

THE SELECT NEW CASES AND OTHER RECENT DEVELOPMENTS IN BANKRUPTCY ABOUT WHICH ALL PRACTITIONERS SHOULD KNOW¹

1. Attorneys' Fees

1.1 Postpetition attorneys' fees of unsecured creditors and sections 101, 502, and 506(b)

In re Ogle, 2009 WL 87598 (N.D.N.Y January 12, 2009)

- Debtor and F&D entered into contracts that provided for recovery of attorneys' fees by F&D;
- Debtor filed a chapter 11 petition;
- F&D's proof of claim included a claim for attorney's fees incurred post-petition;
- Debtor objected to the claim for attorneys' fees, relying on section 506(b) and also the *Timbers* case
- The bankruptcy allowed the claim.
- The United States district court affirmed.
- This is a question of post-petition attorneys' fees to unsecured creditors was raised but not addressed by the United States Supreme Court in the *Travelers Casualty* case, 127 S.Ct. 1199 at 1208 (2007). In answering this question, both the bankruptcy court and the United States district court quoted from and relied on the *SNTL Corp.* case, 380 B.R. 204 (9th Cir. BAP 2007); but cf *In re Cranston*, 387 B.R. 480, 488-89 (Bankr. Md. March 3, 2008)
- See generally Mark Scarberry, Interpreting Bankruptcy Code Sections 502 and 506: Post-petition Attorneys Fees In a Post-Travelers' World, 15 Am. Bankr.Inst.L.J. 611 (2007)

¹ These materials contain the "select new cases" [or at least somewhat "select" and somewhat "new"] part of what the title promises. Topic and title supplied by SBLI.

2. Avoidance of Security Interests

2.1. Relationship of collateral identification in security agreement and financing statement

Helms v. Certified Packaging Corp., 2008 WL 5396852 (Dec. 20, 2008)

- Property of the estate included “commercial tort claim:
- Security agreement covered “Commercial Tort Claims Listed on Schedule B” but Schedule B was blank;
- Financing statement included “commercial tort claims”

Bankruptcy judge ruled that settlement of commercial tort claim belonged to estate, not secured party. District court reversed. Posner, writing for Seventh Circuit reinstated bankruptcy court decision

§ 9-108. Sufficiency of description.

(a) Sufficiency of description. Except as otherwise provided in subsections (c), (d), and (e), a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described. * * *

(e) When description by type insufficient. A description only by type of collateral defined in the Uniform Commercial Code is an insufficient description of:

(1) a commercial tort claim;

2.2. Relationship of sections 547, 550, 551 and 541(a)(4) when a security interest is avoided under section 547

In re Taylor, 390 B.R. 654 (9th Cir. BAP June 20, 2008)

- Delay in pre-bankruptcy perfection of security interest in automobile;
- 17 months after bankruptcy, trustee instituted avoidance litigation;
- Court entered judgment for trustee under section 550 for \$18,020- the value of the collateral at the time of the petition, leaving secured party with security interest on the car;

- Judge Bruce Markell, writing for the BAP, affirmed. In so ruling, he stated “We begin by examining section 550(a), which all parties agree controls the discussion.”

550. Liability of transferee of avoided transfer

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under [section * * * 547](#) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, * * *

Compare with In re Trout, 392 B.R. 869 (Bk Colo Aug 29, 2008)(no right to 550 judgment for value of lien, expressly rejecting Taylor and relying on sections 551 and 541 [and the Epstein, Nickles & White discussion]; and concluding “Leaving the consequences of lien avoidance to section 551 alone and allowing a trustee the remedies of section 550(a) only were possessory interests in property are avoided, eliminates the strained application of these two sections” Id at 872)

§ 551. Automatic preservation of avoided transfer

Any transfer avoided under [section * * * 547](#), of this title, or any lien void under **section 506(d)** of this title, is preserved for the benefit of the estate but only with respect to property of the estate.

§ 541. Property of the estate

(a) The commencement of a case under **section 301, 302, or 303** of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

* * * (4) Any interest in property preserved for the benefit of or ordered transferred to the estate under **section 510(c)** or **551** of this title.

