17, 2013.

The Supreme Court held that the Bankruptcy Code itself sets forth the circumstances in which otherwise exempt property is available to the trustee to distribute to creditors, and that the "Code's meticulous . . . enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exemptions."

The Supreme Court then rejected the argument that Section 105(a) was the source of relevant authority to take action prohibited by the text of the Code. "Section 105(a) confers authority to carry out the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits." As a result, the Supreme Court concluded that the Bankruptcy Code creates no such power to deny an exemption on a ground not specified in the Code.

TRANSFER RESTRICTIONS

<u>Phoenix, LLC, v. The Alameda Liquidating Trust (*In re* Alameda Investments, LLC)</u>, BAP No. CC-13-1333-PaTaKu (B.A.P. 9th Cir. Mar. 5, 2014).

<u>Issue</u>: Whether transfer restrictions in a limited liability company operating agreement bar the transfer of a debtor's membership interest to a liquidating trust pursuant to a confirmed chapter 11 plan.

Before the debtor, Alameda Investments, LLC, filed its chapter 11 petition, it entered into an operating agreement to form West Lakeside, LLC, a California limited liability company with Phoenix, LLC and AKT Investments, Inc. Alameda and Phoenix each owned 50 percent membership interest in West Lakeside, LLC, and AKT served as the managing member. Both the operating agreement and applicable California law (Cal.

Corp. Code 17301(a)) prohibit transfers of a member's interest without prior written approval of a majority of the other members.

On January 9, 2009, Alameda, along with some of its affiliates, filed a chapter 11 petition in the United States Bankruptcy Court for the Central District of California. The debtors later had a joint chapter 11 plan confirmed, establishing a liquidating trust for the liquidation and distribution of Alameda's assets. The plan further provided that substantially all of Alameda's rights, title and interest in and to Alameda's assets (Alameda's membership interest West Lakeside, LLC) were "irrevocably transferred, absolutely assigned, conveyed, set over and delivered to the Alameda Liquidating Trust" for the benefit of the trust beneficiaries.

The liquidating trustee was initially involved in the management of West Lakeside, LLC. But, after some time had passed, AKT, the managing member, questioned whether the liquidating trustee had actually obtained the right under the plan to participate in management of the LLC, or whether the liquidating trust had simply received an economic interest in the LLC due to the transfer restrictions under the operating agreement and California law. AKT ultimately stopped involving the liquidating trustee in the management of its operations.

In response, the liquidating trustee filed a motion in the bankruptcy court for an order determining that the liquidating trust had received full membership rights in West Lakeside, LLC under the plan, arguing that the operating agreement was not an executory contract; thus, the trust received the same membership interests and benefits to which Alameda was entitled prior to the chapter 11 filing or confirmation of the chapter 11 plan.

In response, AKT argued that the operating agreements status as executory or not was inapposite, given the restrictions on transfer in the agreement and under applicable law or, in the alternative, the operating agreement was executory because it contains a number of provisions requiring a vote of the majority of its members. AKT and Phoenix joined together to further argue that, (1) even if the operating agreement is an executory contract, the plan and confirmation order stating that "any provisions of a limited liability company agreement or operating agreement . . . which purport to restrict the transfer of the economic interest in such entity . . . is invalidated as an "*ipso facto*" clause under [s]ection 365(e) of the Bankruptcy Code" limit the liquidating trust to an economic interest; and (2) the membership interest could not have been assigned to the liquidating trust without a majority vote of the non-transferring members, because the liquidating trust is a third-party to which section 541(c) of the Bankruptcy Code's nullification of transfer restrictions is not applicable.

The bankruptcy court ruled in favor of the liquidating trustee, holding that the liquidating trust had received a full membership interest in the LLC under the plan because: (1) the operating agreement was not an executory contract - there was no performance due by each party as of the petition date such that the failure to perform would constitute a material breach of the operating agreement; (2) section 365(e) of the Bankruptcy Code and the related provisions of the plan and confirmation order cited by AKT and Phoenix are inapplicable to the operating agreement because they only pertain to *executory* contracts; and (3) section 541(c) did not nullify restrictions on transfers to the liquidating trust because because the liquidating trust was an extension of the estate.

