Business Bankruptcy Case Developments - 2022

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I. ADMINISTRATIVE MATTERS

A. *Jurisdiction, Constitutional Authority and Powers of the Court*

Non-Debtor Voluntarily Consented to Jurisdiction Over State Court Claims.
VSP Labs, Inc. v. Hillair Cap. Investments, L.P. (In re PFO Global, Inc.), 26 F.4th 245 (5th Cir. 2022) (Higginbotham, J.).

PFO entered into a contract with VSP Labs, Inc., which obligated the debtor to develop and transfer eyewear technology to VSP, but allowed VSP to take over development and charge PFO for costs incurred if performance milestones were not satisfied. VSP filed suit against PFO, alleging breach of contract and PFO asserted counterclaims against VSP in California state court. Prior to trial, PFO filed chapter 11 bankruptcy. In PFO's bankruptcy case, it agreed to sell its assets, including its counterclaims to Hillair Capital Investments, L.P. Hillair then moved the California Court to sever its claims and VSP moved for relief from the automatic stay to offset PFO's counterclaims. The Bankruptcy Court entered an order modifying the automatic stay to allow VSP to liquidate its claims against PFO and setoff any excess amounts through a proof of claim against PFO, but prohibited money damages recovered against Hillair arising the from the California litigation. VSP sought to amend its complaint after learning that Hillair had instructed PFO to breach its agreement with VSP, which led Hillair to seek an order enforcing the Bankruptcy Court's order modifying the automatic stay. The Bankruptcy Court denied Hillair's motions to reconsider its order modifying the automatic stay and motion for relief from the automatic stay, reasoning that the language in the order modifying the automatic stay was negotiated and agreed to by the parties. VSP appealed to the District Court, which affirmed the Bankruptcy Court's rulings. The Fifth Circuit affirmed the Bankruptcy Court's ruling. The Fifth Circuit held that while the order modifying the automatic stay itself was a core proceeding, the provision regarding VSP's claims against Hillair were not core, but satisfied "related to" jurisdiction as claims that could impact PFO's estate. Because VSP and Hillair consented to the Bankruptcy Court's jurisdiction over these claims, the Bankruptcy Court had jurisdiction over the dispute and its subsequent interpretation of that order. Although VSP argued that abstention was appropriate, the Fifth Circuit held that VSP had waived that argument by failing to raise abstention before the Bankruptcy and District Courts. Additionally, the plain terms of the order modifying the automatic stay unambiguously conditioned the automatic stay by ordering that funds could not be recovered from Hillar.

City Waived Governmental Immunity in Breach of Contract Claim.
USA Promlite Technology, Inc. v. Am. First Nat'l Bank (In re USA Promlite Technology, Inc.), 636 B.R. 743 (Bankr. S.D. Tex. 2022) (Rodriguez, J.).

The City of Hidalgo contracted with USA Promlite Inc. to install LED lights throughout government owned buildings and areas under which the City agreed to pay Promlite 90% of the energy savings on a monthly basis over a seven-year period. Promlite sued the City in Texas state court, alleging breach of contract. Promlite filed bankruptcy in 2018 and removed the state court suit to the Bankruptcy Court. The City alleged that the Bankruptcy Court lacked jurisdiction to adjudicate the dispute because the City did not waive governmental immunity. Applying the Fifth Circuit's recent ruling in *Tecero v. Tex. Southmost Coll. Dist.*, 989 F.3d. 291 (5th Cir. 2021), which held that "in the absence of constitutional sovereign immunity, a governmental entity cannot bar a

federal court from exercising jurisdiction over claims that state courts would recognize and enforce." The Bankruptcy Court then examined the contractual relationship between the parties, specifically, whether the contract was: (i) in writing; (ii) stated the essential terms; (iii) provided for goods or services; (iv) to the local governmental entity; and (v) was executed on behalf of the local governmental entity. The Bankruptcy Court concluded that the original contract between Promlite and the City constituted a writing despite the fact that Promlite had assigned its rights under the contract to a third party. Because the contract stated that Promlite was to receive 90% of the energy savings accrued, the contract sufficiently set forth the set forth essential terms. The third and fourth elements were satisfied because the contract provided replacement lighting to the City, which was a governmental entity. Finally, the Bankruptcy Court concluded that the contract was executed on behalf of a local governmental entity because it was executed by a city manager and complied with the Texas Local Government Code. As a result, the Bankruptcy Code denied the City's motion to dismiss.

Although Narrow, Post-Confirmation Jurisdiction Remains for Parties Availing Themselves to the Bankruptcy Code.
In re EP Energy E&P Company, L.P., No: 19-35647, 2021 WL 5917771 (Bankr. S. D. Tex., Dec. 14, 2021) (Isgur, J.)

Due to the Covid-19 pandemic, EP Energy ("EP") stopped production of its wells in the Eagle Ford field in the summer of 2020. In June 2020, EP resumed production but the Eagle Ford lessor group ("MSB") alleged that its 16 leases with EP were terminated due to this gap in production. MSB claimed that the Bankruptcy Court lacked jurisdiction to adjudicate this dispute, because their temporary cessation claim arose under state law. The Bankruptcy Court determined that it had "related to" jurisdiction over MSB's claims because they could impact the administration of EP's bankruptcy estate. Further, MSB sought an administrative expense for EP's alleged trespass, which would require EP to use estate funds to satisfy MSB's claim, further satisfying "related to" jurisdiction. MSB also argued that the Bankruptcy Court had limited jurisdiction to adjudicate its claims because they arose after the confirmation of EP's chapter 11 plan. Although the Bankruptcy Court agreed that post-confirmation jurisdiction is limited in nature, the fact that MSB sought an administrative claim was inherently a core proceeding "arising in" the Bankruptcy Code. Turning to the merits of MSB's claim, the Bankruptcy Court rejected MSB's alleged trespass damages as a "strained reading" of the leases, stating such a reading was contrary to the leases' plain language and would "result in unreasonable real-world consequences." The Bankruptcy Court determined that EP's Eagle Ford leases remained in force despite the temporary pause in production. Because the leases remain in force, EP's continuing operations could not constitute a trespass.

Express Plan Reservation Language is "Icing on the Cake" – Bankruptcy Courts Always Have Post- Confirmation Jurisdiction to Enforce Their Own Orders.
In re Senior Care Centers, LLC, 622 B.R. 680 (Bankr. N.D. Tex. 2020) (Jernigan, J.).

The post-confirmation lessor to the reorganized debtor brought an action in a Texas state district court seeking to enjoin the sale of the reorganized debtor's equity interests, alleging violations of the "change of control" provisions of the master lease agreement entered into under the terms of the confirmed chapter 11 plan. The reorganized debtor and parent removed the action to the Bankruptcy Court where they were joined by the liquidating trustee. Lessor sought to remand

the case back to state court, arguing that the Bankruptcy Court did not have subject matter jurisdiction over the post-confirmation dispute.

The Bankruptcy Court found that it possessed subject matter jurisdiction over the dispute. In reaching this decision the Bankruptcy Court noted that the Supreme Court has provided that Bankruptcy Courts always maintain jurisdiction to enforce their orders even absent explicit language stating so, and that the addition of any explicit retention of jurisdiction is "icing on the cake." The icing was present here as the Bankruptcy Court had expressly retained jurisdiction over the assumption of unexpired leases and the adjudication of disputes related to distributions under the plan pursuant to the confirmation order. The Bankruptcy Court also found that it possessed subject matter jurisdiction over the dispute as the lessor's actions interfered with the implementation of the reorganized debtor's plan which was not yet fully consummated, and amounted to a collateral attack on the plan and confirmation order by seeking to enjoin the liquidating trustee's ability to sell the reorganized debtor's equity in accordance with the terms thereof when such objections could have been brought during the confirmation process.

In Non-Core "Related-To" Proceedings, the Shorter Deadlines under the Bankruptcy Rules Apply.

In re Lac-Mégantic Train Derailment Litigation, 999 F.3d 72 (1st Cir. 2021) (Selya, J.).

Under Rule 59(e) of the Federal Rules of Civil Procedures (the "Civil Rules"), a party has 28 days after entry of a final order to move for reconsideration. Rule 9023 of the Federal Rules of Bankruptcy Procedures (the "Bankruptcy Rules") makes Civil Rule 59 applicable in bankruptcy proceedings, but the deadline under the Bankruptcy Rules is reduced to 14 days. A timely motion filed either under rule tolls the deadline for filing a notice of appeal.

This case tested the limits of these competing rules and deadlines. The U.S. Court of Appeals for the First Circuit[1] held that the Bankruptcy Rules—not the Civil Rules—applied to the dispute, which was a non- core "related to" lawsuit between non-debtor parties. In so holding, the First Circuit agreed with the only two other Circuit Courts of Appeal to address the issue.[2] As a result, the shorter deadline applied, and the Court of Appeals dismissed the appeal for lack of appellate jurisdiction because the appellants failed to file a timely Rule 59 motion in the trial court below.

The dispute in *Lac-Mégantic* arose from a train derailment and explosion in Lac-Mégantic, Canada. Plaintiffs filed wrongful death actions in various state courts in Illinois and Texas. One of the co-defendants—Montreal, Maine, and Atlantic Railway (MMA)—commenced a bankruptcy case in the District of Maine. The lawsuits were removed to federal court and, because 28 U.S.C

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[1] Unless otherwise noted, this document refers to one or more of the thirteen federal appellate courts as "circuit courts" or "courts of appeals" collectively and "First Circuit," "Second Circuit," and so on individually, general trial courts as "district courts" collectively and "district court" individually, and "bankruptcy courts" collectively and "bankruptcy court" individually. If capitalized, the term "Circuit Court," "Bankruptcy Court," or "District Court" refer to the specific court that issued the relevant decision.

[2] *See In re Celotex Corp.*, 124 F.3d 619, 629 (4th Cir. 1997); *Phar-Mor,Inc. v. Coopers & Lybrand*, 22 F.3d 1228, 1238 (3d Cir. 1994); *cf. Double Eagle Energy Servs., L.L.C. v. MarkWest Utica EMG, L.L.C.*, 936 F.3d 260, 264 (5th Cir. 2019) (applying Bankruptcy Rule 7004 to a "related to" proceeding).

§ 157(b)(5) provides for the District Court with jurisdiction over a bankruptcy case to adjudicate personal injury and wrongful death claims related to the bankruptcy proceeding, the plaintiff-appellants joined the MMA bankruptcy trustee's requests to have all cases transferred to and consolidated in the District of Maine.

The plaintiff-appellants then settled with all defendants except appellee Canadian Pacific, a non- debtor co-defendant. Thus, the claims of non-debtor plaintiffs proceeded against a non-debtor defendant in the United States District Court for the District of Maine, as a non-core proceeding that was "related to" MMA's bankruptcy.

The District Court granted Canadian Pacific's motion to dismiss and denied the plaintiffs' motion for leave to amend the complaint. **Twenty-eight (28) days later**, the plaintiffs filed a motion under Civil Rule 59(e) to reconsider the District Court's orders. The District Court denied the motion in a margin order. This appeal followed.

Canadian Pacific moved for summary dismissal of the appeal for lack of appellate jurisdiction, arguing that the appeal was untimely because the plaintiffs' Rule 59 motion failed to toll the appellate deadline since it was not filed within the **fourteen (14) days** required by Bankruptcy Rule 9023. Thus, the issue presented to the First Circuit was: Which rules apply?

The Court of Appeals explained that support for the application of the Bankruptcy Rules could be found in the language of Bankruptcy Rule 1001. That rule applies to "cases under title 11 of the United States Code." While this language does not precisely mirror the definition of core cases in 28 U.S.C. § 157, the Court concluded that the term "under title 11" as used in Bankruptcy Rule 1001 could be read to apply to non-core cases that remain in federal district court under § 1334(b) as merely "related to" a bankruptcy case, such as this case. As support for this broader interpretation of the rule, the Court explained that the Bankruptcy Rules were adopted in 1987, three years after Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA) in response to *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

The First Circuit found further support for its conclusion in what it called "the practicalities attendant to the efficient operation of the modern bankruptcy system." The Court explained that it would be impractical for a federal district court, presiding over both core and non-core claims among the same parties, to apply different sets of rules within the same proceeding. "We, too, think it implausible that Congress could have intended to create such a Rube-Goldberg-like adjudicative contraption."

The First Circuit then considered and rejected the plaintiffs' "fallback position" that a district court has discretion to apply either set of rules to non-core "related to" cases, finding no statutory support for "such a pick-and-choose approach." Finally, it addressed the plaintiffs' plea for equitable relief based on their argument that they received insufficient notice of the possibility that the 14-day deadline under the Bankruptcy Rule 9023 might apply. To this argument, the Court of Appeals explained that there was no basis for equitable exceptions to jurisdictional requirements. Further, it noted that the plaintiffs had joined a request to transfer their cases to the District of Maine as cases "related to" MMA's bankruptcy case. "At the time, the existing case

law, though sparse, put them on notice that the Bankruptcy Rules would apply." Thus, the Court declined to provide an exception and dismissed the appeal for lack of jurisdiction.

Jurisdiction Existed Over Collection Action Having a "Conceivable Effect" on Bankruptcy Estate.
Cross Keys Bank v. Ward (In re Karcredit, L.L.C.), 630 B.R. 14 (Bankr. E.D. La. 2021) (Hodge, J.).

"Related to" bankruptcy jurisdiction existed over third-party claims brought by the non-debtor lenders against the non-debtor issuer of stock in a scheme concocted by the debtor's insiders to "double- pledge" stock in a non-debtor entity as security for loans made to the debtor. The Court concluded that the "conceivable effect" test was "easily satisfied" because a lender's successful recovery of money or collateral from the non-debtor defendant "could result in a dollar-for-dollar reduction of the amount of its claim against the estate."

Bankruptcy Court Has "Arising In" Jurisdiction Over Complaint Alleging Misrepresentations in Connection with Bankruptcy Court's Prior Approval of Settlement.
Rohi v. Brewer & Prichard, P.C. (In re ABC Dentistry, P.A.), 2021 WL 955932, 2021 Bankr. LEXIS 591 (Bankr. S.D. Tex. Mar. 12, 2021) (Isgur, J.).

A former whistleblower who settled a lawsuit against the debtor alleging violations of the Texas False Claims Act in November 2017 later sued his former lawyers for allegedly securing his agreement to a settlement with the debtor by making material representations to him related to how much they would each net from the settlement proceeds. After the law firm removed the litigation to the bankruptcy court that had approved the underlying settlement, the Bankruptcy Court granted the law firm's motion to dismiss, ruling that *res judicata* precluded the plaintiff whistleblower from challenging the settlement order. This dismissal was later reversed by the Fifth Circuit, which ruled that *res judicata* did not apply because the alleged misrepresentations made by plaintiff's lawyers were not alleged to have been made to him until after the Court approved the settlement. After the case was remanded by the Fifth Circuit, plaintiff returned to the Bankruptcy Court and first amended his complaint and then sought to have the case remanded back to state court.

Relying on the "well-pleaded complaint rule," which states that federal jurisdiction exists only when a federal question is presented on the face of the plaintiff's properly pleaded complaint, plaintiff argued that since his amended complaint raised only state law claims, the Bankruptcy Court lacked subject matter jurisdiction and should therefore remand the case to state court. The Bankruptcy Court first held it inappropriate to apply the "well-pleaded complaint rule" to bankruptcy jurisdiction arising under 28 U.S.C. § 1334 was inappropriate, and looked instead to the plaintiff's amended complaint and its relation to the underlying bankruptcy case to determine whether subject matter jurisdiction existed. Ultimately, the Bankruptcy Court found it had "arising in" jurisdiction over the plaintiff's amended complaint, finding that the material misrepresentations alleged therein, if proven, influenced proceedings before it insofar as it may not have approved the allocation of settlement proceeds in the manner that it did. The Court added that any fraud committed against the plaintiff would amount to a fraud upon the court.

B. Executory Contracts and Unexpired Leases

Fifth Circuit Clarifies Rejection of Filed Rate Contracts Under Mirant.
Federal Energy Regulatory Commission v. Ultra Resources, Inc. (In re Ultra Petroleum Corp.), 28 F.4th 629 (5th Cir. 2022) (King, J.)

In 2008, Ultra Resources, Inc. ("***Ultra***") contracted with Rockies Express Pipeline LLC ("***REX***") to transport natural gas from Ultra's oil fields in Wyoming to Ohio. In 2017, Ultra and REX executed a second Transportation Service Agreement and Firm Transportation Negotiated Rate Agreement (the "***Firm Rate Contract***"), which required that Ultra pay a reservation fee of for its capacity on REX's pipeline, regardless of whether or not it was utilized. The rates established under the Firm Rate Contract were a "filed rate," subject to FERC's exclusive jurisdiction under the Natural Gas Act. In 2020, Ultra filed a second chapter 11 bankruptcy case, where it sought to reject the Firm Rate Contract pursuant to section 365 of the Bankruptcy Code. FERC opposed Ultra's proposed rejection on the grounds that rejection constituted a de facto abrogation of the filed rate, which fell within FERC's sole jurisdiction. Judge Marvin Isgur conducted an evidentiary trial and concluded that Ultra's proposed rejection of the Firm Rate Contract did not negatively implicate the public interest because it had no discernible impact on natural gas customers served by REX's pipeline, nor on the supply of natural gas and authorized Ultra's proposed rejection of the Firm Rate Contract. FERC appealed the Bankruptcy Court's ruling, which was certified for direct appeal to the Fifth Circuit Court of Appeals.