3. Avoidance of Postpetition Transfers

3.1. Relationship of sections 549 and 547 and 548

In re Straightline Investments, Inc. 525 F.3d 870 (9th Cir. May 8, 2008)

- Bankruptcy court order denied 11 debtor's request for postpetition using accounts financing;
- Nonetheless, debtor sold accounts with face value of \$200,600 to Aalfs for \$186,455;
- Aalfs was "fully aware" that (i) debtor was in bankruptcy and (ii) bankruptcy court had denied debtor's accounts financing request;
- Aalfs collected \$163,007;
- Subsequently, trustee appointed and trustee filed a section 549 complaint;
- The bankruptcy court ruled for the trustee, ordering payment to the estate of the \$163,007 collected and return of all uncollected accounts;
- A divided BAP affirmed;
- The Ninth Circuit affirmed, stating (1) "We decline to expand the diminution of estate doctrine from its established application in section 547 and 548 cases to THIS (emphasis added) section 549 case. * * * [T]he plaintiff's failure to demonstrate a measurable depletion of the estate is not enough to allow a transfer to stand when it is otherwise avoidable under section 549 because it satisfies all of the explicit requirements of an avoidable postpetition transfer." Id at 878-879 and (2) "Although the bankruptcy court's judgment may allow the Debtor's estate theoretically to remain \$186,455 ahead of where it would have been in the absence of any transfer, the estate has a greater equitable claim than does Aalfs. Aalfs was fully aware that * * * the bankruptcy court had previously denied Straightline's request to obtain loans secured by its accounts receivable." Id at 884.

3. 2. Relationship of section 549 and state recording statute

In re Tippetts, 542 F.3d 685 (9th Cir. Sept 4. 2008)

- Chapter 7 debtors sold their homestead after filing but before the trustee recorded a copy of the petition in the land records;
- The chapter 7 trustee filed an adversary proceeding to quiet title, relying on sections 541 and 362, not section 549;
- The bankruptcy court ruled for the trustee, holding that the Tippetts' grant deed and the lenders' liens were void ab initio as violations of the automatic stay
- BAP reversed, relying on section 549
- The Ninth Circuit affirmed, relying on California's recording statute. In so ruling the Ninth Circuit concluded that (1) "Because the Trustee does not rely on § 549(a) to avoid the Tippetts' transfer, the protections of bona fide purchasers provided by § 549(c) is of no use to Coleman. His title stands or falls under California law." 542 F3d 690 and (2) "We next consider whether the Bankruptcy Code occupies the field of title transfers initiated by Chapter 7 debtors and accordingly preempts California's statute protecting bona fide purchasers such as Coleman. We conclude that it does not." Id at 689.

549. Postpetition transactions

(c) The trustee may not avoid under subsection (a) of this section a transfer of an interest in real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of an interest in such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such real property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to such interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

3.3. Relationship of sections 549 and 363(b)

The Straightline opinion also has a extensive discussion of vertical and horizontal tests for whether transfer is “ordinary course” for purposes of section 363(b) and so protected from avoidance by section 549(a)(2)(B). Id at 879-881

549. Postpetition transactions

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate--

(1) that occurs after the commencement of the case; and

(2)

(A) that is authorized only under section 303(f) or 542(c) of this title; or

(B) that is not authorized under this title or by the court.

4. 363 Sales

4.1. Relationship of Sections 363 and 365 and sales free and clear of leases

In re MNH Automotive Group, LLC., 385 B.R. 347 (Bankr. S.D. Fl March 18, 2008)

- MNH filed for chapter 7 relief on September 27, 2005;
- Six years earlier, debtor's predecessor as real property owner had entered into a 99-year Billboard Lease with CPH;
- Billboard Lease had a \$600,000 buy-out option;
- Billboard Lease was not recorded in state real property records and was not scheduled in the bankruptcy case as an executory contract;
- Court approved sale of MNH's real property to South Motor free and clear of all liens and interests;
- Trustee did not notify CPH of the sale although trustee had "actual notice" of the Billboard Lease (Trustee had a copy of the Billboard Lease and had been told about it in two depositions, Id at 357);
- Buyer, South Motor, who did not have notice of the Billboard Lease, filed an adversary proceeding seeking a determination that it took free and clear of the Billboard Lease;
- The bankruptcy court held that (1) because the trustee had actual knowledge of the Billboard Lease, CPH was entitled to receive notice of the proposed sale but (2) the appropriate remedy would be a \$600,000 payment. In so ruling, the court endorses and relies on the Seventh Circuit's decision in *Qualitech*, 327 F.3d .537 (7th Cir.. 2003)