Phoenix, LLC appealed the bankruptcy court's order on the section 365(e) and 541(c) issues. The Ninth Circuit B.A.P. affirmed the bankruptcy court's ruling on both points. The B.A.P. provided further support for the bankruptcy court's 365(e) holding, stating that California contract law, which applied to the relevant plan provision, disfavors construing contractual provisions in any way that would render other provisions mere surplusage. Phoenix's construction of the plan ignored both the context of the relevant provision (the confirmation order's effect on executory contracts and unexpired leases) and the provisions of the plan and confirmation order providing that all of the debtor's interests in the transferred assets to be deemed irrevocably transferred and delivered to the trust. The section dealing explicitly with the interests of the trust is what governed whether the entire operating agreement transferred to the trust.

The B.A.P. also provided further support for the bankruptcy court'section 541(c) holding, citing section 1123(b)(3)(B) of the Bankruptcy Code, which allows a plan to provide for "the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any claim or interest." Section 1123 provides a mechanism for the appointment of a liquidating trustee that will serve as a continuing representative of the estate and become the "functional equivalent" of a chapter 11 trustee.

EXECUTORY CONTRACTS AND UNEXPIRED LEASES

***In re* Cain**, No. 13-45030 MEH (N.D. Cal. April 11, 2014).

Issue: Whether a debtor may "promptly" cure its default under an assumed lease through installment payments over an extended period of time.

The debtors' proposed plan was premised on the assumption of two commercial leases, both with the same landlord, Haoson, LLC. The leases ran from March 15, 2011 to March 31, 2016. The debtors proposed to cure their default under the lease agreements - unpaid rent calculated by the debtors at $32,217.00 - through 42 monthly installment payments of $767.07.

The landlord objected to confirmation of the plan, arguing, *inter alia*, that: (1) the debtors' estimate of unpaid rent was too low because it was based on a lower initial monthly rate, which had increased prior to the petition date according to the terms of the lease agreements and (2) the proposed cure schedule violated the prompt-cure requirement of section 365(b)(1).

The debtors countered that the lower rental rate was correct because the landlord had orally agreed to accept the lower rental rate, and had waived its right to receive the higher rental rate by filing a proof of claim based on the lower rental rate. The debtors also argued that the cure schedule was sufficiently prompt because it tracked the remainder of the lease term.

The bankruptcy court first addressed the issue of the proper monthly rate under the lease agreements. The bankruptcy court quickly rejected the debtors' argument that the landlord had entered into an oral modification of the leases, citing the California statute of frauds, which requires any lease of real property for a period longer than a year to be evidenced by a written agreement.

However, the Bankruptcy Court held that the debtors' waiver argument was partially correct, stating that, by filing a proof of claim based on the lower rate, the landlord consented to that (lower) rate until the date it filed its objection and asserted its right to the higher rate. This waiver would not apply to rent due after December 2013, because the lease agreements expressly provided that a waiver of prior amounts owed did not constitute a waiver of any future amounts to be owed. Based on this monthly-rate schedule, the Bankruptcy Court calculated the amount of the debtors' outstanding default under the lease agreements at $40,637.

After determining the amount of the debtors' default, the Bankruptcy Court turned to the debtors' plan to assume the leases and cure the defaults thereunder over time. To assume a lease under section 365 of the Bankruptcy Code, a debtor must: (1) cure any existing default or provide adequate assurance of prompt cure of the default, (2) compensate, or provide adequate assurance of prompt compensation for any monetary loss, and (3) provide adequate assurance of future performance of the lease.

The Bankruptcy Court summarily rejected the debtors' argument that the cure installment payments over a 42-month period proposed under the plan constituted adequate assurance of prompt cure and compensation for monetary loss, stating that "[c]ourts have consistently held that a cure period of over two years is not "prompt" for purposes of § 365(b)(1)." citing *Matter of DiCamillo*, 206 B.R. 64, 72 (Bankr. D. N.J. 1997) (collecting cases).

<u>In re Physiotherapy Holdings, Inc.</u>, Case No. 13-12965(KG) (Bankr. D. Del. March 19, 2014).

<u>Issue</u>: Whether a debtor may assume a software license but reject numerous other agreements, including a master agreement, with a given counterparty.

Prepetition, the debtors, who operated an outpatient physical therapy clinic, hired a consulting firm, Huron Consulting Services, LLC, dba Wellspring + Stockamp Huron Healthcare ("Huron") to assist in improving their revenue cycle. At that time, the debtors entered into a number of agreements with Huron, including a master agreement and a software license agreement that granted the debtor the right to use Huron's accounting software. About two years later, the debtors filed petitions under chapter 11 accompanied by a prepackaged plan that (1) sought to assume the software license agreement and (2) at the same time, reject the remaining agreements, including the master agreement. The debtors' reason for the selective assumption was no secret: the debtors required the continued use of the licensed accounting software for a period of time post-emergence because the software was critical to the operation of their business. In addition, the debtors had already paid for the use of the accounting software; therefore, the assumption cost was negligible. The debtors sought to reject the master agreement because it contained a broad provision that required the debtors to indemnify Huron for any liability, loss, and expense related to claims by third parties arising out of Huron's service to the debtors. The debtors could not afford to take on this indemnification risk, especially in light of the lawsuit that the prepackaged plan's litigation trust had commenced against Huron for alleged problems relating to the software.