The Fifth Circuit observed that "this is not the first time these two titans have clashed. Instead, today's battlefield lies in the shadow of our precedent in *In re Mirant Corp*" and upheld the Bankruptcy Court's decision. The Fifth Circuit determined that the Bankruptcy Court satisfied *Mirant's* requirements by inviting FERC to participate in the bankruptcy process and expressly considering the impact on public interest from Ultra's rejection of the Firm Rate Contract. In addition, the Fifth Circuit noted that where Congress intended there to be limits on rejection of specific types of contracts, the statutory exceptions are clear. Also, in rejecting FERC's arguments to distinguish *Mirant*, the Fifth Circuit (i) dismissed FERC's assertions that certain language in *Mirant* that would enjoin FERC after plan confirmation was dicta; (ii) clarified that the prohibition in section 1129(a)(6) of the Bankruptcy Code requiring FERC approval of "rate changes" under a chapter 11 plan did not apply; and (iii) ruled that the Bankruptcy Court's determination of the public interest did not require a full hearing before FERC, but rather was satisfied by a hearing with FERC's participation.

Executory Contracts Subject to Rejection When "Touch and Concern" Elements are not Satisfied.
Occidental Petroleum Corp. v. Sanchez Energy Corp. (In re Sanchez Energy Corp.), 631 B.R. 847 (Bankr. S.D. Tex. 2021) (Isgur, J.)

In 2017, Sanchez Energy Corporation ("***Sanchez***"), through its affiliate SN EF Maverick, LLC ("***Maverick***"), along with SN EF UnSub, LP ("***Unsub***") and Gavilan Resources, LLC ("***Gavilan***") purchased the majority of Anadarko's certain assets and working interests in the Texas' Comanche Field from Anadarko E&P Onshore LLC and Kerr-McGee Oil and Gas Onshore LP (collectively, "***Anadarko***"). Thereafter, the parties entered into a Purchase and Sale Agreement (the "PSA") on January 12, 2017. Prior to the sale, Springfield Pipeline, LLC ("***Springfield***") built

extensive midstream oil and gas gathering systems (the "***Springfield Gathering System***") to transport production from Anadarko's Comanche assets downstream. As part of the Comanche Transaction, Anadarko retained ownership of Springfield and the Springfield Gathering System. The purchasers entered into an Oil Gathering Agreement ("***Springfield OGA***") and a Gas Gathering Agreement ("***Springfield GGA***") (collectively, the "***Springfield Agreements***"). Additionally, Maverick entered a Development Agreement promising to drill annual quotas of new wells or else pay set fees to Anadarko.

The Debtors filed a Plan, which was confirmed and established a post-effective date deadline for creditors and parties-in-interest to object to the proposed assumption or rejection of executory contracts by both Sanchez. The Plan also vested certain interests and rights in the reorganized debtor, Mesquite Energy, Inc. ("***Mesquite***"). In accordance with the Plan, counterparties' rights and defenses to assumption or rejection were expressly preserved under the Plan Confirmation Order. Sanchez filed its rejection schedule on April 29, 2022, which proposed rejecting various Comanche Agreements, including the Springfield Agreements and the Development Agreement. Occidental, Anadarko's successor-in-interest, filed its objection and complaint to seeking a declaration that the Springfield Agreements and Development Agreement were covenants running with the land that were not could not be rejected under section 365 of the Bankruptcy Code.

The Bankruptcy Court first held that Occidental could not collaterally attack the Confirmed Plan because Occidental – a creditor that received notice of the Plan and its contents – was bound because it did not object to or appeal confirmation of the Plan. Moreover, the Confirmed Plan included detailed procedures for parties seeking resolve rejection dispute – and there was also additional protectionary language within the Plan Confirmation Order which preserved all of Occidental's rights and defenses against rejection of its executory contracts with Sanchez. Although Occidental filed a limited objection to confirmation of the Confirmed Plan, the Limited Objection noted that Occidental agreed with the "general approach" to rejection set forth in the Plan, which subsequently led to the inclusion of the preservation of rights provisions that was incorporated into the Court's Plan Confirmation Order.

The Bankruptcy Court next analyzed whether Mesquite could reject the Springfield and Development Agreements, and whether these Agreements contained covenants running with land in light of the Court's holding in *In re Alta Mesa Resources, Inc.,* 613 B.R. 90 (Bankr. S.D. Tex. 2019) (applying Oklahoma law, but commenting that the laws concerning covenants running with the land in Oklahoma and Texas are substantially similar for purposes of a § 365 analysis) (Also stating that "[r]eal property covenants are non-executory, and therefore not subject to rejection under § 365 of the Bankruptcy Code"). *Id.* at 859-60. Although the Bankruptcy Court noted that its holding in *Alta Mesa* could lead parties to believe that real property covenants can never be rejected in the context of a bankruptcy, the Bankruptcy Court ultimately concluded that the presence of a real property covenant does not hinder a debtor's right to reject its future performance and duties in relation to an executory contract. The Bankruptcy Court also noted that Congress granted debtors the expansive right to reject *any* executory contract under section 365 of the Bankruptcy Code, and that the existence of a real property covenant does not limit the rejection power that Congress provided to debtors. Against this backdrop, the Bankruptcy Court found that Mesquite could reject the Springfield Agreements because both the Springfield OGA and Springfield GGA are executory contracts and because Mesquite had shown that rejection satisfies

its business judgment in relation to the agreements. The Bankruptcy Court also reasoned that the rejection was a reasonable exercise of its business judgment, since it could presumably negotiate more favorable gathering terms in the future.

The Bankruptcy Court next analyzed whether the Springfield Agreements touch and concern the Comanche Leases, and whether Maverick was permitted to reject these agreements. Under Texas law, a covenant runs with the land when: (i) the obligation touches and concerns the land; (ii) the obligation relates to a thing in existence, or specifically binds the parties and their assigns; (iii) the original parties intended the covenant to run with the land; and (iv) the successor has notice of the obligation. *In re El Paso Refinery, LP,* 302 F.3d 343, 355 (5th Cir. 2002). Additionally, and in finding that Maverick could reject the Springfield Agreements, the Bankruptcy Court also observed that the Springfield Agreements affect the nature, quality, and value of Maverick's Comanche Leases, and that the Springfield Agreements intended to bind successors and assigns. This point was corroborated by testimony from the principal of Sanchez, whom credibly testified the Springfield Agreements contained various provisions expressing an intention to bind that its affiliates agreed to be bound, including Maverick, which was, at that time, a wholly owned subsidiary of Sanchez. Moreover, the Bankruptcy Court determined that the principal had actual and apparent authority to bind Maverick under the company's agreement, and that the principal was an officer of both Sanchez and Maverick when the Comanche Agreements were signed on half of both entities.

The Bankruptcy Court also found that Mesquite may reject the Development Agreement and avoid its obligation to pay for promised but uncompleted wells. In doing so, the Court also found that this was in the sound business judgment of Mesquite – but unlike the Springfield Agreements – the Development Agreement did not form any real property covenants. Nor did the Development Agreement grant Occidental other contractual rights that would survive rejection. Additionally, although the Development Agreement included specific provisions that expressly stated that it was intended to form covenants running with the land, the Bankruptcy Court found that it nevertheless failed to satisfy the "touch and concern" element under Texas law, since the Development did not actually require an overt act upon the land, and because the Development Agreement precluded land based equitable remedies. Thus, because the touch and concern element is only satisfied if Maverick elected to drill, and the default fee shows the parties did not truly intend to form a real property covenant, the Drilling Agreement did not form a real property covenant under Texas law. Thus, the Court observed in its final remarks that "statements of intent in an agreement are not dispositive of actual intent to form a covenant running with the land." As such, when the only remedy is a monetary remedy, the stated intent will not be honored.

Pre-Petition Repudiated Contract was not Executory.
In re Cornerstone Valve LLC, 2021 WL 1731770, 2021 Bankr. LEXIS 1120 (Bankr. S.D. Tex. Apr. 27, 2021) (Isgur, J.).

Before filing its bankruptcy, the Debtor had a contract with a valve company that it repudiated. The valve company knew of the Debtor's bankruptcy filing but filed a proof of claim for rejection damages four months after the claims deadline. The valve company then moved to compel payment, arguing that its claim was timely because it was filed within the time for filing permitted for contract rejection damage claims.

The Court determined that because the Debtor repudiated the contract several months before filing bankruptcy, there were no material obligations left to perform and, thus, it was not considered an executory contract subject to rejection under § 365(a). In addition, the valve company was not able to show factors under Bankruptcy Rule 9006(b) for excusable neglect to allow a late-filed claim, and as such, the motion to compel was denied.

Oil and Gas Operator Could Not Seek Reimbursement for Costs to Which They Did Not Previously Agree.
In re Legacy Reserves Operating LP, 630 B.R. 787 (Bankr. S.D. Tex. 2021) (Isgur, J.).

Reorganized Debtor owns interests in numerous mineral wells. The operator ("Operator") entered into a Joint Operating Agreement ("JOA") with the Debtor allowing it to charge the Debtor costs for production. It also entered into a Production Election and Marketing Agreement ("PEMA") which governs gathering charges. The Operator runs compressors that increase production by lowering the pressure at the wellheads. The Operator argued that since production was increased, the Debtors must pay compression costs. After the Debtor filed its chapter 11 bankruptcy, the JOA and PEMA were assumed under the confirmed plan. The Operator sought reimbursement for the compression costs in the form of a cure payment.

The Court held that while the JOA allowed Operator to charge the Debtor for costs associated with production, the Debtor did not owe cure payments in the form of compression fees. Neither the JOA nor the PEMA dictated whether the operator could charge the Debtor for the compression costs. Because the PEMA only permitted the Operator to charge flat fees – which superseded the JOA – the Operator could not seek reimbursement for compression.

Status of Material Obligations (i.e., Executoriness) is Determined as of Petition Date.
Spyglass Media Group, LLC v. Bruce Cohen Productions (In re Weinstein Company Holdings, LLC), 997 F.3d 497 (3d Cir. 2021) (Ambro, J.).

A work-made-for-hire contract signed in 2011 that resulted in the writing and production of *Silver Linings Playbook*—a film released in 2012—was no longer executory by the time the Weinstein Company filed its bankruptcy case in 2018. Under New York law, while the debtor had material obligations to make future payments to the writer/producer, the writer/producer had already substantially performed all material obligations. Further, the Third Circuit concluded that the parties did not "clearly and unambiguously" contract around the "substantial performance" rule that could have presented an exception to the Countryman definition for determining whether the contract remained executory. As a result, the purchaser was not required under § 365 to "cure" any obligations owed to the writer/producer—in this case, approximately $400,000 in unpaid compensation due as of the effective date of the sale. The purchaser was only required to pay future obligations, and the Circuit Court agreed that such a result left the writer/producer no worse off than merely holding a general unsecured claim against the debtor.

Labels from an MSA and a Stipulation Held Insufficient to Establish Covenant Running with Land.
Nine Point Energy Holdings, Inc. v. Caliber Measurement Services LLC (In re Nine Point Energy, LLC), 2021 WL 2212007, 2021 Bankr. LEXIS 1486 (Bankr. D. Del. June 1, 2021) (Walrath, J.).

Despite a 2018 stipulation by the debtor's predecessor that a master services agreement (the "MSA") contained an unrejectable covenant running with the land, Court ruled on summary judgment that the MSA contained no such covenant under North Dakota law, where labels are insufficient to establish restrictive covenants.

On the merits, the agreement conveyed no interest in real property, and the gathering and transportation services provided thereunder did not actually "touch and concern" any real property. The Court further held that: (i) the MSA could be rejected under § 365; (ii) *Mission Products* appeared to be distinguishable such that the rejection of the MSA could lead to an effective termination of the all parties' rights under the MSA; and (iii) the debtors' assets could be sold free and clear of the counterparty's rights under the MSA because there was a *bona fide* dispute over such rights, and the MSA contemplated satisfaction of such rights through the payment of money.

COVID-related Closures Did Not Justify Extensions of the § 365(d)(3) Rent Deferrals Beyond the Statutorily Mandated 60 Days.
In re CEC Entertainment, Inc., 625 B.R. 344 (Bankr. S.D. Tex. 2020) (Isgur, J.).

CEC Entertainment, Inc. ("CEC"), the debtor, operates the national chain of Chuck E. Cheese dining and arcade establishments. Due to the COVID-19 pandemic and subsequent governmental regulations aimed at curbing the spread of the virus, CEC limited operations at its venues across the country. The resulting financial hardship led CEC and its affiliates to file petitions for chapter 11 relief on June 24, 2020. On August 3, 2020—*i.e.*, during the first 60 days of the bankruptcy cases—CEC filed a motion seeking a court order abating rent payments for 141 stores closed or otherwise limited in operations by government COVID- 19 restrictions until those restrictions were lifted. Several lessors objected to this motion, and many were resolved consensually in subsequent months.

In a December 2020 opinion dealing with the unresolved objections of six lessors from three states (North Carolina, Washington and California), the Bankruptcy Court denied CEC's abatement motion as to the objecting lessors on the basis of the Bankruptcy Code's explicit text. As the Bankruptcy Court observed, § 365(d)(3) requires a debtor to "timely perform all the obligations of the debtor ... arising from and after the order for relief under any unexpired lease of nonresidential real property until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." It further provides that "[t]he court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period." Finding this language unambiguous on its face, the bankruptcy court construed § 365(d)(3) as compelling commercial real property lessees continue to perform after filing for bankruptcy. In so doing, the Bankruptcy Court explicitly disagreed with the decision of the Bankruptcy Court for the Eastern District of Virginia in *In re Pier 1 Imports, Inc.*, 615 B.R. 196 (Bankr. E.D. Va. 2020), which held that § 365(d)(3) "does not compel a debtor to timely pay rent in accordance with a lease." Admittedly, the Bankruptcy Code allows a bankruptcy court to delay performance of a debtor's

lease obligations, as the *Pier 1* court concluded. However, the Bankruptcy Court here saw any such delay as limited to sixty days after the order for relief. A bevy of dissimilar rulings did not persuade it otherwise.

The Bankruptcy Court found a similar dearth of authority in either the applicable leases or relevant states' laws. Upon a review of each of the six leases, it held that none of the applicable force majeure clauses therein allowed CEC to abate or reduce rent under the circumstances. Applicable state laws (in North Carolina, California and Washington) on the frustration of purpose doctrine allowed parties to delegate the risk of frustration, and the leases at issue did, in fact, "delegate the risk to CEC, preventing application of the frustration doctrine." Even if this doctrine somehow applied, it was no panacea, for either the value of the venue was not completely destroyed by the temporary closures, or rescission of the lease—not abatement of performance—was the only remedy available for frustration.

In dicta, the Bankruptcy Court added: if either "the leases or state law allow CEC to abate or reduce rent payments, then CEC's obligation to perform under § 365(d)(3) will reflect such abatement or reduction."

C. Property of the Estate, the Automatic Stay and other "First Day" Issues

Medicaid Enforcement Suit Held to Fall Under "Police or Regulatory" Exception of § 362(b)(4).

In re RGV Smiles by Rocky L. Salinas D.D.S. P.A., 626 B.R. 278 (Bankr. S.D. Tex. 2021) (Rodriguez, J.).

In 2014, the State of Texas commenced an action under the Texas Medicaid Fraud Prevention Act ("TMFPA") in the District Court of Travis County, Texas, 53rd Judicial, naming one entity—RGV Smiles by Rocky L. Salinas, D.D.S. P.A.—and its principal—Rocky Lamar Salinas—as defendants. With the case still pending years later, the defendants filed initial chapter 11 petitions in the United States Bankruptcy Court for the Southern District of Texas on June 1, 2020, and a Suggestion of Bankruptcy in the state court on July 1, 2020. Months after Bankruptcy Court granted the debtors' request for the joint administration of their separate cases, the State of Texas sought a determination that the automatic stay did not apply to its prepetition action against the debtors pursuant to § 362(b)(4), a request that the debtors opposed. Later, Texas filed both an adversary complaint and a proof of claim against the debtors based on the state court matter's underlying factual allegations. After the parties' effort at mediation failed, and after the debtors filed their objection to Texas' proof of claim, the Bankruptcy Court conditionally approved the debtors' amended disclosure statement—and took the motion to determine under advisement.

In an opinion partly granting Texas' request issued on January 6, 2021, the Bankruptcy Court provided a guide to bankruptcy law's approach to the police or regulatory exception codified in § 362(b)(4). Finding no reason to question whether Texas qualified as a "governmental unit" under this subsection, the it then outlined (and applied) the two separate but related tests commonly used to determine whether a governmental unit is enforcing its police or regulatory powers—the pecuniary interest test and the public policy test—based on the totality of the circumstances.