§ 363. Use, sale, or lease of property

(f) The trustee may sell property under subsection (b) or (c) of this section free and

clear of any interest in such property of an entity other than the estate, only if--

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

- (2) such entity consents;
- (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- (4) such interest is in bona fide dispute; or
- (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

4.2 Relationship of 363(f) and patent law and sales free and clear of intellectual property rights

Fujifilm Corp. v. Benum, 2008 WL 2676596 (USDC N.J. June 30, 2008)

- Debtor manufactured camera; infringing on Fuji's patent;
- After Fuji obtained a \$30 million judgment against Debtor, Debtor filed for chapter 11 which was later converted to 7;
- As a part of a section 363 sale of substantially all of the Debtor's assets, the trustee sold cameras that infringed on Fuji's patent;
- Fuji objected to the sale of the cameras'
- The buyer argued that because the cameras were sold free and clear, they were sold free of any Fuji patent rights.
- Under patent law, only a sale authorized by the patentee exhausts patent rights to the products sold with respect to later purchasers.
- The district court ruled for Fuji, stating "the bankruptcy sale did not constitute a patent exhausting sale because the cameras were sold without Fuji's consent."

4.3 Relationship of sections 363(f) and 1129(b) [and section 363(m)] and sales free and clear of junior liens

In re PW, LLC v. Knupfer, 391 B.R. 25 (BAP 9th Cir. July 18, 2008)

- 11 debtor owned parcel of land subject \$40 million first lien and \$2.5 million second lien;

- Bankruptcy court approved the sale of the land to the holder of the first lien (who credit bid), free and clear of the second lien;
- In so ruling, the bankruptcy court looked to section 363(f)(5) and concluded that the junior lienor could be compelled to release its lien in a legal proceeding, -- a cramdown under a plan of reorganization;
- The bankruptcy court also found that buyer/first lien holder was a good faith purchaser for purposes of section 363(m);
- Junior lienor was not able to obtain a stay. and the sale closed .
- Judge Markell, writing for the BAP, first found that the portion of the sale order permitting lien stripping under section 363(f) was not moot: -- not statutorily moot because section 363(m) refers to section 363(b), not section 363(f); not equitably moot because the remedy of reinstating the junior lien was available;
- BAP further holds that section 363(f)(3) applies only if the sale price is more than the face amount of all liens
- With respect to section 363(f)(5), the holding is much narrower: “The question is whether there is an available type or form of legal proceeding in which a court would compel [the junior lienor] to release its lien for a payment of an amount that was less than value of the [junior lienor’s] claim. Neither the trustee nor the [holder of the first lien] has directed us to any such proceeding under nonbankruptcy law, and the bankruptcy court made no such finding.” Id at 46 While there is no mention of state foreclosure proceedings in the opinion, there is dictum that suggests a “narrow view of paragraph (5)” Id at 43

See generally Dennis J. Connolly and Sage M. Sigler, Section 363 Revisited: The Limitations on Free and Clear Sales, Norton Bankruptcy Adviser, November 2008; Robert M. Lawless, BAP Prohibits Sale Free and Clear of an

Underwater Junior Lien, Bankruptcy Law Letter, October, 2008; Joel Levitin, Stephen Gordon & Richard Stieglitz, Jr., Ninth Circuit BAP Dresses Down Lienstripping, ABI Journal, October, 2008. Recall that the National Bankruptcy Review Commission in its report, Bankruptcy: The Next Twenty Years, recommended “Congress should make clear that bankruptcy courts can authorize sales of property of the estate free and clear of creditors’ interests, regardless of the relationship of the face amount of the any liens and the value of the property sold.” Recommendation 2.4.11 at page 458.