Huron objected to the proposed assumption and rejection, arguing that under section 365(c)(1) the three agreements should be treated as one integrated agreement; thus, the software license could not be assumed over its objection. The court confirmed the prepackaged plan but reserved judgment on the issue.

Citing *In re Fleming Cos.*, 499 F.3d 300, 308 (3rd Cir. 2007), the bankruptcy court acknowledged that Third Circuit law was clear - "[w]hen a debtor assumes a contract, it does so with all of the burdens of the contract." Thus, the crux of the court's analysis was whether the three agreements could each be independently assumed, assigned, or rejected, or whether they comprised a single integrated agreement that could only be assumed, assigned, or rejected as one. In support of its objection, Huron cited integration clauses appearing in both the license and master agreements. The master agreement provides that its terms "shall be incorporated" into the license agreement, and the license agreement provides that "the terms and conditions of the Master Agreement are incorporated into this Agreement by this reference."

In response, the debtors argued that the agreements could not have been intended to be read as a single agreement, because the master agreement and the licensing agreement contain conflicting indemnity provisions. The debtors argued that the broad indemnity provisions of the master agreement would render the licensing agreement's narrower indemnity provision effectively moot if the two agreements are read as one. The debtors further cited a provision of the licensing agreement stating that the language therein "supersedes conflicting portions" of the master agreement.

The Bankruptcy Court ruled in the debtors' favor, concluding that "the Agreements are each separate, stand-alone, complete agreements. Under the circumstances, [s]ection 365 of the Code permits the [d]ebtors to pick and choose which of the Agreements they want to assume." In so holding, the Bankruptcy Court distinguished the agreements at issue from the cases cited by Huron that involved a master lease incorporating numerous separate leases that could not be severed from the master lease.

Other characteristics the Bankruptcy Court cited in support of its holding were that: (1) the agreements were signed at different times; (2) the terms of the license agreement took precedence in the event of a conflict between its term and the terms of the master agreement; and (3) the integration clause in the master agreement did not reduce the separate license agreement to a component of the master agreement but rather reflected that the intention of the parties were reflected in the agreements as written.

In re Tousa, Inc., Case No. 08-10928-JKO (Bankr. S.D. Fla. January 16, 2014).

Issue: Whether a claimant could obtain specific performance or money damages under a rejected contract where the contract limited the remedies for breach to specific performance.

Prior to its chapter 11 filing, homebuilder TOUSA, Inc. (and its affiliates) entered into two contracts that required TOUSA to build and then sell homes to Superior Homes and Investments, Inc. The contracts expressly provide that, in the event of default, Superior Homes' "sole and exclusive remedy any such failure or breach, shall be . . . to either (i) terminate this Contract and receive from Escrow Agreement and immediate refund of so much of the Deposit as has not been applied to the Aggregate Purchase Price or (ii) exercise any and all rights and remedies available to [Superior Homes] in equity, including, without limitation, the right of specific performance . . . provided, however, [Superior Homes] hereby waives any right it may now or in the future have, at law, in equity or otherwise, to seek or obtain money damages from [TOUSA]."

After filing its chapter 11 petition, TOUSA received approval to reject the two contracts with Superior Homes. Superior Homes then filed a proof of claim, seeking monetary damages related to the rejection. The debtors objected to the claim, citing the language in the contracts limiting Superior Homes' available remedies to a return of certain deposits or equitable relief. Superior Homes argued that it was entitled to monetary damages under Florida law, notwithstanding the language of the contracts.

The Bankruptcy Court began its analysis by summarily rejecting Superior Homes' right to specific performance, citing *Collier on Bankruptcy* for the proposition that rejection of the contract under section 365 of the Bankruptcy Code deprives the nondebtor party of a specific performance remedy it might otherwise have under applicable non-bankruptcy law. The bankruptcy court next addressed section 502(c)(2) of the Bankruptcy Code, stating that while this provision provides for estimation of equitable remedies, it does not suggest that equitable remedies may inherently be boiled down to a monetary value. Instead, this section only allows for estimation if a claim "involves a right to payment" in the first instance. Accordingly, the Bankruptcy Court's analysis focused on whether Superior Homes had an equitable right to payment under either the contract or state law.