Because Texas aimed to ensure the integrity of the Texas Medicaid Program and thereby protect the health and safety of Texas resident in general and Medicaid patients in particular with its TMFPA lawsuit against the debtors, its action against the debtors fit § 362(b)(4)'s exception for a governmental unit's enforcement of its police and regulatory power. That Texas had sought monetary compensation in its suit did not change this calculus, as those monies did not qualify as "damages" but rather as "steep penalties intended to prevent and deter future fraud and punish wrongdoers" under Texas law. Similarly, for purposes of the public policy test, even in cases where private persons stand to gain monetarily based on a government's successful suit, courts have found that the government was acting for public policy reasons when the behavior targeted threatened public health, safety, or welfare. Because the TMFPA constituted, to quote the Texas Supreme Court, a "powerful tool … for targeting fraud against the Texas Medicaid program," Texas had acted so as to effectuate public policy, and § 362(b)(4) therefore applied per the public policy test.

Having found § 362(b)(4) to control under both extant tests, the Bankruptcy Court thereupon refused to construe Texas' filing of a proof of claim as consent to its jurisdiction over the state court action or issue an injunction against its post-petition continuation. The former conclusion followed from the language of 28 U.S.C. § 1452(a): "A party may remove any claim or cause of action in a civil action other than ... a civil action by a governmental unit to enforce such governmental unit's police or regulatory power." The Court further declined to issue the § 105(a) injunction in the context of a contested matter, outside of an adversary proceeding filed under Bankruptcy Rule 7001(7).

Applying Rules of Punctuation, Grammar and Logic, Court Approves Cash Management Waivers Under § 345(b).

In re King Mountain Tobacco Company, Inc., 623 B.R. 323 (Bankr. E.D. Wash. 2020) (Holt, J.).

The debtor entered the case with three categories of deposit accounts: (1) operational accounts with Heritage Bank, totaling over $570,000; (2) an operational account with Truist Bank, totaling over $1 million; and (3) 21 segregated escrow accounts, totaling over $51 million, in the aggregate, representing "reserve funds" for each state where the debtor operates to "effectively collateralize potential claims the particular state might assert against the debtor." Neither Heritage Bank nor Truist Bank was an authorized depository under the local U.S. Trustee's program.

The debtor filed a motion seeking authority to continue its existing cash management system, notwithstanding the requirements under § 345(b) that were not satisfied by the existing banks. The U.S. Trustee objected, arguing that the Court lacked authority to approve a waiver of the requirements of § 345(b), and that, even if the Bankruptcy Court had authority, the circumstances did not warrant such a waiver. The Bankruptcy Court overruled the objection on both counts and granted the motion.

First, the Bankruptcy Court addressed its authority to approve a waiver of the § 345(b) requirements "for cause." The U.S. Trustee argued that the hanging paragraph in § 345(b) ("unless the court for cause orders otherwise") only described the second subsection (b)(2). In other words, the U.S. Trustee argued that the Bankruptcy Court could only waive the requirement to deposit securities of the kind described in 31 U.S.C. § 9303, but that the Court could not waive the requirement to post a bond as required under subsection (b)(1).

Looking to the punctuation and grammar of the section, the Bankruptcy Court explained that the use of a semicolon to separate subsections (b)(1) and (b)(2) from the "Orders Otherwise Clause" was clear evidence of congressional intent for the "Orders Otherwise Clause" to modify both subsections, not merely the latter one. Independent of grammar and punctuation, the Bankruptcy Court explained that logic supported this conclusion, given the disjunctive nature of subsections (b)(1) and (b)(2). If the debtor could satisfy one or the other, the Court found no logic behind the U.S. Trustee's argument that the "Orders Otherwise Clause" only modified the latter. Finally, the Court looked to legislative history to confirm the plain meaning of the statute. Here, the "Orders Otherwise Clause" was added to § 345(b) in 1994, months following the Third Circuit's decision in *United States Trustee v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.)*, 33 F.3d 294 (3d Cir. 1994) (concluding that the bankruptcy court had no authority to allow a debtor to maintain its cash management system other than as expressly enumerated in section 345(b)). Accordingly, the Bankruptcy Court overruled the U.S. Trustee's objection to the debtor's motion on statutory grounds.

Turning to the factual grounds for objection, the Bankruptcy Court applied the *Service Merchandise* factors—*i.e.*, sophistication of the debtor's business, size of the operations, amount of investment involved, applicable banks' ratings, safeguards in place within the debtor's own business, ability to reorganize in the face of a potential bank failure, benefit to the estate of maintaining existing accounts, and harm, if any, to the estate of requiring the debtor to move funds to new accounts, and reasonableness of the requested relief in light of the overall circumstances.[3] On balance, and "[t]aken collectively," the Bankruptcy Court held that the debtor demonstrated sufficient "cause" to order otherwise, "thereby waiving the need for the debtor to rearrange its banking affairs to satisfy section 345(b)."

Trustee Ordered to Return Misappropriated Cash; § 541(a)(7) Does Not Apply to Stolen Funds.

In re CM Resort, LLC, 2021 WL 3889790, 2021 Bankr. LEXIS 2378 (Bankr. N.D. Tex. Aug. 31, 2021) (Morris, J.).

In this long running dispute among the Ruff family over the management of a family trust established to hold Suzann Ruff's assets following the death of her husband Arthur Ruff, the family trust (managed by the Ruff children) asked the Bankruptcy Court to compel the Bankruptcy Trustee to return alleged "family trust funds" paid by Suzann Ruff to the Bankruptcy Trustee without authorization from the Ruff children, as co-trustees for the family trust.

At the time of Arthur Ruff's death in 1998, Suzann allegedly owned approximately 4,000 acres of real property in Palo Pinto County, Texas, including ranch property commonly referred to as the 7-R Ranch. These bankruptcy cases were filed in 2018, following extensive litigation and arbitration awards. The debtors ostensibly own various portions of the 7-R Ranch, although equitable ownership of such property remained in dispute between Suzann and the Ruff children.

The immediate dispute concerns $420,000 paid by Suzann to the Bankruptcy Trustee to insure and manage the real property. The Ruff children alleged that such funds belonged to the

[3] *In re Service Merchandise Co.*, 240 B.R. 894, 896 (Bankr. M.D. Tenn. 1999); *see also In re Ditech Holding Corp.*, 605 B.R. 10, 20 (Bankr. S.D.N.Y. 2019).

family trust, and that Suzann had no right to transfer trust funds to the Bankruptcy Trustee. They filed a motion asking the Bankruptcy Court to compel the Bankruptcy Trustee to return such funds.

The Bankruptcy Court noted that, while the Ruff children's motion failed to recite a legal theory for the turnover request, such relief would require proof of the following key facts: (1) that the Ruff Children were Co-Trustees of the Trust at the time of Suzann's transfer of both the initial $70,000 and the subsequent $350,000; (2) that, by failing to obtain the approval of a majority of the Ruff children for the transfers, Suzann did not have the authority under the terms of the Trust Agreement to make the transfers; and (3) that the relief requested is contemplated by the Agreed Restraining Order under which the Bankruptcy Trustee, according to the Trust, "agreed not to spend funds from Suzann Ruff absent further Order of this Court." The Bankruptcy Court further explained that the common law theory of "money had and received" required proof that (i) the Bankruptcy Trustee holds the funds in dispute, and (ii) such funds "in equity and good conscience" belong to the family trust.

On the merits, the Bankruptcy Court found that the Bankruptcy Trustee had already spent $70,000 on insurance, so the most it could return was $350,000 which remained in the trustee's possession.

The Bankruptcy Court then turned to § 541 as a starting point to determine what right or interest the Bankruptcy Trustee held in such funds. Suzann argued that § 541(a)(7) provides that any property acquired by the Bankruptcy Trustee post-petition becomes "property of the estate." The Bankruptcy Court rejected this argument, because, under Texas law "a thief cannot pass good title" to personal property. In this case, the Bankruptcy Trustee gave no consideration for the cash and merely booked the funds as an equity contribution by Suzann. Thus, the Bankruptcy Court turned to concepts of "equity and good conscience." Here, the Bankruptcy Court found that the cash was clearly property of the family trust, and that Suzann indisputably had no right or authority to transfer it to the Bankruptcy Trustee. While Suzann was seeking to have her children disqualified as co-trustees in probate court, the Bankruptcy Court recognized that any dismissal would be *prospective* only, which would not retrospectively authorize the transfer of the funds to the Bankruptcy Trustee. Accordingly, the Bankruptcy Court granted the family trust's motion and ordered the Bankruptcy Trustee to return $350,000 of the cash to the family trust, and denied all other relief requested.

D. Professional and Executive Compensation

Hindsight is 20/20, But Not the Proper Standard for Awarding or Denying Professional Compensation.
Edwards Family Partnership, L.P. v. Johnson (In re Community Home Financial Services, Inc.), 990 F.3d 422 (5th Cir. 2021) (Elrod, J.).

The Debtor had legitimate disputes with its two primary creditors. Such disputes were the subject of adversary proceedings and a contested confirmation process. Debtor's counsel represented the estate in these disputes for several months before withdrawing as counsel when it came to light that the debtor's president transferred all of the debtor's cash to foreign accounts and set up a "rogue" business in Panama and Costa Rica. The bankruptcy court appointed a trustee, and debtor's counsel withdrew.

Following the trustee's appointment and withdrawal, the Bankruptcy Court awarded compensation to debtor's counsel for the fees incurred through the trustee's appointment. On appeal to the district court, the District Court vacated the fee award, despite its recognition of *In re Woerner*, 783 F.3d 266, 276 (5th Cir. 2015) (en banc), as binding precedent. In vacating the fee award, the District Court concluded that the "legal services were neither necessary nor 'reasonably likely' to benefit" the debtor's estate, and that such a legal strategy was "not a good gamble." 2020 WL 4506788.

On appeal to the Fifth Circuit, the Court of Appeals concluded that the District Court's application of *Woerner* was erroneous and "based on its own retrospective assessment of the propriety of the adversary proceedings," without giving deference to the Bankruptcy Court's own assessment based on what would have been reasonable at the time of the activity. When viewed prospectively at the time of such services, the Fifth Circuit concluded that "pursuit of the adversary proceedings was 'necessary to the administration of the case' to resolve otherwise unsettled disputes about the priority of claim." As such, it reversed the District Court's ruling and reinstated the Bankruptcy Court's fee award.

The Fifth Circuit also held that the appeal was not moot, despite a settlement between appellants and former counsel for the debtor, because the chapter 11 trustee need not have a pecuniary interest in the fee dispute. An order on professional fee awards affects the administration of the bankruptcy estate. Thus, the chapter 11 trustee had a "sufficient legal interest" to continue the appeal.

Debtor Must Prove More than Mere Business Judgment to Obtain Approval of Key Employee Retention Program.
In re Country Fresh Holding Company Inc., 2021 WL 2932680 (Bankr. S.D. Tex. Jul. 12, 2021) (Isgur, J.).

The debtors proposed a Key Employee Retention Program ("KEIP") to reward five high-level employees with bonuses for achieving certain performance goals during the bankruptcy process. The debtors characterized the KEIP as "incentive based," while the objecting parties, including the Committee and the U.S. Trustee, argued that such characterization was a sham aimed to reward high-level employees with a bonus for easily achievable targets. The KEIP at issue had two components. First, the debtors offered to pay 25% of the employees' base salaries for maintaining a post-petition aggregate "fill-rate" of 95.5% (the percentage of times the debtor could fill its customers' orders on a timely basis). Second, this KEIP offered a "sale-based" incentive to the employees based on the result of the auction process—specifically $123,550 in the aggregate for each $1 million received over the Stalking Horse Bid, with a cap on four of the five employees, but without a cap on the CEO's potential bonus.

Citing *Pilgrim's Pride*, 401 B.R. 229, 236 (Bankr. N.D. Tex. 2009), the Bankruptcy Court first concluded that the "facts and circumstances" language in § 503(c)(3) required a heightened burden of proof beyond the debtors' mere business judgment—*i.e.*, the debtor must demonstrate that the KEIP was "more likely than not" to incentive the participants. Having determined the burden of proof required, it explained that the debtors successfully demonstrated, by a preponderance of the evidence, that the fill-rate target properly incentivized the employees, was aimed to improve the debtors' value during the course of the chapter 11 sale process, and was not

an easily achievable target in light of the declining fill-rate in the weeks leading up to the bankruptcy filing. However, the record was unclear whether the employees actually hit their 95.5% target rate and, thus, the Bankruptcy Court deferred this determination to the chapter 7 trustee based on the Court's validation of the fill-rate component of the incentive plan.

Finally, the Bankruptcy Court determined that the debtors carried their burden of proving that the sale-based target properly incentivized the employees in a manner that was justified under the circumstances of the case—*i.e.*, the employees were incentivized to assist in the marketing of the assets to drive up the potential purchase price. Although it noted that the review should not be based on a retrospective view, the Court found relevant the $13.2 purchase price increase over the Stalking Horse Bid. The Bankruptcy Court did, however, find that the absence of a cap on the CEO's sale-based incentive could not be justified by the facts and circumstances of the case. Without a cap, the CEO would have been entitled to a bonus of 4.5 times his base salary. The Bankruptcy Court found that he would have been equally incentivized to maximize the debtors' assets had the sale-based target bonus been capped at 50% of his base salary. When adjusting the bonus with this cap, the Bankruptcy Court found that the total bonus pool was roughly 2% of the increased sale price, which was justified by the facts and circumstances given the participating employees' efforts to maximize the debtors' sale value. Accordingly, it approved the sale-based target component of the KEIP, as modified to include the cap for the CEO.

E. ***Sale Issues***

State Law Alone may Authorize a Sale Free and Clear.
In re Royal Steet Bistro, L.L.C., No. 26 F.4th 326 (5th Cir. 2022) (per curiam).

The chapter 11 trustee sought to sell the debtor's real property free and clear of all claims and interests under section 363 of the Bankruptcy Code. Two lessees objected to the proposed sale; however their interests in the properties were subordinate to a senior secured lender under state law. The Bankruptcy Court held that because the property could be sold free and clear under state law, this satisfied section 363(f)(1) of the Bankruptcy Code and authorized the sale. The Bankruptcy Court also cited the failure to pay required lease as another reason to deny the sale under section 363(f)(4) of the Bankruptcy Code, citing the Seventh Circuit's decision in *Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537 (7th Cir. 2003). However, the Fifth Circuit clarified that in this case, because state law authorized the sale, that was all that was required and cautioned against a broad application of *Qualitech's* holding.

Appeal Equitably Moot for Failure to Obtain a Stay.
Su v. C Whale Corp. (In re C Whale Corp.), No. 21-20147, 2022 WL 135125 (5th Cir. Jan. 13, 2022) (per curiam).

Su was the president and owner of a large fleet of shipping containers, including C Whale, which employed under-deck piping technology and were funded by Mega International Commercial Bank Co., Ltd. and a syndicate of lenders. Despite confirming a chapter 11 plan, the shipping containers failed to generate sufficient revenue and Mega sought relief from the automatic stay to sell C Whale. The Bankruptcy Court approved the sale of C Whale pursuant to a credit bid by the lenders. Su appealed the sale to the Fifth Circuit alleging bad faith, but had not sought a stay of the sale. The Fifth Circuit dismissed Su's appeal as moot because he failed to produce any

evidence of bad faith on the record and because the District Court had dismissed the appeal as moot under section 363(m) of the Bankruptcy Code because Su had failed to obtain a stay of the sale.

"Fatal means Fatal" – Fifth Circuit Declined to Review Sale Order Without a Stay, Despite Due Process Concerns.
In re Walker County Hospital Corp., 3 F.4th 230 (5th Cir. 2021) (Jolly, J.).

The Debtor sought to sell substantially all of its assets to a Buyer. The Committee initially opposed the sale, but ultimately waived its objection when it reached a settlement with the Buyer that provided for, among other things, an agreed sharing of Medicaid receivables expected after the contemplated sale closing date. The settlement terms were memorialized in the initial sale order. However, after entry of the sale order, the closing was delayed while the Buyer's lender completed its due diligence. During the intervening time, the Debtor and Buyer entered into side agreements to allow the Debtor to maintain hospital operations through closing, and the Debtor ultimately received the Medicaid payment *before* closing. These circumstances forced the Debtor to file an emergency motion to amend the sale order, which undermined the Buyer's prior settlement with the Committee, but was necessary to ensure a timely closing with the Buyer. The Committee opposed the emergency motion and filed this appeal, but the Committee did not seek a stay pending appeal before the sale closed less than 24 hours after the Court approved the amended sale order.

Before considering the merits of this appeal, the Fifth Circuit cited its four-decades-long history of declining judicial review for statutorily moot sale orders.[4] From these decisions, it made one thing clear: "[A] failure to obtain a stay is *fatal* to a challenge of a bankruptcy court's authorization of the sale of property. . . And fatal means fatal."[5]

While it noted the Committee's proffered distinction between the sale order and the *amended* sale order, the Fifth Circuit found the distinction to be one without a material difference. The Court concluded that the amended order was "integrally linked to, and indeed, inseparable from, the Sale Order. The Amendment Order does just that—it amends the Sale Order—and therefore cannot be separated from it, just as the lease in *American Grain* and the cash disbursement in *Sneed Shipbuilding*." Because the Committee did not obtain a stay of the amended order, the Fifth Circuit affirmed the District Court's dismissal of the appeal as statutorily moot under § 363(m) and did not reach the merits of the appeal.