§ 363. Use, sale, or lease of property

(m) The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

4.4. Sales free and clear of restrictive covenants

In re Touse, 393 B.R. 920 (Bankr. S.D.Fla Sept 22, 2008)

- Chapter 11 developer moved for section 363 sale free and clear of restrictive covenant not prohibited sale of lots in subdivision for less than \$325,000
- In upholding the sale, the court concluded that (i) restrictive covenant is an “interest in property” and not a claim and (ii) “an interest in property that would prevent me from permitting a section 363 sale free and clear of all liens, claims and encumbrance”, Id at 922, but (iii) this restriction was unenforceable under Florida law because it is unreasonable.

4.5 Sales free and clear of co-owners

In re Ocean Blue Leasehold Property, 2008 WL 652113 (Bankr. S.D. Fla. March 7, 2008)

- Chapter 11 debtor, 14/15ths owner of a commercial office building in Miami, moved to sell the building free and clear of claims of co-owners for \$31,260,000;

- Owners of other 1/15 objected , arguing that “they want to retain their interests because the Property may appreciate in value, thereby benefiting them in the future or benefiting their heirs”;
- Judge Cristol rejected this argument: “Section 363(h) provides only four requirements for compelling such a sale. The possibility that a co-owner’s interest may substantially appreciate in value over time, while not unrealistic, is not a factor.”
- The court adopted a \$375,000 valuation of the co-owner’s 1/15th interest

§ 363. Use, sale, or lease of property

(h) Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—

(1) partition in kind of such property among the estate and such co-owners is impracticable;

(2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;

(3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and

(4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

6 Leases and Executory Contracts

6.1 Stub rent and section 365(d)(3) and 503(b)

In re Stone Barn Manhattan, LLC., 2008 WL 5365739 (Bankr. S.D.N.Y. December 17, 2008)

- lease required payment of rent on the first day of the month;
- debtor filed 11 on July 8, without having paid July rent;
- Judge Gropper adopted the proration approach – debtor was liable under section 365(d)(3) for the rent that accrued only a daily basis after the July 8th filing;
- Because three circuits (Third, Sixth, and Seventh) have rejected this proration approach in favor of a “billing day” approach which makes rent for the entire stub month a section 365(d)(3) obligation, Judge Gropper stayed the decision to give the parties an opportunity to appeal.

6.2 Lease termination payment and sections 547 and 101

Midwest Holding #7 LLC v. Anderson, 387 B.R. 892 (N.D.Ga. April 22, 2008)

- In 2002, Debtor leased shopping center space for 5 years;
- In 2005, Debtor paid the landlord \$87,172.50 to terminate the lease;
- Less than 90 days later Debtor filed for Chapter 7 relief;
- The trustee initiated a proceeding to recover the termination payment as a section 547 preference.

- The bankruptcy court held for the trustee, relying on In re Upstairs Gallery, 167 B.R. 915 (9th Cir. BAP 1994)
- The landlord argued that the word “owed” in section 547(b) is meaningless unless section 547 is limited to “legally collectible at the date of the transfer.” 387 B.R. 896.
- The district court affirmed, relying on the definitions of “debt” and “claim” in section 101.

§ 547. Preferences

(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property-- . . .

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

6.3 Advance lease payments and sections 547 and 101

In re Callaway, 2008 WL 4261087 (Bankr. Idaho September 12, 2008)

- Debtors entered into a residential lease agreement;
- Debtors paid landlord \$5000 to apply to future rent payments;
- About a month later, Debtors filed a chapter 7 petition
- The bankruptcy court held that the chapter 7 trustee could recover the rent prepayment under sections 547 and 550. In so holding, the court considered Upstairs Gallery and the arguments noted above.

6.4 Effect of rejection of a trademark license and section 365(g) (n)

In re Exide Technologies, 2008 WL 522516 (USDC Del. Feb 27, 2008), affirming, 340 B.R. 222

- Debtor licensed use of trademark to a competitor;
- On filing for bankruptcy, Debtor rejected the licensing agreement.
- The questions before the bankruptcy court and the district court were (1) whether Debtor could reject the licensing agreement and (2) what the effects of rejection were.
- In its very short opinion affirming the bankruptcy court, the district court stated:” In the event of rejection of an executory contract, the holder of such contract is left with a claim for rejection damages, unless provided with additional protection under 11 U.S.C. § 365(n). Given that trade names, trademarks, and other proprietary marks are expressly excluded from the definition of “intellectual property” in § 365(n), EnerSys is left with only a claim for breach. See *In re HQ Global Holdings, Inc.*, 290 B.R. 507, 513 (Bankr.Del.2003). As a result of the rejection, therefore, Exide's obligation to allow EnerSys to use the EXIDE trademark was extinguished.”