Superior Homes contended that it was entitled to such monetary damages, despite the express waiver of monetary damages in the contracts, citing an exception found in Florida case law, which allows for monetary damages in certain instances where specific performance under a contract is impossible because the product contracted for has already been sold, and remedies are contractually limited. Based on these cases, Superior Homes argued that Florida law allows it to quantify monetary damages based on its specific-performance remedy notwithstanding the waiver language in the contract; thus, the Bankruptcy Court could calculate monetary damages under section 502(c) of the Bankruptcy Code, ultimately creating a claim under section 101(5)(b).

The Bankruptcy Court rejected Superior Homes' argument, holding that the cases cited by Superior Homes require the vendor to have profited from the transactions and TOUSA did not profit from its sale of the houses at issue.

Accordingly the Bankruptcy Court ruled that the only remedy available to Superior Homes was a return of its deposits pursuant to the contract.

PLAN-CONFIRMATION REQUIREMENTS

<u>In re Friendship Dairies</u>, Case No. 12-20405-RLJ-11 (Bankr. N.D. Tex.. January 3, 2014).

<u>Issue</u>: Whether a debtor's failure to meet projections may render its proposed plan infeasible.

Friendship Dairies proposed a chapter 11 plan that would pay all creditors the present value of their allowed claims over time and permit the debtor's partners to retain their partnership interest. The full payments contemplated under this proposed plan were premised on Friendship Dairies making significant changes to its operations to make them more efficient and generate greater revenues. Friendship Dairies had already begun to make these changes during the pendency of the bankruptcy case, moving its operations to a more intensive milking and complementary farming operation.

The proposed plan generally received a warm reception from creditors - with all impaired classes but one voting to accept the plan. The only objection to the plan came from AgStar Financial Services, FLCA, as loan servicer and attorney-in fact for McFinney Agri-Finance, LLC (collectively, "AgStar"), the debtor's largest secured creditor (AgStar also held all claims in the only impaired class to reject the plan).

AgStar objected to confirmation of the plan, arguing that, *inter alia*, Friendship Dairies could not make the payments contemplated in the plan; thus, the plan failed to satisfy the feasibility requirement of section 1129(a)(11) of the Bankruptcy Code.

The Bankruptcy Court began by citing the standard for feasibility under Fifth Circuit caselaw, stating that the overarching goal is to determine whether the debtor has shown, by a preponderance of the evidence, the existence of the reasonable possibility that a successful rehabilitation (*i.e.*, the plan is not likely to be followed by liquidation or the need for further financial reorganization) can be accomplished within a reasonable period of time. The Bankruptcy Court then went on to identify factors courts have employed in evaluating feasibility, including: "the debtor's capital structure, the earning power of the business, economic conditions, the ability of debtor's management, the probability of continuation of management, and any other related matter."

Friendship Dairies had retained an expert who opined that Friendship Dairies, as reorganized under a more intensive milking/farming operation, would generate sufficient revenues to pay all operating expenses with excess funds that can be used for plan payments and reserve accounts. However, the Bankruptcy Court found two significant problems with the expert's projections. First, the projections did not incorporate Friendship Dairies' required payments under the Plan. Second, the projections had already become significantly out of line with Friendship Dairies' actual performance.

The projections predicted that, on our about the date of the confirmation hearing, Friendship Dairies should have available funds of $224,000 to be used for payments to creditors and the funding of reserve accounts. The projections further assumed that Friendship Dairies would build up and maintain a cash reserve of $500,000 to cover short-run shortfalls from month to month. However, the Bankruptcy Court notes, as of the confirmation hearing, Friendship Dairies had no reserve account at all and had, in fact, lacked sufficient available funds to make all the payments that would be due on the effective date of the plan.

Friendship Dairies argued that it was in discussions with certain administrative claimants to defer their payments, and other disputed claims would not be resolved until some time after the effective date; thus, the debtor was unlikely to have to make all contemplated effective-date disbursements. While acknowledging that assessing cash flow is difficult, particularly with a dairy enterprise, the Bankruptcy Court nonetheless held that the evidence was not enough to justify feasbility - "a debtor in chapter 11 must provide concrete evidence that it can make the payments called for by the effective date. A debtor's ability to meet its initial round of obligations is strong evidence of its ability to operate under positive projections going forward. Its failure to definitively prove that it can make its first round of payments signals an impending crisis."