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[4] *Am Grain Ass'n v. Lee-Vac, Lts.*, 630 F.2d 245, 247 (5th Cir. 1980); *Fabrique, Inc. v. Corman*, 813 F.2d 725, 725 (5th Cir. 1987); *In re Gilchrist*, 891 F.2d 559, 560 (5th Cir. 1990); *In re Sneed Shipbuilding, Inc.*, 916 F.3d 405, 407 (5th Cir. 2019); *see also In re Bleaufontaine, Inc.*, 634 F.2d 1383, 1389 n.10 (5th Cir. 1981); *In re Ginther Trusts*, 238 F.3d 686, 689 (5th Cir. 2001).

[5] *In re Walker Cty. Hosp. Corp.*, 3 F.4th at 234 (quoting *In re Ginther Trusts*, 238 F.3d at 689) (internal quotations omitted, emphasis in the original).

Statutory Mootness Applied, Despite Absence of Express Findings of "Good Faith."
Sanford v. Piazza (In re Pursuit Holdings (NY), LLC), 845 Fed. Appx. 60 (2d Cir. Mar. 9, 2021) (per curiam).

The Second Circuit dismissed this appeal in a summary ruling. The debtor and its *pro se* principal appealed an order approving a settlement between the trustee and a creditor that provided for the creditors' payment of cash, conveyance of property to the creditor and mutual release of claims among the parties.

While the Bankruptcy Court did not expressly approve the settlement as a sale under § 363(b), the Trustee's motion cited § 363(b) as a statutory predicate, the Trustee stated at the hearing that the transaction was a sale-settlement hybrid, and the Bankruptcy Court approved the motion in its entirety. Further, while the Bankruptcy Court did not expressly find that the creditor was a "good faith" purchaser under § 363(m), the record included findings of good faith, arms' length negotiations among the trustee and creditor, which implied that the creditor acted in good faith. On this record, the Second Circuit agreed with the District Court that "the bankruptcy court's order approving the settlement agreement was an authorization of a § 363(b) sale and thus § 363(m)'s mootness rule applies."

Buyer Had Expressly Assumed Obligations Under Purchase and Sale Agreement.
Sanare Energy Partners, LLC v. Petroquest Energy, L.L.C., No. 4:21-CV-2443, 2021 WL 6194715 (S.D. Tex. Nov. 22, 2021) (Hoyt, J.).

Sanare alleged that Petroquest had failed to obtain required consents to transfer certain oil and gas leases in accordance with a purchase and sale agreement, which closed prior to Petroquest's bankruptcy case. Petroquest did not obtain consents from Eni US Operating Co., Inc. and the Bureau of Ocean Energy Management. The District Court held that Sanare had taken control of and operated the leases at issue and as a result, were bound by the PSA to assume all obligations and liabilities.

Challenging "Good Faith" is not Statutorily Moot, Even Without a Stay Pending Appeal.
In re Palm Springs II, LLC, 2021 WL 3213013, 2021 U.S. Dist. LEXIS 141351 (N.D. Tex. Jul. 29, 2021) (Boyle, J.).

This appeal presents the exception to "fatal is fatal" rule set forth in *Walker County Hospital, supra*. One of the issues raised in this appeal was whether the purchasers were "good faith" purchasers within the meaning of § 363(m). As a general matter, the doctrine of statutory mootness limits an appellate court's ability to review a court order approving the sale of estate property pursuant to § 363(m), thereby assuring good faith buyers that once a bankruptcy court approved sale is consummated, the order cannot later be set aside by an appellate court or otherwise attacked.

Here, because the appellant challenged that very issue—*i.e.*, whether the purchasers met the "good faith" standards to receive the statutory protections of § 363(m)—the District Court concluded the appeal was not moot, at least with respect to the "good faith" issue. Thus, the District Court denied the motion to dismiss the appeal as moot and set a briefing schedule.

F. *<u>Dismissal, Conversion and Other Relief</u>*

Bankruptcy Court Dismissed Cases Filed to Gain an Unfair Litigation Advantage and Were Not Filed in Good Faith.
In re National Rifle Association of America, 628 B.R. 262 (Bankr. N.D. Tex. 2021) (Hale, J.).

The NRA filed the bankruptcy case seeking protection from a prepetition lawsuit filed by the New York Attorney General seeking dissolution of the NRA based on the allegations that (1) the NRA exceeded the authority conferred upon it by New York law and conducted its business in a persistently illegal manner and abused its powers contrary to the public policy of the state of New York by operating without effective oversight or control by its officers and directors, and (2) the directors or members in control of the NRA looted or wasted the corporate assets, perpetuated the corporation solely for their personal benefit, or otherwise acted in an illegal, oppressive, or fraudulent manner. Shortly after the NRA filed bankruptcy, the AG filed three alternative forms of relief: dismissal of the bankruptcy cases, the appointment of a chapter 11 trustee, or the appointment of an examiner.

After an extensive trial that lasted several weeks, the Bankruptcy Court issued a memorandum opinion dismissing the bankruptcy cases as having been filed in bad faith. The Bankruptcy Court considered the *Little Creek* factors and the totality of circumstances and concluded that the NRA did not file bankruptcy for legitimate restructuring purposes—*e.g.*, to reduce operating costs, address burdensome executory contracts, modernize its charter and organization structure, or obtain a breathing spell. Instead, the Bankruptcy Court explained that the NRA's filing was for non-bankruptcy purposes—*i.e.*, to avoid or frustrate the regulatory dissolution proceeding pending in New York. Such an illegitimate purpose deprived the New York attorney general of its state law police and regulatory remedies under nonbankruptcy law.

Finally, the Bankruptcy Court held that keeping the bankruptcy cases alive with the appointment of a trustee or examiner would not serve the best interests of creditors and estate. It determined that outside of bankruptcy, the NRA could pay its creditors faster than in bankruptcy, continue to fulfill its mission, continue to improve its governance and internal controls, contest the dissolution of the NRA in the lawsuit, and pursue legal steps necessary to leave New York.

Ultimately, the Bankruptcy Court held, consistent with precedent, the bankruptcy cases were filed to gain an unfair litigation advantage and were not filed in good faith. While the cases were dismissed without prejudice, the Court cautioned that an immediate refiling of another chapter 11 case could provide sufficient grounds for the appointment of a trustee in a subsequent case. Notably, the NRA declined to appeal or file another chapter 11 case following this decision.

Involuntary Petitions Dismissed Due to Petitioning Creditors' Failure to Make Proper Disclosures.
In re Banner Resources, LLC, 2021 WL 2189085, 2021 Bankr. LEXIS 1452 (Bankr. N.D. Tex. May 28, 2021) (Jones, J.).

The Bankruptcy Court dismissed an involuntary petition because the petitioning creditor refused to comply with Bankruptcy Rule 1003(a). The rule requires disclosure of the consideration

and terms of any prepetition transfer of the claim, as well as a statement verifying that the claim was not acquired for the purpose of filing an involuntary petition.

The Bankruptcy Court also held that there was a *bona fide* dispute over the other three petitioning creditors' claims because the only evidence presented suggested that their claims were against the alleged debtor's wholly owned subsidiary, not the alleged debtor, and the petitioning creditors declined to participate in the trial to refute this evidence. Noting a presumption of good faith for the filing of involuntary petitions, the Bankruptcy Court was unpersuaded by the record to find bad faith on the petitioning creditor's part.

Bad Faith Not an Independent Basis for Dismissal of an Involuntary Petition.
In re Seven Three Distilling Company, L.L.C., 2021 WL 3814802, 2021 Bankr. LEXIS 2072 (Bankr. E.D. La. Aug. 4, 2021) (Grabill, J.).

In this involuntary bankruptcy case, the Bankruptcy Court found that the petitioning creditors had standing as creditors and proved beyond a preponderance of the evidence that the alleged debtor was not paying its undisputed debts as they became due. Notwithstanding this finding and clear basis for entering an order for relief, the alleged debtor asked the Bankruptcy Court to dismiss the petition as a bad faith filing, citing, as authority for such relief, the Third Circuit's ruling in *Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 330 (3d Cir. 2015).

According to the alleged debtor, under the *Forever Green* decision, bad faith is an independent basis to dismiss the involuntary petition, even though the petitioning creditors carried their burden under section 303(b) and (h). The Bankruptcy Court noted that, under *Little Creek* and its progeny, bad faith can support "cause" for dismissal of *voluntarily* filed petitions under §§ 707(a), 1112(b) and 1307(c). However, in the absence of clear guidance from the Fifth Circuit on the *Forever Green* line of authority, and particularly in light of the petitioning creditors having carried their burden of proof under § 303(b) and (h), the Bankruptcy Court was not persuaded that "bad faith" or "cause" was a valid basis for dismissal under § 303.

The Bankruptcy Court agreed with the other circuits to rule on this issue and held that if petitioning creditors have carried their burden under § 303(b) and (h), then a bankruptcy court lacks authority to impose a non-statutory requirement to the procedure for filing involuntary petitions. Moreover, the Bankruptcy Court cited a number of cases for the proposition that there is a presumption of good faith in favor of the petitioning creditors, and that the alleged debtor would have the burden to overcome this presumption. In this case, the alleged debtor failed to produce sufficient evidence to overcome the presumption of good faith. Thus, even if the Fifth Circuit adopted the *Forever Green* line of authority, the Bankruptcy Court concluded that the record did not support dismissal of the involuntary petition based on bad faith.

Second Committee of Commercial Creditors Warranted Once Committee Became Comprised Solely of Tort Claimants.
In re Roman Catholic Church of the Archdiocese of New Orleans, 2021 WL 454220, 2021 Bankr. LEXIS 302 (Bankr. E.D. La. Feb. 8, 2021) (Grabill, J.).

In this case, the Bankruptcy Court ruled that a creditors' committee, which eventually consisted of only tort claimants, did not adequately represent the interests of the body of unsecured

creditors, particularly the commercial trade creditors. It likewise found that adding commercial creditors to the relevant committee would not provide commercial creditors with a meaningful voice on the committee, and so instead ordered that a separate committee of unsecured commercial creditors be formed under § 1102(a)(2).

In determining whether the committee could adequately represent the interests of the entire creditor body, the Bankruptcy Court examined a number of factors. In respect of the first factor, whether the existing committee had the ability to function, the Bankruptcy Court found that although there had been some disagreements between the tort claimants and TMI Trust Company (the commercial creditor who filed the motion to reconstitute the committee), the committee was generally functioning. The Bankruptcy Court noted, however, that just because a committee is functioning does not mean all creditor groups are adequately represented. Second, the Bankruptcy Court examined the nature of the case and the need for representation. There, while it found that the bankruptcy case was not a "mega" case and involved only a single debtor, there was a significant body of commercial claimants requiring representation, and the Bankruptcy Court was not comfortable the committee could do so given the lack of any commercial claimants on the committee. Next, the Bankruptcy Court examined the standing and desires of the various constituencies and the ability of creditors to participate without an additional committee. The Court found that the Debtor was supportive of either an additional committee or the addition of commercial claimants to the existing committee, and that though the U.S. Trustee opposed the motion, it did not provide evidence or testimony at the hearing. The committee likewise opposed the request, but stated at the hearing that it was not opposed to adding additional members, and that its only issue with a second committee related to the additional costs that the estate would incur as a result.

G. Subchapter V and Small Business Cases

Statutory Deadline for Filing Plan is not an Absolute Bar to Request for Extension.
In re Excellence 2000, Inc., 636 B.R. 475 (Bankr. S.D. Tex. 2022) (Rodriguez, J.).

The debtor filed a chapter 11 case under subchapter V of the Bankruptcy Code, which required that the debtor file its chapter 11 plan no later than December 27, 2021. The debtor failed to meet this deadline but filed an emergency motion to extend the deadline for filing its chapter 11 plan on December 28, 2021. The Bankruptcy Court examined whether a debtor could file a motion to extend the deadline to file a chapter 11 plan under subchapter V after the time prescribed under the statute had closed. Although section 1189 of the Bankruptcy Code established a deadline for a debtor to file a chapter 11 plan, it did not establish a time for filing a requested extension. The Bankruptcy Court contrasted this statutory language with section 1121 of the Bankruptcy Code, which requires that a motion to extend be filed within the time period prescribed. Noting the tension between the two statutory provisions, the Bankruptcy Court concluded that had Congress intended to prohibit the filing of an extension after the close of the statutory period, it would have done so. The Bankruptcy Court held that it had discretion under the statute to grant retractive relief if merited. However, after careful consideration of the facts and circumstances in this case, the Bankruptcy Court ultimately concluded the debtor lacked merit for the requested extension.

Sua Sponte Appointment of CRO Warranted.
In re Ironside, LLC, No. 20-34222, 2022 WL 509890 (Bankr. S.D. Tex. Feb. 18, 2022) (Rodriguez, J.).

The debtor had sold significant assets including a 3D printer for $165,000 and a mill for $12,000. The debtor did not disclose these sales or seek the Bankruptcy Court's approval. As a result, the Bankruptcy Court appointed a CRO to oversee the debtor's operations, direct litigation strategy, and formulate a restructuring plan, among others. The Bankruptcy Court further ordered that the persons in control of the debtors turn over all estate property and books and records to the CRO and enjoined others from exercising control over estate property.

Individuals Not "Engaged in Commercial or Business Activity" Could Convert to Subchapter V.
In re Johnson, 2021 WL 825156, 2021 Bankr. LEXIS 471 (Bankr. N.D. Tex. Mar. 1, 2021) (Morris, J.).

Cord David Johnson and Sunny Lea Johnson (the "Debtors") commenced their joint Chapter 7 bankruptcy case on May 22, 2019. After months of discovery, the U.S. Trustee commenced an adversary proceeding to object to their discharge. By this time, the Small Business Reorganization Act of 2019 ("SBRA") took effect. Admittedly, to avoid the U.S. Trustee's objection to discharge, the Debtors moved to convert their case to Chapter 11, but ***only if*** they could maintain their case under the new Subchapter V of Chapter 11. The U.S. Trustee and certain creditors objected on several grounds, including their ineligibility for Sub Chapter V.

Mr. Johnson served as a full-time employee and President of his parent's energy company. Mrs. Johnson was a full-time nurse for a local hospital in Fort Worth, Texas. Before the commencement of the bankruptcy cases, Mr. Johnson owned and managed several oil and gas drilling companies (the "Defunct Companies"). Most of the debts in the case arose from Mr. Johnson's management (or mismanagement) of the Defunct Companies. The record was clear that Mr. Johnson had no intention of restarting drilling operations under the Defunct Companies.

To qualify for relief under new Subchapter V of Chapter 11, the Debtors must meet the definition of "small business debtors" under § 101(51D), which requires that the debtors be "engaged in commercial or business activities." Thus, the issue before Judge Morris in this case was whether the Debtors qualified as small business debtors. On the facts presented, the Bankruptcy Court concluded that the Debtors did not qualify for two reasons.

First, analogizing similar language from railroad and farming bankruptcy provisions, the Bankruptcy Court concluded that "engaged in" under the definition of "small business debtors" required current operations as of the Petition Date.[6] In this case, both Debtors were W-2 employees for companies owned by non-debtors, and the Defunct Companies were shuttered before the Petition Date with no evidence that they would restart operations in the future. Second, the Bankruptcy Court concluded that neither of the Debtors was "engaged in the exchange or buying

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[6] *Id.* at *7 (citing *Hileman v. Pittsburgh & Lake Erie Props., Inc.* (*In re Pittsburgh & Lake Erie Props., Inc.*,), 290 F.3d 516, 519 (3d Cir. 2002); *Watford v. Fed. Land Bank of Columbia (In re Watford)*, 898 F.2d 1525, 1528 (11th Cir. 1990); *In re McLawchlin*, 511 B.R. 422, 427-28 (Bankr. S.D. Tex. 2014)).

and selling of any economic goods or services of their own for profit." Even Mr. Johnson's position as president of his parents' company was "insufficient under the facts and circumstances of this case to equate [Mr. Johnson's] individual engagement in commercial activities." Thus, because the Debtors did not qualify as "small business debtors" under § 101(51D), they were not entitled to relief under Subchapter V, and the Court accordingly denied their motion to convert.

Unlike All Other Chapter Trustees, Subchapter V Trustees Must Remain Neutral at All Times.
In re 218 Jackson LLC, --- B.R. ---, 2021 WL 3662377 (Bankr. M.D. Fla. Aug 17, 2021) (Vaughan, J.).

The Court removed the subchapter V trustee and denied his compensation, concluding that the trustee was not "disinterested," as required under § 1183(a). "Simply put, an attorney who is adverse to the Debtor's principal in another case cannot serve as the subchapter V trustee."

Unlike trustees appointed under Chapters 7, 11, 12 and 13, subchapter V trustees are "the *only* trustee directed to 'facilitate the development of a consensual plan of reorganization'" per § 1183(b)(7).