Recall that the National Bankruptcy Review Commission in its report, Bankruptcy: The Next Twenty Years, recommended “The concept of rejection in section 365 should be replaced with ‘election to breach.’ Section 365 should provide that the trustee’s ability to elect to breach a contract of the debtor is not an avoiding power.” Recommendation 2.4.1 at page 455.

6.5 Effect of rejection and sections 365 and 707 and 101 and state law

In re Ortiz, 2009WL 151218 (USDC C.D. Cal. Jan. 21, 2008)

- Ortiz is a professional boxer
http://www.boxrec.com/list_bouts.php?cat=boxer&human_id=257314

- In 2005, Ortiz entered into a a five year exclusive promotional agreement with Top Rank;
- In January 2008, Ortiz filed a chapter 7 petition;
- Neither the trustee nor Top Rank took an any action with respect to the promotional agreement;
- In April 2008, Ortiz filed an adversary proceeding against Top Rank seeking a declaration that (1) the contract was rejected by operation of law and (2) he was no longer required to perform his obligations under the exclusive promotional agreement. Ortiz also asked the bankruptcy court to enjoin Top Rank from interfering with fight promotion negotiations between Ortiz and third parties.
- The bankruptcy court ruled for Ortiz on both the declaratory and injunctive relief.
- The district court reversed and remanded in a lengthy opinion on the effect of section 365 rejection that discusses and relies on Mike Andrews' 20 year-old article.
- The court also addresses Ortiz's argument that section 707(b)(3)'s addresses the effect of rejection of a personal services contract.

707. Dismissal of a case or conversion to a case under chapter 11 or 13

(3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider—

- **(B)** the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

7. Setoffs

7.1. Setoff and sections 365(g), 502(g), and 553

In re Communications Dynamics, Inc., 382 B.R. 219 (Bankr. Del Feb. 21.2008)

- Debtor rejected executory contract;
- Nondebtor party asserts that it has the right setoff its prepetition obligation to the Debtor against its claim against the Debtor resulting from the rejection;
- In permitting the setoff, the bankruptcy court expressly rejected the approach taken by the bankruptcy court in In re Delta Airlines, Inc., 341 B.R. 439 (Bankr. S.D.N.Y. 2006)

§ 502. Allowance of claims or interests

(g)

(1) A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

§ 553. Setoff

- (a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that--

7.2. Triangular setoff

In re Semcrude, L.P., 2008 WL 68873 (Bankr. Del January 9, 2009)

- Chevron had various contracts with various Semcrude subsidiaries;

- Each of the master contracts provided: “In the event that either party fails to make a timely payment . . . or . . . timely delivery . . . the other party may offset any deliveries or payments due under this or any other Agreement between the parties AND THEIR AFFILIATES” (emphasis added)
- When Semcrude and its various affiliates filed for chapter 11 relief, Chevron moved for relief from stay to setoff amounts that it owed to Semcrude entity against the amount that another Semcrude entity owed to Cheron, i.e., a “triangular setoff”;
- Chevron argued that the (1) language in the Agreement satisfied section 553’s mutuality requirement or (2) parties can contract around the mutuality requirement;
- The bankruptcy court addressed and rejected both arguments, disallowing stay relief. ‘Mutuality can not be supplied by a multiparty agreement contemplating a triangular setoff.’ “Nothing in the language of the Bankruptcy Code upon which to base a conclusion that there is a contractual exception to the ‘mutual debt requirement’”

See also *In re EBW Laser, Inc.*, 2009 WL 116995 (Bankr. M.D. N.C. Jan . 15, 2009)(Stocks)(because North Carolina nonbankruptcy setoff law is for the most part in accord with general nonbankruptcy setoff law, it seems safe to predict that North Carolina also would not allow triangular setoff.FN3)

FN3. Even in the event that North Carolina were to allow it, triangular setoff is generally not allowed for the purposes of § 553. 5 *Collier on Bankruptcy* ¶ 553.03[3][b], p. 553-31.