In re Premiere Hospitality Group, Inc.,, Case No. 13-02145-8-RDD (Bankr. E.D.N.C. December 12, 2013).

Issue: Whether a chapter 11 plan is fair and equitable to an oversecured creditor that would retain its lien and receive a new debt obligation with a lengthy amortization schedule and a balloon payment at maturity.

Premier Hospitality Group, Inc. proposed a chapter 11 plan that would treat the claim of Branch Banking and Trust Company ("BB&T"), its largest secured creditor, as secured in the amount equal to the outstanding balance on the petition date, less all postpetition payments. Such secured amount would be amortized over a period of thirty years with interest accruing at 4.75% per annum, and a balloon payment in ten years.

BB&T, the only claimant in its class, voted to reject the plan and also objected to confirmation on numerous grounds, including that the plan was not fair and equitable because (1) the proposed reamortization of BB&T's claim is not representative of the risk factors inherent in Premier's business and financial position; and (2) the proposed amortization period of thirty years with a 4.75% interest rate and a ten-year balloon payment is unreasonable and inconsistent with the market terms for loans to similar businesses.

Addressing BB&T's fairness objection, the Bankruptcy Court provided that: "[a] plan must be fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. Section 1129(b)(2) sets forth the standards a plan must meet to be considered fair and equitable. However, these requirements are not exclusive. Even if a plan meets the standards of 11 U.S.C. § 1129(b)(2), it can still be considered not fair and equitable and, therefore, nonconfirmable. For a plan to be fair and equitable, the plan must literally be fair and equitable." (*internal citations and punctuation removed*).

Applying this standard, the Bankruptcy Court relied heavily on testimony from BB&T's Special Assets Manager that was: (1) the debtor would not, at the time, qualify for a loan; (2) a 20-year amortization schedule would have been more reasonable based on the debtor's history and the unique circumstances banks consider when lending to hotel properties; and (3) based on a risk assessment, his opinion is that a 6.25–6.5% interest rate would have been more reasonable than the 4.75% proposed under the plan. Based on this testimony, the Bankruptcy Court concluded that the proposed plan's treatment of BB&T's claim was not fair and equitable, stating that (1) the plan "proposes a lengthy period of amortization and places all of the risks associated with the debt on" BB&T (2) the thirty-year amortization period "is not a reasonable market term for a loan of this nature," and (3) the ten-year balloon "is not reasonable and is inconsistent with the market terms for loans of similar businesses."

The Bankruptcy Court concluded its analysis by simply stating that "[a] plan which imposes substantial risks upon a creditor may not be fair and equitable under 11 U.S.C. § 1129(b)(1)."

PROFESSIONAL FEES

ASARCO, L.L.C. v Baker Botts, L.L.P. (In re ASARCO, L.L.C.) , Case No. 12-40997 (5th Cir. April 30, 2014).

Issue: Whether debtor's counsel was entitled to a fee premium for its work in a successful reorganization.

Baker Botts and Jordan Hyden successfully prosecuted complex fraudulent-transfer claims to recover ASARCO's controlling interest in Southern Copper Corporation, which its parent companies (three entities referred to collectively as the "Parent" in the Fifth Circuit opinion and in this summary) had directed it to transfer to the Parent itself. The judgment against ASARCO's Parent, valued at between $7 and $10 billion, was the largest fraudulent-transfer judgment in chapter

11 history. After 52 months in bankruptcy, ASARCO emerged pursuant to a plan of reorganization in late 2009 (funded by its Parent as a result of the fraudulent-transfer recovery) with little debt, $1.4 billion in cash, and the successful resolution of its environmental, asbestos, and toxic-tort claims.

In their final fee applications, Baker Botts and Jordan Hyden sought (1) lodestar fees, (2) expenses, (3) a 20% fee enhancement for the entire case, and (4) fees and expenses for preparing and litigating their final fee applications. ASARCO, once again controlled by its Parent, vigorously objected to the fees, going so far as to issue a discovery request covering every document Baker Botts produced during the 52-month bankruptcy. No ASARCO objection to Bakers Botts's core fees was joined by the United States Trustee.

The Bankruptcy Court rejected all of ASARCO's objections to the core fee request and awarded more than $113 million to Baker Botts and $7 million to Jordan Hyden for core fees and expenses. The Bankruptcy Court also approved percentage-fee enhancements for the work they performed on the fraudulent-transfer litigation but not on the remainder of the bankruptcy case, which, while good, was not superlative enough to warrant fee enhancements under like the fraudulent-transfer work.