In other words, a subchapter V trustee is "an independent third party and fiduciary who must be fair and impartial to all parties in the case." In this case, the Bankruptcy Court found that the trustee spent his time "thwarting the Debtor's efforts to reorganize and taking the side of the secured creditor. This is not the role of a subchapter V trustee."

H. ***Parties Behaving Badly***

Receiver Had an Interest and thus Standing to Defend Sanctions Order for Persistent and Baseless Claims.
In re Cleveland Imaging & Surgical Hospital, L.L.C., 26 F.4th 285 (5th Cir. 2022) (Smith, J.)
In re Cleveland Imaging & Surgical Hospital, L.L.C., No. 14-34974, 2022 WL 677459 (Bankr. S.D. Tex. Mar. 7, 2022) (Isgur, J.)

The Cleveland Imaging and Surgical Hospital, L.L.C. was a four bed hospital, which filed bankruptcy in 2014, sold the majority of its assets, and retained certain causes of action in a litigation trust, which expired by its own terms in 2018. In its bankruptcy case, a group of doctors, which had invested in the hospital had sought to purchase the hospital, but lost to a competitor. The Bankruptcy Court approved the sale and the doctors did not appeal the sale order. In 2019, the doctors filed an adversary proceeding, alleging that the sale of the hospital's assets was fraudulent and a breach of fiduciary duty by the receiver appointed to the estate. The Bankruptcy Court ultimately sanctioned the doctors' conduct for acting in bad faith by knowingly violating the court's confirmation order. The Bankruptcy Court's remedies included payment of the receiver's attorney's fees for the doctors' adversary proceeding and issued an injunction which imposed a $100,000 penalty for each future violation. The doctors paid the sanctions but appealed to the District Court, which affirmed the Bankruptcy Court's ruling. The key issue on appeal to the Fifth Circuit was whether the litigation trustee had standing to defend the sanctions order since the trust had expired. The Fifth Circuit ultimately held that the litigation trustee had retained an interest in the outcome of the litigation, because he retained an interest in ensuring the litigation trust's funds

were distributed to the trust's beneficiaries. After addressing the jurisdictional issue, the Fifth Circuit ultimately affirmed the Bankruptcy Court's sanctions order.

In August 2021, while the Fifth Circuit appeal was pending, the doctors filed a motion to vacate the Bankruptcy Court's sale order, again alleging that the parties involved had perpetrated a fraud on the court. In response, the debtors and trustee sought sanctions under Bankruptcy Rule 9011 against the doctors and their counsel. In a measured response, the Bankruptcy Court first denied the doctors requested relief as moot because the 180-day deadline to revoke the confirmation order under section 1144 of the Bankruptcy Code had lapsed. Addressing the doctors' allegations, the Bankruptcy Court examined the record and found no support for the doctors' claims and concluded that sanctions were appropriate, but said such sanctions may be ameliorated by beneficial conduct, such as an apology or withdrawal of allegations.

Attorney Disgorged Prepetition Amounts Received for Failure to Provide Services to the Estate.
In re Smdonovick Ventures, LLC, No. 21-33716, 2022 WL 710196 (Bankr. S.D. Tex. Mar. 9, 2022) (Rodriguez, J).

The debtor and its attorney failed to appear for a meeting of creditors and the chapter 7 trustee filed a motion to dismiss the debtor's bankruptcy case. The debtor's representative advised the chapter 7 trustee that his attorney was in the hospital but had represented that she would seek a continuance of the meeting of creditors. The Bankruptcy Court conducted a hearing regarding in which it ordered the debtor's representative and its attorney to appear. Although the debtor's representative appeared, its attorney did not and the Bankruptcy Court issued a bench warrant. The attorney eventually self-surrendered to the United States Marshalls Service and voluntarily surrendered her admission to the Southern District of Texas. In light of the circumstances, the Bankruptcy Court continued the motion to dismiss and granted the debtor additional time to find substitute counsel. The Bankruptcy Court also ordered that the attorney disgorge approximately $6,800 received prepetition for cause because she had not provided any reasonable value to the debtor.

Bankruptcy Court Finds Former CEO in Civil Contempt for Repeated Violations of TRO.
Highland Capital Mgmt., L.P. v. Dondero (In re Highland Capital Mgmt. L.P.), 2021 Bankr. LEXIS 1533, 2021 WL 2326350 (Bankr. N.D. Tex. June 7, 2021) (Jernigan, J.).

The Bankruptcy Court held a debtor's co-founder in civil contempt in the latest chapter in the contentious twenty-month plus bankruptcy of Highland Capital Management LP.

In the 1993, James Dondero and Mark Okada formed the investment advisory firm that would become Highland Capital and moved their business to Texas. Lean years gave way to success and notoriety until trouble hit in 2008. Over the next decade, Highland Capital found itself mired in consistent litigation against investors, investment banks, and at least two ex-employees. On October 16, 2019, with Dondero at the helm as its CEO, Highland opted to file a chapter 11 petition shortly before it was due in Delaware Chancery Court for a hearing related to a $189 million arbitration award against the firm's "Crusader" funds, launched with just $20 million in 2000 and valued to $3 billion by 2007, and about two weeks after Okada's retirement

announcement. By December 2019, Highland's reorganization case had been transferred to the Northern Texas Bankruptcy Court, and no other Highland-linked entity had followed.

When it later faced the prospect of the appointment of a trustee to oversee the case—and potentially wrest control of the process from its hands—Highland agreed to changes in its governance structure with its the Official Unsecured Creditors Committee and the U.S. Trustee. Per this accord, Highland removed Dondero as an officer of the bankrupt entity and as the director of its general partner, but left undisturbed his position as an employee and portfolio manager at Highland itself and his leadership roles at other entities owned by Highland-affiliated non-debtor entities. In October 2020, this uneasy coexistence ended when Highland's new independent board and manager opted to end Dondero's services.

Within a week of this termination, Dondero began challenging Highland's restructuring efforts, often joined by non-debtor entities that he directly or indirectly controlled as co-plaintiffs. Filed by Dondero and two entities—NexPoint Advisors, L.P., and Highland Capital Management Fund Advisors, L.P.—whose presidency he held and in which he enjoyed some indeterminate ownership stake, the first sought to impede the proposed sale of various Debtor assets by its chief restructuring officer, Jim Seery. In response, Highland first filed an adversary complaint for injunctive relief and then sought an entry of a temporary restraining order with the same goal in mind: to prevent Dondero from further interfering with its operations, management of assets, and pursuit of a plan. On December 10, 2020, the bankruptcy court issued the requested temporary restraining order. Within weeks, Dondero and another two linked entities—the Charitable DAF Fund LP and the CLO Holdco Ltd—sued Seery, among others, in the U.S. District Court for the Northern District of Texas. Accordingly, less than a month after the entry of the TRO, Highland filed a motion to hold Dondero in civil contempt of court for allegedly violating the TRO. As Highland LP contended, Dondero has not stopped his "vexatious" litigation strategy; rather, he and the entities he controlled had persisted.

Based on "convincing evidence," the Bankruptcy Court found Dondero to have violated the specific wording of the TRO. The court held that he had done so by interfering with Highland's decisions concerning disposition of its assets, communicated and conspired against Highland with its own employees. Emphasizing that a court's power to hold a litigant in contempt is an ancient one and heeding the longstanding, if muddled, purposive distinction between civil and criminal contempt,[7] the Bankruptcy Court held Dondero in civil contempt for numerous violations of sections 2(c) and 3(a) of the TRO, awarded $450,000 in compensation to Highland's estate, and promised to add $100,000 for any future unsuccessful motions for rehearing, appeals, or petitions for certiorari.

Confirmed Chapter 11 Case Converted to Chapter 7, Plan Trustee Ordered to Disgorge Fees. *Weigel v. Barnard, --- B.R.* ---, 2021 WL 3793794 (E.D.N.Y. Aug. 26, 2021) (Brown, J.).

The liquidating trustee was appointed under a plan that was confirmed in 2011. Over the next six years, the liquidating trustee disbursed all of the trust assets, including over $375,000 to

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[7] This aspect of the opinion implicates the applicability of § 362(b)(1)'s "criminal" exception to a class of ostensibly civil contempt orders designed to punish a debtor for his or her defiance of prior judicial orders and issued pre-petition by a state court, the subject of a multi-decade debate among scholars and federal courts.

pay the trustee's fees. After the case lingered, the Bankruptcy Court contacted the reorganized debtor to seek entry of a final decree. The reorganized debtor responded by filing a letter stating that the case was complete and ready for entry of a final decree. The U.S. Trustee filed an objection, noting that no operating reports had been filed since the second quarter of 2012, nor had statutory fees been paid.

The Bankruptcy Court scheduled a hearing to determine how to address the case in light of the filing and fee deficiencies. Finding the plan trustee to be responsible for the failure to file post-confirmation operating reports and remitting quarterly U.S. Trustee fees, the Bankruptcy Court concluded that the only recourse was to convert the case to Chapter 7 and order disgorgement of the trustee's fees. This appeal followed.

In this decision, the District Court affirmed Bankruptcy Court's authority and jurisdiction to use equitable powers, under §§ 105(a) and 1142 and Bankruptcy Rule 3020, to convert the case to Chapter 7 and compel the plan distribution trustee to disgorge fees he previously paid to himself as the remedy for the trustee's failure to pay post-confirmation U.S. Trustee fees and file post-confirmation quarterly reports.

II. CONTESTED MATTERS AND OTHER LITIGATION

A. CLAIM ALLOWANCE, SUBORDINATION, PRIORITY AND LIEN DISPUTES

Fifth Circuit Warns Oil and Gas Producers to Beware the "Amazing Disappearing Security Interest."

Deutsche Bank Trust Co. Ams. v. U.S. Energy Dev. Corp. (In re First River Energy, L.L.C.), 986 F.3d 914 (5th Cir. 2021) (Jones, J.).

The Fifth Circuit affirmed the Bankruptcy Court's order granting in part and denying in part a motion for summary judgment filed by a lender in respect of competing security interests over the proceeds from certain oil sales. In this case, the Debtor had purchased crude oil and condensate form certain producers (the "Producers") prior to the bankruptcy filing which it then sold to downstream purchasers. After the Debtor did not pay the Producers for the purchased oil, the Producers asserted statutory liens on the oil production and proceeds, which liens arise under both Texas and Oklahoma law. Deutsche Bank Trust Company Americas (the "Lender") asserted a competing lien on the sale proceeds based upon its lien on accounts receivable.

In ruling on the Lender's motion for summary judgment, the Bankruptcy Court below was required to wade through significant conflicts of law issues. The Lender's credit agreement with the Debtor was governed by Delaware law, and the control agreement between the parties and JPMorgan Chase, under which the Lender was granted a security interest in all of the Debtor's accounts held at JPMorgan Chase, was governed by New York law. The Texas Producers' purported lien rights to the sale proceeds stemmed from Texas UCC § 9.343, a non-standard provision which gives producers a first priority purchase money security interest in oil and gas produced in Texas as well as proceeds in the hands of any "first purchaser" like the Debtor. The Oklahoma producers relied upon the Oklahoma Lien Act, which creates a similar statutory lien but one unconnected to the Uniform Commercial Code.

Applying the Restatement (Second) of Conflicts of law, as Texas courts do, the Bankruptcy Court below looked to Texas UCC § 9.301, which applies the law of the jurisdiction where the debtor is located, and found that Delaware law would apply to the lien dispute as the Debtor was a Delaware LLC. It rejected the Producers' argument that Texas UCC § 9.343(p) displaces the general choice of law rules under the Texas UCC in sections 9.301 through 9.307, finding instead that the latter provisions made no exception for security interests created by section 9.343.

Because the Delaware UCC did not contain a provision similar to Texas UCC § 9.343, the Court found that the Lender's security interest was senior on account of its filed UCC-1 financing statements, which perfected the Lender's security interests and were on file prior to the sale of the oil in question. However, because the Oklahoma Lien Act was not tied to the UCC, and because the Delaware UCC does not preempt statutory liens created by other states, the Fifth Circuit affirmed the finding below that the Oklahoma Producers had the senior security interest in the oil sale proceeds. In fact, the Oklahoma Lien Act was enacted in large part to avoid the result suffered by the Texas Producers here, a point of which the Fifth Circuit suggested that the Texas Legislature should take note.

Claim for Attorneys' Fees Allowed in Part Under Section 502(b)(6) of the Bankruptcy Code. *In re RGN-Grp. Holdings, LLC*, No. 20-11961, 2022 Bankr. LEXIS 394 (Bankr. D. Del. Feb. 17, 2022) (Shannon, J.).

This case concerned the request of Teachers Insurance and Annuity Association of America ("***TIAA***") for the allowance of attorneys' fees and interest as part of its claim against the debtor H-Work, LLC and its affiliates (the "***Debtors***"). During the bankruptcy, TIAA timely filed a proof of claim against H-Work asserting damages arising from the breach of a commercial property lease in Dallas, Texas. The Debtors subsequently filed an objection to TIAA's Claim and, prior to trial, the parties agreed that the Debtors' objection to the portion of TIAA's Claim related to interest and attorneys' fees would be held in abeyance until the Court decided the main issues in dispute.

In October 2021, the Debtors objected to TIAA's request for attorneys' fees and interest. In December 2021, the Debtors filed a letter with supplemental authority in support of their objection to TIAA's interest claim. The Debtors objected to the allowance TIAA's claim for attorneys' fees, contending that: (i) neither the Lease nor applicable law permits TIAA to recover attorneys' fees on its claim; (ii) TIAA's requested fees are unreasonable; and (iii) other deficiencies and the doctrine of res judicata preclude recovery of a portion of TIAA's requested fees. TIAA first argued that the bankruptcy court allowed part of its claim and, therefore, it was a prevailing party that can recover its attorneys' fees. The Debtors disagreed, asserting that the Lease included at least preconditions to recovery that TIAA could not satisfy. Namely, that (a) the Lease required the lawsuit to be between parties to the Lease, and (b) that the Lease required TIAA to obtain a prevailing judgment in a lawsuit, and that a proof of claim is not lawsuit but, instead, a "written statement that a debt exists."

In rejecting the Debtors arguments, the Court concluded that even though H-Work has assigned its interest to an affiliate, it remained responsible for the obligations under the Leases. The Court further concluded that an objection to a proof of claim initiates a contested matter under Bankruptcy Rule 9014, and therefore satisfied the Lease's requirement that TIAA obtain a

prevailing judgment in a lawsuit. The Debtors also argued that TIAA's attorneys' fee claim was precluded by section 502(b)(6) of the Bankruptcy Code. Concerning this point, TIAA argued that the attorneys' fees did not fall within the "rent reserved" cap of section 502(b)(6)(A) of the Bankruptcy Code and, therefore, are not subject to the statutory cap. In doing so, TIAA relied on a three-part test, which requires a charge to meet a three-part test to constitute "rent reserved" under section 502(b)(6) of the Bankruptcy Code: (1) the charge must (a) be designated as "rent" or "additional rent" in the lease; or (b) be provided as the tenant's/lessee's obligation in the lease; (2) the charge must be related to the value of the property or the lease thereon; and (3) the charge must be properly classifiable as rent because it is a fixed, regular or periodic charge. *In re McSheridan,* 184 B.R. 91, 99-100 (9th Cir. B.A.P. 1995).

The Court agreed that the statutory cap on landlord damage claims is broader than the "rent reserved" analysis. Section 502(b)(6) of the Bankruptcy Code caps a landlord's claim "for damages resulting from the termination of a lease of real property." But – to determine whether attorneys' fees (and other non-rent costs) are *termination* damages, other courts have considered the following: Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the lease had not been terminated?" Previously, the Court issued a September 15, 20212 Opinion that allowed TIAA's claim against H-Work in three parts: (i) unpaid rent obligations outstanding as of the date of termination of the Lease ($19,720.44); (ii) broker commissions (reduced to $1,672,425.14); and (iii) tenant relocation expenses ($1,688,009.79). The Court disallowed TIAA's claim for lobby renovations ($2,056,169.57). However, only attorneys' fees related to the unpaid rent obligations accruing prior to termination of the lease would not be subject to the 502(b)(6) cap. TIAA's Claim for broker commissions and tenant relocation expenses, along with the attorneys' fees incurred in the pursuit of those claims, would not exist except for the termination of the Lease. therefore, those claims, and the attorneys' fees associated with them, were determined to be subject to the statutory cap set for the in section 502(b)(6) of the Bankruptcy Code.

The Debtors also argued against the allowance of the attorneys' fees in claiming that TIAA's attorneys' fee claim was unreasonable and should be disallowed or reduced. However, the Court found that, after careful review of the billing entries, the records submitted reflected intensive trial preparation, briefing, and discovery entirely consistent with what the Court would expect for a complex commercial trial. Next, TIAA argued that it was entitled to post petition interest on the Allowed Claim at the contract rate, as provided for under the Lease. The Debtors timely objected, contending that the appropriate rate for postpetition interest on unimpaired claims is the federal judgment rate. In reaching its conclusion, the Bankruptcy Court relied on a prior Delaware bankruptcy case – *In re Hertz Corp.,* 20-11218, 2021 Bankr. LEXIS 3491 (Bankr. D. Del. Dec. 22, 2021) – in which Judge Mary F. Walrath, observed that the federal judgment rate, rather than the contract rate, was the appropriate standard to determine the appropriate amount of postpetition interest payable to unimpaired creditors by a solvent debtor. Thus, the Bankruptcy Court agreed with the analysis set forth in the *Hertz* opinion, concluding that TIAA was entitled to interest on its allowed claim at the federal judgment rate.

Indenture Trustee Failed to Demonstrate a Substantial Contribution, Despite Clear Language In the Indenture Agreements Authorizing Payment of Fees Postpetition.
In re Sanchez Energy Corp., 2021 WL 1747364, 2021 Bankr. LEXIS 1175 (Bankr. S.D. Tex. May 3, 2021) (Isgur, J.).

The debtors issued an indenture prepetition. The Delaware Trust Company ("DTC") was the successor Indenture Trustee under such agreements. The debtors listed the indenture agreements as executory contracts on their bankruptcy schedules and ultimately rejected them under their confirmed chapter 11 plan.

Post-confirmation, DTC sought allowance of its fees pursuant to §§ 503(b) and 507(a)(2). The fees and costs were incurred post-petition but before the plan Effective Date. The reorganized debtor objected. The Bankruptcy Court noted that although indentures contemplated the allowance of fees and expenses incurred to be treated as administrative expenses in a bankruptcy case, such provision did not replace the Court's authority to grant or deny administrative claims. Thus, the Court turned to § 503(b)(3)-(5) for such analysis.

Section 503(b)(3)-(5) sets a higher standard for when creditors, including indenture trustees, and their respective professionals are entitled to administrative priority. DTC argued that the mere existence of 503(b)(3)-(5) did not preclude it from seeking reimbursement under § 503(b)(1)(A), as a reasonable and necessary expense of the estate. The Bankruptcy Court rejected this argument, however, explaining that such application would render § 503(b)(3)-(5) superfluous, because no indenture trustee would seek an administrative expense under the higher standards of § 503(b)(3)-(5), if all they had to show under section 503(b)(1)(A) was that the expense was a reasonable and necessary expense incurred by the estate. Despite the contractual language in the indentures authorizing DTS to seek attorneys' fees, the Bankruptcy Court denied the application, concluding that DTS failed to carry its burden of showing a substantial contribution to the estate.

Void or Voidable? The Distinction Proves Critical in Dispute Over Liens On Oil and Gas Leases.
In re Sanchez Energy Corporation, 2021 WL 923182 (Bankr. S.D. Tex. Mar. 10, 2021) (Isgur, J.).

The Bankruptcy Court determined that liens held by senior noteholders on certain oil and gas leases were potentially avoidable because the deeds of trust creating the liens failed to reference the leases in question with reasonable certainty. In this case, after discovering certain inaccurate references to the leases on the recorded deeds of trust, the senior noteholders filed correction affidavits in respect of the deeds of trust shortly before the Debtors' bankruptcy filing. After the bankruptcy was filed, an ad hoc group of unsecured noteholders suggested that the correction affidavits constituted avoidable preferences. The Debtors then confirmed a chapter 11 plan which allowed unsecured creditors to designate a representative to pursue the litigation over the liens.

The senior noteholders had also provided DIP financing to the Debtors, and in doing so obtained a lien on all unencumbered assets of the Debtors but not on avoidance actions or their proceeds. This meant that if errors on the deeds of trust were immaterial, the senior noteholders' pre-petition liens on the leases would be treated as if perfected. If the errors were material and

rendered the liens void, the leases would be considered unencumbered assets as of the bankruptcy filing and therefore would be subject to the senior noteholders' DIP liens. However, if the errors were material but only rendered the liens voidable, and the liens were then perfected by the correction affidavits, the senior noteholders would lose their lien on the leases if the correction affidavits were avoidable as preferences under § 547.

The errors on the deeds of trust related to the six challenged leases were of two main varieties, in some instances the leases were identified by reference to a single county with incorrect recording information, and in other instances the challenged leases or lease memoranda contained misleading property descriptions. There was no dispute that the correction affidavits fixed all of these errors which the senior noteholders described as merely clerical in nature.

The Bankruptcy Court found that three of the challenged leases were not identified with reasonable certainty on the deeds of trust, and that Texas and Fifth Circuit case law established that this rendered the liens voidable rather than *void ab initio*. The court then found that the correction affidavits may be avoidable as the granting of a lien on the leases constituted a transfer of the Debtor's property, and that transfer was not deemed to have occurred until the lien was perfected by the filing of the correction affidavits. Whether the correction affidavits were actually avoidable (i.e. whether the trustee could prove the remaining elements of § 547) was left for subsequent litigation.

Bonus Payment to Mineral Interest Holder Not Entitled to Secured Status Under Oklahoma Law.
In re Alta Mesa Resources, Inc., 2021 WL 1731774, 2021 Bankr. LEXIS 1121 (Bankr. S.D. Tex. Apr. 27, 2021) (Isgur, J.).

The working interest holder owned several oil and gas working interests in Kingfisher County, Oklahoma, part of a pooled well unit. One of the debtors ("Debtor") was the operator of the pooling unit. At one point, the Debtor notified the interest holder that it would drill three new wells in the pooling unit. Rather than operate them, the interest holder opted to receive a cash payment in place of royalty payments. The Debtor never completed the wells, and it, along with several affiliates ultimately filed chapter 11 bankruptcy. The interest holder filed a proof of claim asserting a secured claim for the bonus amount.

The Bankruptcy Court determined that working interest holder's prepetition election for a cash payment converted its royalty interests into a general unsecured claim for the agreed upon bonus. Likewise, it did not create a lien under applicable Oklahoma law because the debtors were not first purchasers of oil and gas and the bonus obligation was not an obligation to pay a sales price.

Creditor's Motions to Permissively Dismiss Claims and Remand Affirmed by District Court.
2999TC LP, LLC v. Hodges, 2021 WL 1375744, 2021 U.S. Dist. LEXIS 69973 (N.D. Tex. Apr. 12, 2021) (Pittman, J.).

Debtor-Appellants and Appellees entered into prepetition promissory notes whereby the Appellees were the lenders. Upon defaulting on the notes, Appellees sued in Tarrant County District Court. Appellees eventually moved for summary judgment, and on the eve of the hearing,

the Debtors filed for chapter 11 bankruptcy and subsequently filed a counterclaim. During the pendency of the bankruptcy, Appellees sought dismissal of their claims under Civil Rule 41(a)(2) against the Debtors and moved to have the claims remanded back to state court, upon which the Bankruptcy Court granted. Debtors filed an appeal in the U.S. District Court for the Northern District of Texas seeking reversal.

The District Court tackled two issues: (i) whether the bankruptcy court erred in granting the dismissal and (ii) whether the bankruptcy court erred in granting the remand. On the first issue, the District Court determined that dismissal of the case did not cause "harm or legal prejudice" to the Appellants, nor did it preclude them from prosecuting their counterclaim. On the second, after reviewing multiple factors, the District Court determined that the bankruptcy court was not clearly erroneous in remanding the case. The appeal was affirmed.

Court Allowed Late Filing of Claim, Despite Employees' Knowledge of the Bankruptcy Filing.
In re Helios & Matheson Analytics, Inc., 629 B.R. 772 (Bankr. S.D.N.Y. 2021) (Jones, J.).

The creditor was not listed on creditor matrix and, thus, did not receive formal notice of the claims bar date. However, certain employees of the creditor received "actual notice" of the bankruptcy before the bar date. Despite such notice, the Bankruptcy Court concluded under the circumstances that the employees' knowledge of the bankruptcy was insufficient to afford creditor "a reasonable opportunity to file a proof of claim" before the bar date. Thus, the Court granted a creditor's motion for leave under Bankruptcy Rule 3002(c)(6)(A) to file late claim in chapter 7 case.

Convenient but Ineffective – Email Service of Bar Date Ruled Not Sufficient to Establish Notice of Bar Date.
In re Cyber Litigation Inc., 2021 WL 4927550, 2021 Bankr. LEXIS 2905 (Bankr. D. Del. Oct. 21, 2021) (Goldblatt, J.).

The Bankruptcy Court held that notice of a bar date delivered via email does not comply with the Bankruptcy Rules and in itself is insufficient to enforce the bar date. In this case, service of the bar date to the debtor's largest unsecured creditor was mailed to the wrong address, though the proof of service indicated that the bar date notice was also sent to an email address actively used by the creditor's principal (though not for business). The creditor filed an untimely proof of claim, to which the debtor objected on grounds that it was not timely filed, and the creditor argued that it did not learn of the bar date until after it had passed.

Though the Bankruptcy Court noted that the email service to the creditor's principal seemingly satisfied due process insofar as a debtor truly desirous of informing a creditor of a bar date could easily determine that the most appropriate and effective way to do so would be to inform the creditor's principal through an email address known by the debtor to be used by the principal. However, it observed that satisfying due process is not enough—the debtor must also satisfy the Bankruptcy Rules, which do not allow for email service. Accordingly, as the Bankruptcy Rules provide for at least 21 days' notice by mail pursuant to Bankruptcy Rule 2002(a)(7), the Bankruptcy Court ruled that the bar date could not be enforced against the creditor in the absence of a showing that the error was harmless.

To establish that the error was harmless, the debtor was required to demonstrate that the creditor had actual, subjective knowledge of the bar date. The debtor was unable to do so. The creditor's principal testified that he was unaware of the bar date until he received a Bankruptcy Rule 2004 subpoena after the bar date had passed. He testified that he would have filed a claim in advance of the bar date had he been aware of it given that the creditor was owed approximately $350,000 from the debtor. The Bankruptcy Court therefore overruled the debtor's objection on the basis that the claim was not filed in advance of the bar date.

Words in an Agreement Matter as Evidenced by the Bankruptcy Court's Calculation of Royalty and Interest Rate.
Petty Bus. Enters., L.P. v. Chesapeake Exp., L.L.C. (In re Chesapeake Energy Corp.), 2021 WL 4190266, 2021 Bankr. LEXIS 2503 (Bankr. S.D. Tex. Sept. 14, 2021) (Jones, J.).

Before the bankruptcy filings, the debtors entered into a series of mineral leases with the lessor covering 25,000 acres in the Eagle Ford Shale formation. The leases were virtually identical but contained several unusually favorable terms for the lessor, including (i) calculation of royalties before the deduction of costs; (ii) variations of pricing formulas for royalties due from the production of specific minerals; (iii) imposition of royalties on all financial transactions, and (iv) provision of third-party beneficiary treatment for the lessor in any agreement affecting the sale, disposition or transportation of minerals attributable to the leases. A month before the bankruptcy, the lessor filed suit against the debtors seeking money damages for the alleged underpayment of royalty due under the leases.

First, the Bankruptcy Court determined the calculation of royalty as follows, pursuant to the terms of leases:

- *Natural Gas Liquids Claim*. The transportation and fractionation fee should have been added back to the royalty base prior to calculating the royalty on the NGLs.
- *Financial Derivative Claim*. Royalty was not due on gains from the debtor's financial hedging program because no *minerals* were specifically hedged or the subject of any derivative agreement. The leases required the involvement of *minerals*, and the lessor failed to produce any evidence that minerals were ever at risk in any hedging transaction.
- *Mile/Oil Condensate Pricing Claim*. The proper calculation of royalty on all oil, condensate and field liquids produced is based on the price received by the Lessee regardless of whether the purchaser is an affiliate. The adjustment for gravity and quality to the royalty base by the debtor was appropriate.

Next, the Bankruptcy Court considered the lessor's claims of breach of utmost good faith and fair dealing, holding that an error by the debtor in contract interpretation did not rise to the level of intentional breach of duty, especially without evidence from the lessor to support such claim. Similarly, the lessor failed to prove that the miscalculation of royalty was a breach of fiduciary duty and not just a mistake. Additionally, the Bankruptcy Court determined that the contractual language "the highest rate allowed by the law applicable to this transaction, but in no event, less than ten (10%) percent per annum" sufficiently specifies an interest rate. Finally, the Bankruptcy Court awarded attorney's fees for lessor.

Adversary Complaint Filed Before the Proof of Claims Bar Date Served as Timely Information Proof of Claim.
In re Expo Construction Group, LLC, 630 B.R. 289 (Bankr. S.D. Tex. 2021) (Rodriguez, J.).

The Bankruptcy Court applied the Fifth Circuit's *Nikoloutsos* test for determining whether an adversary complaint could qualify as an informal proof of claim. "This test requires that, to qualify as an informal proof of claim: (1) the claim must be in writing; (2) the writing must contain a demand by the creditor on the debtor's estate; (3) the writing must evidence an intent to hold the debtor liable for such debt; (4) the writing must be filed with the bankruptcy court; and (5) based upon the facts of the case, allowance of the claim must be equitable under the circumstances." *Nikoloutsos v. Nikoloutsos (In re Nikoloutsos)*, 199 F.3d 233, 236 (5th Cir. 2000) (adopting the test from *Reliance Equities, Inc. v. Valley Fed. Sav. & Loan Ass'n* (*In re Reliance Equities, Inc.*), 966 F.2d 1338, 1345 (10th Cir. 1992)).

Here, the complaint satisfied the test because: (i) it was in writing, (ii) it demanded monetary damages in a specific amount, (iii) it evidenced the intent to hold the debtor liable for the alleged misapplied funds, (iv) it was filed prior to the proof of claim bar date, and (v) disallowance of the informal claim by the bankruptcy court would be inequitable under the circumstances because the complaint was filed well before the bar date and the claimant is entitled to its share of the estate.

After Failed Attempt to File a Class Claim, and Two Year Delay to File Individual Claims, District Court Held that Claimants Demonstrated Excusable Neglect Warranting Leave to File Late Claims.
W. Wilmington Oil Field Claimants v. CJ Holding Co., 2021 WL 3356371, 2021 U.S. Dist. LEXIS 149292 (S.D. Tex. Jun. 29, 2021) (Rosenthal, C.J.).

Before the Court was an appeal from the bankruptcy court's order denying the appellant's motion to file late-filed proofs of claims on behalf of the 96 individual creditors who comprised a putative class of wage claimants. During the course of the bankruptcy, there was some confusion about whether the appellants needed to file individual proof of claims or whether they could rely on previously filed class proof of claims. The bankruptcy court denied the appellant's motion, finding that the claimants failed to meet the standards of excusable neglect. The individual claims were filed two years and nine months after the bar date.

The District Court reversed, holding that the appellant carried its burden because the record reflected that: (i) the appellant-claimants acted in good faith; (ii) there was little to no danger of prejudice the debtors because the plan already included a disputed claims reserve, and the class claim put the debtors on notice of the individual claim amounts in dispute; (iii) while the 2+ year delay to file the individual proof of claim was a long time, the District Court found that the delay would "not significantly affect the bankruptcy proceedings" because the plan already contemplated such a lengthy delay to allow similarly situated claimants to liquidate their individual and class claims in California federal court; and (iv) the delay was caused by circumstances beyond the claimants' reasonable control. Specifically, the claimants' counsel struggled to locate and contact all 96 individual claimants, and the delay was prolonged by counsel's efforts to negotiate a global resolution. Under these circumstances, the District Court found that the appellant- claimants

demonstrated cause for relief, and that the bankruptcy court erred in denying leave to file late claims over two years after the bar date.

Government Waiver Extinguished Surety's Subrogation Rights Because Claims Were Not "Paid in Full."

Giuliano v. Ins. Co. of State of Pa. (In re LTC Holdings, Inc.), 10 F.4th 177 (3d Cir. 2021) (Smith, J.).

At common law, the right of subrogation arises when a surety pays the debt of another, but has two limitations: (1) the surety/subrogee takes no more rights than the subrogor/creditor had; and (2) payment in full is typically required before rights are subrogated. In this case, the Third Circuit explained that section 509 "is the statutory enactment of the long-standing doctrine of equitable subrogation." *Id.* (quoting *In re Chateaugay Corp.*, 89 F.3d 942, 947 (2d Cir. 1996)).

Unlike common-law subrogation, subrogation under § 509(a) allows a surety to obtain partial subrogation "to the extent the surety has made *any* payments" to the creditor. However, § 509(c) provides that the surety/subrogee is then "subordinated to the remainder of the creditors' claim until the creditor has been paid in full." *Id.*

In this case, the Third Circuit considered the meaning of "paid in full" under § 509(c). The debtor was a contractor that defaulted on its obligations to the United States to construct the $55 million National Police Command Center in Afghanistan (the "NPCC Contract"). The United States made demand on the debtor's surety, the Insurance Company of the State of Pennsylvania ("ICSP") to honor its surety obligations. ICSP hired and paid a third-party contractor over $12 million to complete the construction.

The status of the United States' claim was critical because the United States waived its right to set off part of its $222 million claims against the debtor's $5.5 million tax refund. The settlement followed a mediation with the trustee, a secured creditor and ICSP. The result of the mediation was that ICSP reserved a right to assert an interest in the $5.5 million tax refund, although the settlement order did not specifically elaborate on what those rights were.