These fee enhancements amounted to an additional $4.1 million for Baker Botts and over $125,000 for Jordan Hyden. The Bankruptcy Court's calculation was based on "rare-and-exceptional" performance and results in the adversary proceeding and a finding that the standard rates charged by Baker Botts were approximately 20% below the appropriate market rate. Finally, the Bankruptcy Court authorized fees and expenses for the firms' litigation in defense of their attorneys'-fee claims, resulting in another $5 million (plus expenses) to Baker Botts and over $15,000 to Jordan Hyden.

The District Court affirmed the fee enhancements, agreeing that the fees charged by Baker Botts and Jordan Hyden to defend their core fees were compensable, and did not disturb the Bankruptcy Court's authorization to seek an award of appellate fees for the same purpose. However, the District Court also held that attorneys' fees were improperly awarded for Baker Botts's pursuit of its fee enhancement, remanding to the Bankruptcy Court the issue of whether any of the firm's $5 million defense-fee award related to the enhancement awared.

On remand, the Bankruptcy Court concluded that 100% of the defense-fee award compensated Baker Botts for defending core fees incurred in connection with the case. On appeal, the District Court affirmed the final award. ASARCO then appealed to the Fifth Circuit.

The Fifth Circuit approved the fee enhancements over ASARCO's objections, which included, *inter alia*, that (1) such fee enhancements are not permitted under the Supreme Court's opinion in *Perdue v. Kenny A. ex rel. Winn*, 559 U.S. 542 (2010); (2) in the alternative, the judgment the firms obtained in the fraudulent-transfer litigation was not "rare and exceptional"; and (3) in the alternative, a "rare-and-exceptional" result is not alone sufficient to warrant fee enhancements. The Fifth Circuit clarified that *Perdue* pertained to fee-shifting in civil-rights cases, and that it had had already ruled in *In re Pilgrim's Pride Corp.*, 690 F.3d 650 (5th Cir. 2012) that *Perdue* did not overrule Fifth Circuit precedent authorizing fee enhancements in bankruptcy cases.

The Fifth Circuit went on to summarily reject ASARCO's contention that the firms did not achieve a "rare-and-exceptional" result, stating that it did "not disagree with the lower courts' effusive evaluations of the results obtained."

The Fifth Circuit also rejected ASARCO's argument that fee enhancements are impermissible for "rare-and-exceptional" results alone. ASARCO had supported its argument by citing prior Fifth Circuit cases that all, it argued, had additional factors contributing to the enhancement, such as the debtor's consent, or below market rates. The Fifth Circuit disagreed with ASARCO's interpretation of its prior opinions, stating that "[i]n none of the three cases did this court state that some "plus factor" beyond exceptional performance and results was required for a fee enhancement."

Despite approving the firms' fee enhancements, the Fifth Circuit ruled in ASARCO's favor with respect to the fees awarded to the firms for defending their fee applications. The Fifth Circuit explained that "Congress designed fee-shifting provisions" so "the losing party should bear the full costs of counsel for the winner," but "[i]n bankruptcy, the equities are quite different. Both the debtor and creditors have enforceable rights, and there is a limited pool of assets to satisfy those rights and compensate court-approved professionals; in certain cases, moreover, professionals paid from the debtor's estate represent competing interests. No side wears the black hat for administrative fee purposes. In the absence of explicit statutory guidance, requiring professionals to defend their fee applications as a cost of doing business is consistent with the reality of the bankruptcy process."

However, the Fifth Circuit followed this ruling by warning that "[t]his opinion should not be read as encouraging tactical or ill-supported objections to fee applications. The Bankruptcy Code and rules require ample documentation of fee requests in part to deter satellite litigation. We are confident that bankruptcy courts, practicing vigilance and sound case management, can thwart punitive or excessively costly attacks on professional fee applications."

ACTUAL AND NECESSARY EXPENSES

In re ATP Oil & Gas Corp., Case No. 12-36187 (S.D. Tex. Mar. 18, 2014).

Issue: Whether services provided by a third party at the debtor's direction constitute actual and necessary expenses of the estate even if such services are ultimately unprofitable for the estate.