To determine exactly what ICSP reserved, the Third Circuit first had to consider whether the United States had been "paid in full" at the time of the settlement order. It concluded that no reasonable finder of fact could reach this conclusion given that the $55 million NPCC Contract represented only a small portion of the United States' $222 million claims, and the record indicated that the final payments on the NPCC Contract were made *after* the bankruptcy court entered the settlement order. Thus, the Court concluded that the United States was not "paid in full" as of the time of its waiver, and that ICSP's subrogation rights were subordinate to the United States at such time.

Having concluded that ICSP's subrogation rights were subordinated, the Third Circuit concluded that the United States was authorized to waive its setoff rights as part of a settlement of its other claims against the estate, and that such a waiver would have extinguished any rights ICSP may have asserted in the tax refund. After all, a subrogee can obtain no greater interest than the subrogor possesses.

B. CONFIRMATION DISPUTES

After Overruling U.S. Trustee's Objection to Plan Releases, Court Denies Stay Pending Appeal.
In re Retail Group, Inc., 2021 WL 2188929, 2021 Bankr. LEXIS 1455 (Bankr. E.D. Va. May 28, 2021) (Huennekens, J.).

The U.S. Trustee appealed exculpations and third-party releases approved in a confirmed plan and sought a stay pending appeal. In this decision, the Bankruptcy Court denied a stay, concluding that the U.S. Trustee failed the four-part test, most notably the first element—likelihood of success on the merits. The Bankruptcy Court explained that the U.S. Trustee's challenges to the form and manner of the "opt out" notices were not only late, but were also "disingenuous."

The Bankruptcy Court noted that the "crux" of the U.S. Trustee's argument was that a third-party release cannot be binding on creditors unless they take some affirmative steps to opt in. However, the Bankruptcy Court gave examples under the Bankruptcy Code where "the absence of such affirmative action" leads to a loss of a creditor's rights, such as filing a proof of claim or responding to an objection to claim. Based on such specific examples, it concluded that the "opt out" notice procedures employed in the case were "entirely consistent" with the requirements of Bankruptcy Code. The Bankruptcy Court also found that the U.S. Trustee failed to prove that the balance of equities favored a stay or that a stay would serve the public's interest.

Solvent Debtors Impair Creditors' Claims Unless They Pay Contractual Rate of Interest Under Plan.
In re Ultra Petroleum Corp., 624 B.R. 178 (Bankr. S.D. Tex. 2020) (Isgur, J.).

What happens when you have a solvent debtor who seeks to leave creditors unimpaired for voting purposes? Can the solvent debtor propose a uniform plan rate of interest, or must the debtor pay the contractual or some statutory judgment rate? Section 1124(1) defines impairment in terms of whether creditors' rights are left unaltered by "the plan." But how far does this definition go?

In October 2020, Judge Isgur applied the "solvent-debtor exception," concluding that if a debtor is solvent, a plan "impairs" that creditor unless the solvent debtor pays the interest provided for under the creditor's contract, or other applicable law. "The underlying purpose of the [solvent debtor] exception, recognized for nearly three hundred years, is that a debtor must repay its debts in full when it has the means to do so. This means that when a debtor is solvent, 'a bankruptcy court's role is merely to enforce the contractual rights of the parties.'" *Id.* (quoting *In re Dow Corning*, 456 F.3d 668, 679 (6th Cir. 2006)).

California v. Texas – California Bankruptcy Court Rejects the "Solvent Debtor Exception."
In re Cuker Interactive, LLC, 622 B.R. 67 (Bankr. S.D. Cal. 2020) (Adler, J.).

Months after Judge Isgur's ruling in *Ultra Petroleum*, Judge Adler considered the same issue and reached the opposite result. In this case, the debtor was solvent and proposed to provide creditors with a "plan" rate of interest necessary to leave creditors "unimpaired" by the plan. Under binding Ninth Circuit precedent, the Court of Appeals held that the Federal Judgment Rate was the applicable post-petition "legal rate" necessary to be paid to creditors where a debtor is solvent.

See In re Cardelucci, 285 F.3d 1231 (9th Cir. 2002). This decision was followed by Bankruptcy Court in the Northern District of California in 2019. *See In re PG&E Corp*, 610 B.R. 308, 312-13 (Bankr. N.D. Cal. 2019) ("The rule in the seventeen years since *Cardelucci* is clear: unsecured creditors of a solvent debtor will be paid the Federal Interest Rate whether their prepetition contracts call for higher or lower rates, or applicable state law judgment rates are higher, or there are no other applicable rates to consider.").

Thus, while Judge Adler considered Judge Isgur's reasoned decision in *Ultra Petroleum*, this Bankruptcy Court concluded that *PG&E* and *Cardelucci* remained binding. "If the 'solvent-debtor exception' were applied to a debtor with hundreds or thousands of creditors, the estate might be compelled to carry on indefinitely, at a large administrative expense, determining the individual contractual rights of each individual unsecured creditor, and perhaps, resulting in different treatment to creditors of the same class." Accordingly, the *Cuker* Court rejected the "solvent debtor exception" and held that the Federal Judgment Rate was the applicable "legal rate" necessary to leave creditors' legal rights unaltered by the plan.

District Court Affirmed Feasibility, Finding No Error in Bankruptcy Court's Line of Questioning.
In re Quintela Grp, LLC, 2021 WL 4295247, 2021 U.S. Dist. LEXIS 179710 (S.D. Tex. Sept. 20, 2021) (Hanks, J.).

On this appeal, the Internal Revenue Service ("IRS") challenged Bankruptcy Judge Lopez's order confirming the debtor's plan of reorganization. The debtor was a small consulting company, which proposed a plan that would pay the IRS's priority tax claims over a period of time just under five years, as authorized by § 1129(a)(9)(C). The IRS objected to the plan on the basis that the plan was based on unrealistic projections and, therefore, not feasible.

During the confirmation hearing, the IRS objected to the admissibility of the debtor's financial projection exhibits because the debtor did not exchange them within the time required under local rule. Judge Lopez sustained the objection and excluded the exhibits (although, on appeal, the District Court questioned this ruling, noting that the IRS clearly had the underlying projections weeks in advance of the confirmation hearing, as evident from the IRS's own filings).

Perhaps one of the most interesting points of error raised on appeal was the IRS attorney's objection to the Judge Lopez's own line of questioning concerning the financial projections. In overruling the IRS's objection, Judge Lopez explained: "I'm asking where the numbers came from. What facts did he have? What facts can be in evidence? Just asking where they came from. He can answer that."

In this appeal, the District Court found no error in Judge Lopez's line of questioning, concluding that Judge Lopez was free to elicit testimony from the debtor's principal to determine the source of the debtor's past and anticipated revenue projections. Even though Judge Lopez sustained the IRS's objections to the *exhibit*, the District Court agreed that the debtor's testimony adequately supported the Bankruptcy Court's findings of feasibility, and that none of the testimony "quoted from the excluded documents or read them into the record."

The District Court noted that the appeal was apparently equitably moot in light of the debtor's substantial consummation of the plan without a stay pending the appeal. Because no party moved to dismiss the appeal as moot, however, the Bankruptcy Court ruled on the merits.

C. Post-Confirmation and Discharge Matters

Fifth Circuit Finds UST Fee Increase Constitutional.
In re Buffets, L.L.C., 979 F.3d 366 (5th Cir. 2020) (Costa, J.).

To address budget shortfalls and ensure continued funding of the United States Trustee Program, Congress enacted the Bankruptcy Judgeship Act of 2017 ("2017 Act"), which increased the quarterly fees payable to the United States Trustees ("UST") under 28 U.S.C. § 1930(a)(6) for fiscal years 2018 through 2022 if the United States Trustee System Fund (the "Fund") balance fell under $200 million. Per the 2017 Act, if the Fund balance was not maintained, the statutory fees for a debtor could be 1% of total quarterly disbursements, up to $250,000.

Buffets, L.L.C. ("Buffets") and its affiliates filed their chapter 11 cases in 2016—before the enactment of the 2017 Act. However, post-confirmation, the reorganized debtors challenged the constitutionality of the 2017 Act, as applied to them, arguing that the statutory fee calculation should exclude operating expenses. The Bankruptcy Court initially rejected this argument but, on reconsideration, found that the rate increases under the 2017 Act violated the U.S. Constitution in numerous ways. On direct appeal, the Fifth Circuit reversed the Bankruptcy Court decision finding the rate increases were constitutional and not in violation of the uniformity provisions of the Constitution.

Buffets presented five arguments that were all rejected by the Fifth Circuit. *First*, Buffets again argued that "disbursements" should not include operating expenses, which the Fifth Circuit found to be in conflict with the plain language of § 1930(a)(6). *Second*, Buffets asserted that the fee increase could not apply to bankruptcy cases that were underway prior to the enactment date of the 2017 Act. The Fifth Circuit also rejected this argument on plain language grounds as the text of the 2017 Act provided that the fee increase applied to "disbursements made in any calendar quarter that begins on or after" the 2017 Act's enactment date, and that Congress has previously increased rates and applied them to pending chapter 11 cases. *Third*, Buffets argued that application of the quarterly fee increase in pending cases was impermissibly retroactive. The Fifth Circuit noted the due process concerns regarding retroactive application of statutory changes and the presumption against retroactivity, but found the fee increase to be prospective, even though it applied to an entity who initially sought bankruptcy protection before the 2017 Act became effective. The increased quarterly fees only applied after the enactment date and did not impair any rights or increase liability for past conduct. *Fourth*, Buffets brought a due process challenge asserting the quarterly fee increase was excessive and violated Buffets substantive due process rights. The Court rejected these arguments stating that the 2017 Act "easily survived" rational basis review as the fee increase was meant to address potential budget shortfalls, only applied if such a shortfall occurred and the quarterly fee increase was capped at 1% or less of quarterly disbursements, which was lower than the fees certain small debtors are required to pay.

After addressing these preliminary arguments, the Court turned to the constitutional question of uniformity. Bankruptcy Courts are split between those that are part of the United States

Trustee Program ("UST Districts") and those that use Bankruptcy Administrators ("BA Districts"). Six districts located in Alabama and North Carolina are BA Districts, which are funded by the judiciary's general budget, which is set by the Judicial Conference unlike the UST Districts that are funded by fees paid by debtors.

The constitutionality of this dual system was challenged over 25 years ago leading Congress to amend 28 U.S.C. § 1930(a)(7) to give the Judicial Conference discretion to set fees in the six BA Districts "equal to those imposed" in the UST Districts. That amendment seemed to fix the constitutional problem until the 2017 Act increased the fees for cases filed in UST Districts, but not BA Districts. The Judicial Conference delayed its implementation of the fee rate increases in BA Districts until the third quarter of 2018, meaning that fees charged in the first three quarters of 2018 were higher in UST Districts. Subsequently, Congress passed the Bankruptcy Administration Improvement Act of 2020 which clarified that the Judicial Conference no longer had discretion with respect to the rates charged in BA Districts.

Buffets argued that this lack of uniformity rendered the 2017 Act unconstitutional as it violated the uniformity principle of the Bankruptcy Clause in the Constitution. A split panel of the Court of Appeals for the Fifth Circuit disagreed and held that the 2017 Act did not violate the uniformity provisions of the Bankruptcy Clause to the U.S. Constitution, because the "geographically isolated problem" exception allowed for disparate treatment between UST Districts and BA Districts, and although the fee increases were initially enacted only in UST Districts, the difference was not the result of "arbitrary regional differences" and thus was not unconstitutional.

Since the Fifth Circuit's split-panel ruling in *Buffets*, three other Circuit Courts have opined on the issue. On April 29, 2021, a split-panel of the Fourth Circuit joined the Fifth Circuit in upholding the constitutionality of the fee rate increase set forth in the 2017 Act. *See In re Circuit City Stores, Inc*. 996 F3d 156 (4th Cir. 2021). Less than one month later, on May 24, 2021, a unanimous panel of the Second Circuit rejected the constitutionality of the 2017 Act. *See In re Clinton Nurseries, Inc.*, 998 F.3d. 56 (2d Cir. 2021). Finally, on October 5, 2021, a split panel of the Tenth Circuit agreed with the Second Circuit, and held that the 2017 Act was unconstitutionally nonuniform. *See In re John Q. Hammons Fall 2006, LLC*, --- F.4th ---, 2021 WL 4535285 (10th Cir. Oct. 5, 2021).

Upon Reconsideration, Chapter 11 Plan Extinguished State Statutory Lien.
QuarterNorth Energy LLC v. Atl. Mar. Servs. (In re Fieldwood Energy LLC), No. 20-3476 (Bankr. S.D. Tex. Feb. 23, 2022) (Isgur, J.).

Atlantic Maritime provided drilling services for Fieldwood and asserted statutory privileges against Fieldwood under the Louisiana Oil Well Lien Act ("***LOWLA***") after Fieldwood failed to pay for services rendered. Pursuant to its chapter 11 plan, Fieldwood sold certain assets to QuarterNorth Energy LLC. QuarterNorth alleged that it would be required to indemnify working interest owners if Atlantic successfully enforced its privileges under LOWLA and sought a determination that Fieldwood's bankruptcy plan had extinguished Atlantic's LOWLA privileges. In October 2020, the Bankruptcy Court ruled that Fieldwood's chapter 11 plan did not extinguish Atlantic's privileges and that Atlantic could proceed with pending litigation in the Federal District Court in Louisiana. *See QuarterNorth Energy LLC v. Atl. Mar. Servs. (In re Fieldwood Energy*

LLC), No. 20-33948 (Bankr. S.D. Tex. Oct. 15, 2021). QuarterNorth filed a motion to reconsider the Bankruptcy Court's ruling, arguing that the prior ruling was premised on mistaken facts: (i) that Fieldwood's disclosure statement failed to say that its chapter 11 plan would extinguish Atlantic's LOWLA privileges; (ii) that Fieldwood had previously indicated that the plan would not cause Atlantic to lose any rights; and (iii) that the plan sought an injunction. After concluding that reconsideration was appropriate under Rules 54(b), 59, and 60 of the Federal Rules of Civil Procedure, the Bankruptcy Court examined Fieldwood's plan and concluded that it extinguished its debt to Atlantic on the effective date of its chapter 11 plan, and thus had satisfied and settled Atlantic's claim, regardless of whether a distribution was made. Further, Fieldwood's disclosure statement provided Atlantic with notice that it sought to extinguish its LOWLA privileges. Finally, because Fieldwood had sought declaration regarding the extinguishing of LOWLA liens and not an injunction, Fieldwood did not violate Bankruptcy Rule 3016(c), which requires that "the plan and disclosure statement shall describe in specific and conspicuous language . . . all acts to be enjoined."

Bankruptcy Court's Interpretation of the Trust Agreement Determined that Priority Tax Claims Due to the IRS Were Not to be Paid from Litigation Proceeds.
In re Waggoner Cattle, LLC, 2021 WL 2021202, 2021 Bankr. LEXIS 1367 (Bankr. N.D. Tex. May 20, 2020) (Jones, J.).

Post-Confirmation Litigation Trustee sought authorization to disburse recovered litigation proceeds to only general unsecured creditors. The Debtors objected, arguing that the Litigation Trust Agreement required the proceeds be distributed to all unsecured creditors, including both general unsecured creditors and unsecured priority claimants, specifically priority tax claims. The dispute was over the definition of "Allowed Claims" as defined in the Litigation Trust Agreement.

The Litigation Trust Agreement provided that any proceeds recovered from retained litigation are to be paid over to holders of "Allowed Claims." The Litigation Trust Agreement defined "Allowed Claims" as:

> (a) either (i) proof of which has been timely filed with the Bankruptcy Court or has been deemed timely filed by a Final Order; or (ii) if not so filed, scheduled by the Debtors other than as disputed, contingent, or unliquidated; or (iii) any stipulation of amount and nature of a Claim filed prior to entry of the Confirmation Order; and (b) allowed by a Final Order, by the Confirmed Plan, or because no party in interest timely has filed an objection, filed a motion to equitably subordinate, or otherwise sought to limit recovery on such Claim and was classified as a general unsecured claim under the Confirmed Plan.

The Bankruptcy Court held that the construction of an "Allowed Claim," as defined, must satisfy both subpart (a) and subpart (b). The two subparts of the definition were joined by the conjunction "and" to signify that both parts must satisfy the definition of "Allowed Claim."

Next, the Bankruptcy Court turned to the language of both the confirmed plan and the confirmation order. The definition of "general unsecured claim" in both the plan and the

confirmation order did not include administrative, secured, or priority claims. Furthermore, the plan and confirmation order specifically provided that the claims and causes of action transferred to the Litigation Trust were preserved for the benefit of the debtor's unsecured creditors. Thus, the Court construed the provision to mean that only general *non-priority* unsecured creditors were to be paid with the litigation proceeds. Moreover, the Bankruptcy Court noted that the Plan provided that the Debtors continued operations would generate the necessary funds to pay other classes of creditors, including priority unsecured claims.

Bankruptcy Court Held Discharged Debtor Cannot be Forced to Incur Uninsured Defense Costs.
In re Tailored Brands, Inc., 2021 WL 2021472, 2021 Bankr. LEXIS 1375 (Bankr. S.D. Tex. May 20, 2021) (Isgur, J.).