After filing for bankruptcy, ATP Oil & Gas entered into an "Amendment to Work Order" with Omega under which Omega agreed to perform postpetition repair-and-maintenance work for ATP. Most of the services or materials provided by Omega under this contract relate to a production platform known as the "ATP Innovator," which was later ordered to be "shut-in" by the U.S. Bureau of Safety and Environmental Enforcement. ATP timely complied with the shut-in order, and Omega continued to perform repair-and-maintenance work on the Innovator as well as work related to making the platform safe for abandonment. All of Omega's work completed after ATP informed Omega the Innovator was being shut-in was deemed by ATP or a representative of ATP to be essential to making the platform safe for abandonment, and Omega performed that make-safe work at the direction of an inspection company that was working as ATP's representative.

ATP did not dispute the amount owed to Omega or the quality of its work. Despite these uncontroverted facts, ATP objected to Omega's application for administrative expenses, arguing that Omega's work should be reviewed with the benefit of hindsight and, in hindsight, some of the work that it directed Omega to perform did not actually benefit the estate.

The Bankruptcy Court rejected ATP's hindsight-benefit standard and ruled that Omega was entitled to an administrative expense for all of the postpetition services it provided to ATP. The Bankruptcy Court's analysis divided Omega's services into three categories: (1) pre-shut-in expenses; (2) post-shut-in maintenance and repair; and (3) make-safe work.

ATP challenged Omega's application for pre-shut-in expenses, arguing that Omega's repair and maintenance did not enhance ATP's ability to produce. The Bankruptcy Court flatly rejected the idea that enhancing ATP's ability to produce was a requirement to qualify as an administrative expense. The Bankruptcy Court also noted that Omega's repair-and-maintenance work was necessary to ATP's efforts prior to shut-in to sell the Innovator and related properties. Further, the Bankruptcy Court explained that "[t]he fact that ATP did not ultimately sell the Gomez Properties and realize a profit is not dispositive. The estate does not need to actually profit from Omega's services in order to qualify as a "benefit" under Section 503(b)(1)(A). A debtor in possession must pay for the use of a nondebtor's property, even where the use turns out to be unprofitable. Likewise, Omega is entitled to an administrative expense for its postpetition services, even where the services turn out to be unprofitable for the estate. Omega's pre-shut-in services were deemed necessary by ATP to maintain the platform so that it could be sold to a third party for the benefit of the estate."

ATP challenged Omega's post-shut in maintenance and repair for the brief period between the date ATP commenced shut-in and the date ATP's representative instructed Omega to begin safe-out work because Omega should have known about the shut-in order and realized that such services would not be beneficial to the estate. However, ATP's representative directed Omega to do such repair-and-maintenance work on those days. The bankruptcy court stated that "[d]enying an administrative expense like this would require vendors to determine whether and which of its services would provide a 'benefit to the estate' and require them to constantly second guess the debtor's business judgment. This requirement would chill the vendor's willingness to provide goods and services, and ultimately, frustrate the goal of rehabilitation."

Finally, ATP challenged administrative expenses for Omega's safe out work, arguing that, while it had a legal obligation to fulfill certain environmental responsibilities under the shut-in order, a non-debtor did as well, and the fact that such expenses could be recovered from such non-debtor should preclude giving rise to an administrative expense claim against the debtor's estate. The bankruptcy court once again rejected ATP's argument, holding that "[t]he fact that [the non-debtor] also had a legal obligation to make the platform safe for abandonment does not affect ATP's obligations." Quoting its prior opinion in In *In re Am. Coastal Energy Inc.*, 399 B.R. 805, 811 (Bankr. S.D. Tex. 2009) the Court held that "expenditures for remedying violations of environmental and safety laws are necessary to preserve the estate, regardless of whether liability for the state law violation first occurred before or after the filing of a bankruptcy petition." [i]

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Clients and Matters

Among others, Mr. Helt’s recent representations include:

– Counsel to the Chapter 11 Trustee for the bankruptcy estates of Xtreme Iron LLC, and Xtreme Iron Holdings LLC.

– Counsel to the Chapter 11 Trustee for the bankruptcy estate of American Housing Foundation Inc.

– Counsel to Renaissance Hospitals in the Chapter 11 bankruptcies, resulting in plan confirmation and § 363 sale of assets.

– Counsel to Dorado Beckville Partners I L.P. in its Chapter 11 bankruptcy, resulting in plan confirmation and full payout plus interest to unsecured creditors.

– Counsel to debtor-in-possession lender to American LaFrance in its Chapter 11 bankruptcy, resulting in plan confirmation and successful exit from bankruptcy.

– Counsel to the Official Unsecured Creditors’ Committee in Moore Medical Center LLC, resulting in § 363 sale of its assets and corresponding liquidation.

– Counsel to Brook Mays Music Co. in the § 363 sale of all of its assets and corresponding liquidation.

– Counsel to Brazos Electric Power Cooperative Inc. in confirmation of a Chapter 11 plan, resulting in full payout plus interest to unsecured creditors.

– Trial counsel to liquidating trustee in successful prosecution of $700,000 preference verdict.

- Counsel to buyer of substantially all of debtor's assets in Fleming Foods Inc. Chapter 11 bankruptcy.
- Co-counsel to the Official Unsecured Creditors' Committee in Farmland Industries Inc., resulting in plan confirmation and full payout plus interest to unsecured creditors.

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- J.D., Saint Louis University School of Law, *magna cum laude* (2000)
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Professional Affiliations

- Admitted to practice before:
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  - U.S. District Courts for all districts of Texas
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- Member, State Bar of Texas
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Publications and Speeches

Publications

- Co-Author, Reclamation and Other First Day Matters, Bankruptcy Litigation: Advanced Pre-Trial Practice and Procedure Workshop, The University of Texas (February 2007).
- Co-Author, Spoliation: Retention, Production, and Destruction of Documents, Bankruptcy Litigation: Advanced Pre-Trial Practice and Procedure Workshop, The University of Texas (February 2006).

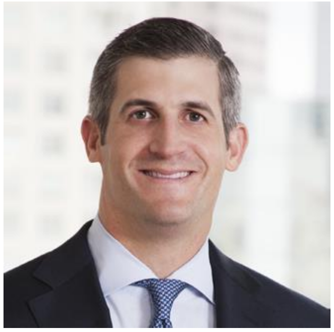
Speeches

- Speaker, Address to the American Bar Association: Erosion of Bankruptcy Remote Structuring by the Courts - What do the General Growth and Sunwest Decisions Mean for Your Practice? (August 2010)
- Speaker, Address to the National Association of Credit Managers: Pre and Post-Bankruptcy Remedies for Trade Creditors - Nuts and Bolts (July 2008).
- Speaker, Address to the Kansas Bankruptcy Bar Association: Reclamation Issues (April 2005).

- Speaker, Address to Husch & Eppenberger: Construction Issues in Bankruptcy (January 2005).
- Speaker, Address to the Kansas City Missouri Bankruptcy Bar Associations: Reclamation Issues (November 2004).

Honors and Awards

- Recognized, The Best Lawyers in America (Steven Naifeh & Gregory White Smith eds., Woodward/White Inc.) (2012-2014)
  - Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law
- Recognized, *Texas Rising Stars*, a Thomson Reuters business, as published in Texas Monthly (2007-2009, 2011-2014)
  - Bankruptcy & Creditor/Debtor Rights



J. Frasher Murphy

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Texas Tech University School of Law

- J.D., 1999

Vanderbilt University

- B.S., 1996
- *cum laude*
- Dean's List

Frasher Murphy's practice is focused primarily on complex Chapter 11 cases; however, he has experience in all areas of bankruptcy law in cases under Chapters 7 and 11. He represents debtors, traditional and nontraditional secured lenders, post-petition lenders, bondholders, purchasers and all other types of secured and unsecured creditors.

Representative Experience

- Secured Creditors: Representation of lenders, lender groups, investors, bondholder groups and all other types of secured creditors
- Unsecured Creditors: Representation of unsecured creditors' committees, trade creditors, landlords, lessors and all other types of unsecured creditors
- Debtors: Representation of Chapter 11 debtors in complex Chapter 11 cases
- Trustees: Representation of Chapter 7 and Chapter 11 trustees in connection with all aspects of case administration, including asset disposition, avoidance litigation and claim objections
- Purchasers: Representation of asset purchasers
- Litigation: Representation of both plaintiffs and defendants in all types of bankruptcy litigation, including preference litigation, fraudulent transfer litigation, lien avoidance, insider litigation, equitable subordination and contract disputes

Professional & Community Involvement

- State Bar of Texas
- Dallas Bar Association
- Dallas Association of Young Lawyers
- DFW Association of Young Bankruptcy Lawyers (Past Secretary and Board of Directors)

Awards & Recognition

- Texas Rising Star, *Texas Monthly*, 2005-2006, 2008-2014

Admitted to Practice

- Texas, 1999
- U.S. District Courts for the Northern, Southern, Eastern and Western Districts of Texas
- U.S. Supreme Court
- U.S. Court of Appeals, Fifth Circuit