Prepetition litigation plaintiff sought relief from the plan discharge injunction to pursue litigation against the discharged debtors under the insurer exception pursuant to § 524(e), which allows plaintiffs to pursue actions against the discharged debtors solely to establish the debtor's nominal liability so to recover directly from the debtor's insurance. However, the plaintiff had failed to file a proof of claim during the pendency of the case. The plaintiff argued that the cost incurred by the debtors to litigate ($179,000) was negligible given the size of the debtors' estates. In denying the plaintiff's request, the Bankruptcy Court held that § 524(e) does not contemplate evaluating the equities. The debtors were required to exhaust their self- insured retention before the policy's coverage took effect. Thus the Bankruptcy Court held that § 524 precluded the plaintiff from forcing the discharged debtors to incur uninsured defense costs or liabilities.

Bankruptcy Court Defines an "Asbestos Prepetition Claim" and Confirmation as a Proxy for Notice in the Absence of Any Official Records for a 1983 Bankruptcy Case that Closed in 1990.
I*n re United Refining Co.*, Bankr. 2021 WL 160433, 2021 Bankr. LEXIS 105 (Bankr. S.D. Tex. Jan. 16, 2021) (Lopez, J.).

United Refining Company filed for bankruptcy almost 40 years ago in 1983, confirmed its plan of reorganization in 1988 and closed its bankruptcy case in 1990. Twenty-eight years later, the estate of one of United Refining's former employees filed a wrongful death suit alleging that the employee had been exposed to asbestos while working for United Refining in the 1960s, leading to a mesothelioma diagnosis in 2016 and, ultimately, his death in 2017. The estate pursued litigation against United Refining for two years until, in July 2020, United Refining moved to re-open its bankruptcy case to determine that any liability to the employee had been discharged under its 1988 plan. Complicating things was that no official records remained from United Refining's bankruptcy case. Indeed, "[n]o official docket (hard copy or electronic), no record of the entries in the docket, no affidavits of service, no disclosure statement, and no schedules of assets and liabilities" were available, and that the only available court documents were "a copy of the Plan, the Confirmation Order, and a few miscellaneous post-confirmation orders retained by United Refining."

Confronted with this empty record, the Bankruptcy Court addressed when a tort claim generally and an asbestos claim in particular is deemed to arise for purposes of determining whether it was discharged— either the time of exposure, *i.e.* the time at which the damaging act

occurred, or of the harm's diagnosis, *i.e.* the date of discovery—in a January 2021 decision issued in the re-opened United Refining Company bankruptcy case. The bankruptcy court first canvassed several different tests that various U.S. courts of appeals had applied over the years in determining when asbestos-related claims are deemed to arise and then applied the Fifth Circuit's "prepetition relationship" test. Because the employee and United Refining had an employer-employee relationship at the time the alleged asbestos exposure occurred, the claim arose at the time of the conduct and thus prepetition.

This result, however, left open a second question: whether the claimant had constructive (or legally sufficient) notice of the bankruptcy, a query hampered by the aforementioned lack of records. Based on two conclusions—that all creditors are bound by the terms of a confirmed plan, and that the Bankruptcy Code "imposes no requirement on chapter 11 debtors to maintain copies of the official court docket to back up the National Archives"—the bankruptcy court found that the employee's claim was discharged. It characterized the confirmation order as "prima facie evidence that prepetition claims were discharged and that proper notice was provided to parties-in-interest," as, in the absence of any definitive records, its "findings … that notice to parties-in-interest was proper is uncontroverted and stands."

D. AVOIDANCE ACTIONS

Court Partially Denies Chapter 7 Trustee's Summary Judgment for Multiple Counts of Fraudulent Transfers.
Sherman v. OTA Franchise Corp. (In re Essential Financial Education, Inc.), 629 B.R. 401 (Bankr. N.D. Tex. 2021) (Larson, J.).

This well-written opinion analyzes cross motions for summary judgment on a Chapter 7 trustee's fraudulent transfer claims and the defendant transferee's defenses. The opinion addresses a wide range of topics, ranging from whether fraudulent intent can be established as a matter of law, to what level of evidence is needed to establish ordinary course of business. The Debtor was placed into an involuntary Chapter 7 following a franchise agreement gone awry.

The Chapter 7 Trustee initiated an adversary proceeding against one of the Debtor's creditors ("Transferee") for multiple causes of action under the Bankruptcy Code and the Texas Uniform Fraudulent Transfer Act ("TUFTA").

The Bankruptcy Court first considered whether a transfer of property was made and whether the debtor had a legal and equitable interest in the property transferred. There was no dispute about the timing of the transfer, and the Bankruptcy Court found that the pre-petition lender's failure to properly perfect its security interests left assets sufficiently unencumbered to give the debtor an equitable interest in the property. Thus, the Bankruptcy Court concluded that the Trustee was entitled to partial summary judgment on the first two elements of the actual fraudulent transfer count.

The Bankruptcy Court next analyzed actual intent to hinder, delay, or defraud the Debtor's creditors—the final element of the actual fraudulent transfer count. Despite a pre-petition admission by the debtor to hinder, delay or defraud creditors, the Bankruptcy Court found insufficient evidence in the record to link this admission to the specific transfer at issue. Thus, the

Bankruptcy Court declined to apply any form of estoppel or "pseudo-estoppel" to find fraudulent intent as a matter of law, leaving the "badges of fraud" as the only way to determine actual intent.

With respect to the "badges of fraud," the Bankruptcy Court determined that the Trustee had established several "badges" as a matter of law, but concluded that there remained genuine issues of material fact on several other "badges" such that a trial would be necessary to determine this issue.

The Bankruptcy Court then turned to the Trustee's constructive fraudulent transfer counts, but found genuine issues of material fact concerning the existence of reasonably equivalent value in exchange for the transfers. Specifically, the Bankruptcy Court explained that the only two facts presented in support of this element of the Trustee's motion—i.e., the absence of affirmative valuation evidence from the Trustee's expert, and creditors' lack of control over the prepetition transfer—fell short of the proof needed to conclusively establish that the transfer was made for less than reasonably equivalent value. Accordingly, the Bankruptcy Court denied summary judgment on these counts.

Although the Trustee did not seek summary judgment on its remaining preference counts, the parties filed cross motions on the Transferee's affirmative defenses, including contemporaneous exchange of new value, ordinary course of business, and subsequent value defenses. The Bankruptcy Court analyzed each in turn.

First, the Bankruptcy Court considered the Transferee's potentially strongest defense—contemporaneous exchange of new value—but could find such a defense to exist as a matter of law because the record was "devoid of any evidence to establish the new value prong." The Bankruptcy Court simply noted that the Transferee "may have a formidable argument at trial."

With respect to the ordinary course defense, the Bankruptcy Court granted summary judgment for the Trustee on one of the transfers, finding that the transfer was sufficiently outside the norm that no reasonable factfinder could conclude that it was made in the ordinary course of business. For the remaining transfers, the Bankruptcy Court found a genuine issue of material fact, leaving the issue for trial. Finally, with respect to the subsequent new value defense, the Bankruptcy Court granted summary judgment in favor of the Trustee, concluding that there was no dispute that the transfer at issue was the last transaction between the parties, leaving no possibility for subsequent value to establish a defense at trial.

Federal Pleading Requirements Do Not Include the Requirement of Disproving Affirmative Defenses.

Schmidt v. Fuchs (In re Black Elk Energy Offshore Operations, LLC), 2021 WL 346226, 2021 Bankr. LEXIS 227 (Bankr. S.D. Tex. Feb. 1, 2021) (Isgur, J.).

A litigation trustee sought to recover fraudulent transfers or preferences paid to various equity owners of the Debtor, alleging that the Debtor and its largest equity holder schemed to sell assets and divert proceeds from secured lenders to equity holders by using the sale proceeds to redeem certain preferred equity instead of using them to pay down secured indebtedness. The trustee sought to recover from the equity holders as subsequent transferees of the sale proceeds, having already obtained default judgments against the initial transferees. Certain defendants

asserted that they were good faith transferees without knowledge of the scheme and moved to dismiss the claims.

The trustee alleged that to avoid having the sale proceeds flow to secured creditors, the Debtor's largest equity holder fraudulently manufactured a group of consenting "disinterested" noteholders that allegedly voted on an amendment to the secured notes to allow the sale proceeds to be used to redeem the preferred equity. In fact, the Debtor's largest equity holder controlled this group of noteholders though that fact was not disclosed.

The Bankruptcy Court noted that it was unclear within the Fifth Circuit whether the heightened pleading standard for fraud claims under Civil Rule 9(b) apply to fraudulent transfer claims. Without deciding the issue, the Bankruptcy Court found that the trustee's complaint met the standard regardless of whether it applied, as the trustee's complaint described the alleged scheme in detail. Likewise, the Court found that the allegations, if true, suggest that the preferred equity redeemed by the sale proceeds was not worth the redemption price, and thus the Bankruptcy Court found that the complaint adequately pled claims for constructive fraud.

The Bankruptcy Court rejected the defendants' argument that because the allegations in the complaint were insufficient to establish that they acted in bad faith, the complaint establishes on its face that the defendants acted in good faith. Rather, it noted that the trustee is not required to disprove an affirmative defense in its complaint, even though the complaint alleges facts that may be relevant to such affirmative defense.

However, in respect of punitive damages sought by the trustee against the defendants under the Texas Uniform Fraudulent Transfers Act ("TUFTA"), the Bankruptcy Court found that the trustee is not entitled to punitive damages because the complaint makes no allegations that the defendants owed any duty to the Debtor, acted with malice or with gross negligence in respect of the Debtor, or that they participated in the fraudulent scheme.

Liquidating Trustee Allowed to Pursue Fraudulent Turnover Claims Against Bank Allegedly Involved in Debtor's Check-Kiting Scheme.
Faulkner v. AimBank (In re Reagor-Dykes Motors, LP), 2021 WL 1219537 (Bankr. N.D. Tex. Mar. 30, 2021) (Jones, J.)

A liquidating trustee brought avoidance and other actions against a defendant bank ("Bank"), alleging that it helped the Debtor's CFO defraud the Company and several of its creditors in a large-scale check-kiting scheme. The Bank filed motions to dismiss under Civil Rule 12(b)(1) and (b)(6). The Bankruptcy Court, however, determined that the Bank was not entitled to dismissal based on lack of standing under Civil Rule 12(b)(1) because the Bank was not denied due process concerning the disclosure of plan amendments and retained causes of action. The reservation of claims plan was specific, thus sufficient to preserve the causes of action in the complaint under § 1123(b)(3). Lastly, the Bankruptcy Court rejected the motion to dismiss under Civil Rule 12(b)(6), concluding that the complaint stated a sufficient basis for relief, including claims under § 548 relating to debtors' alleged check-kiting scheme.

Payments Made before Execution of Contract Were Reasonably Equivalent Value, Not Constructive Fraudulent Transfers under § 548.
Germans Pellets La., L.L.C. v. Wessel GmbH (In re La. Pellets, Inc.), 838 Fed. Appx. 45 (5th Cir. 2020) (per curiam).

The liquidating trustee for the reorganized debtor's estate appealed adverse decisions by the Bankruptcy Court and the District Court to the Fifth Circuit seeking to avoid transfers made to a foreign creditor as constructive fraudulent transfers under section 548 of the Bankruptcy Code and under Louisiana Civil Code article 2036 for increasing the debtor's insolvency. The liquidating trustee ultimately sought to avoid five invoiced payments to the creditor, two of which were for services rendered prior to execution of the contract creating the obligations for either party.

The Fifth Circuit found that none of the invoices were constructive fraudulent conveyances as the disputed payments (i) provided the debtor with reasonably equivalent value in the form of future expected benefits and (ii) satisfied antecedent debt of the debtor.

The Fifth Circuit found that the two invoices submitted prior to execution of the contract creating such obligations were on "tenuous footing" as it was unclear whether there was any payment of antecedent debt. Despite this tenuous footing the Fifth Circuit found that the debtor received reasonably equivalent value from the two invoices in the form of keeping the potentially valuable project alive and preserving the expected future value thereof. The three remaining invoices sent after execution of the contract were found to provide reasonably equivalent value in the form of a dollar for dollar reduction of antecedent debt.

Former LLC Manager's Foreclosure Sale of LLC's Property Was a Breach of Fiduciary Duty, Bankruptcy Trustee Allowed to Avoid the Sale Under Bankruptcy and State Law.
Valley Ridge Roofing & Constr., LLC v. Silver State Holdings, Assignee—7901 Boulevard 26 LLC (In re Silver State Holdings, Assignee—7901 Boulevard 26 LLC), 2020 Bankr. LEXIS. 3531, 2020 WL 7414434 (Bankr. N.D. Tex. Dec. 17, 2020) (Mullin, J.).

In a bankruptcy adversary proceeding, the bankruptcy trustee of a Texas limited liability company sued its former manager for breach of fiduciary duty and another entity for conspiracy to breach fiduciary duty arising out of a sale of property owned by the company.

Prepetition, Richard N. Morash ("Morash") was the sole member, manager, and director of 7901 BLVD 26, LLC ("7901"). In 2015, 7901 purchased the real property and improvements located at 7901 Boulevard 26, North Richland Hills, Texas (the "Property") and leased the Property to a third-party tenant. The tenant converted the Property, formerly a Home Depot, into a high-end indoor shooting range. By early 2018, however, the tenant had defaulted on the lease and abandoned the Property. Thereafter, as the Property had suffered roof damage caused by a storm, 7901 contracted with Valley Ridge Roofing and Construction, LLC ("Valley Ridge") to repair the roof. After a dispute arose over the roof-repair contract balance, the parties went to arbitration, which concluded with a judgment and a judgment lien in favor of Valley Ridge against 7901 and the Property. The Valley Ridge judgment lien on the Property was subordinate to ad valorem tax liens of Tarrant County of nearly $100,000, a $3.4 million lien held by Frost Bank, and a $180,000 third-priority lien held by the City of North Richland Hills ("City").

In late November and early December 2018, even as Valley Ridge was attempting to collect on its judgment, Morash formed Silver State Holdings, Assignee—7901 Boulevard 26 LLC ("Silver State"), and Silver State subsequently acquired the City's claim and lien against the Property. As the new holder of the City's third-priority lien on the Property, Silver State posted the Property for foreclosure and acquired the Property at a January 2, 2019 foreclosure sale, wiping out Valley Ridge's junior lien and leaving the Property subject only to the Tarrant County tax lien and the Frost Bank lien. The net proceeds from the sale totaled $627,050.37, for a property later valued at the time of foreclosure at $4.2 million based on live testimony and Silver Spring's own schedules. Upon discovery of these prepetition maneuvers, Valley Ridge filed an involuntary bankruptcy petition against 7901, and Silver State responded by launching its own bankruptcy case during which it sold the Property to a third party under § 363.

As laid out in conclusions of the law, supported by dozens of factual findings, the Bankruptcy Court found Morash and Silver State jointly and severally liable for the former's fiduciary breach. As the bankruptcy court first acknowledged, the Texas Business Organizations Code does not directly address the duties a manager or member owes to an LLC. Yet, it discerned duty-of-loyalty concerns as underlying statutory provisions addressing transactions with governing persons and renunciation of business opportunities. Meanwhile, provisions of the Business Organizations Code permitting governing persons, such as managers and managing members of an LLC, to rely on various types of information in discharging a duty imply that such persons are charged with a duty of care in their decision making. And finally, to the extent managers or members are subject to duties and liabilities, including fiduciary duties, the company agreement may expand or restrict the duties and liabilities per this same compendium.

Based on these interlocking statutory provisions, the bankruptcy court found Morash, as an agent of 7901, bound by a duty of loyalty to it. Applying these precepts to the evidence on hand, the bankruptcy court held Marsh to have breached his fiduciary duties when he allowed a foreclosure and a third-party sale to occur despite 7901's equity in the Property company and the sale's less than fair market value. Because Silver Spring had conspired with Morash, it was jointly liable for the damages. In a victory for Morash, however, the bankruptcy court deemed Morash immune from liability to the creditors of 7901, a company "fac[ing] financial difficulties" but "not yet … defunct."

Relying on the same factual findings, the bankruptcy court also ruled against the foreclosure sale's validity. As it explained, this transaction was avoidable (a) as a preferential transfer under § 547; (b) as an actual fraudulent transfer under § 548(a)(1)(A); (c) as an actual fraudulent transfer under section 24.005(a)(1) of the Texas Business and Commerce Code (and therefore § 544); and (d) as a constructive fraudulent transfer under section 24.006(b) of the Texas and Business and Commerce Code section 24.006(b) (and therefore § 544). Silver State, in turn, lacked any valid defense to avoidance of the foreclosure or to Valley Ridge's recovery of the funds under §§ 542 and 550.

In light of the foregoing, the bankruptcy also awarded $84,000 in attorney's fees and costs to Valley Ridge.

E. <u>Other Litigation and Contested Matters</u>

District Court Affirmed Bankruptcy Court's Preliminary Fairness Finding Concerning Class Action Settlements.
In re Chesapeake Energy Corp., 2021 WL 2270167, 2021 U.S. Dist. LEXIS 104253 (S.D. Tex. Jun. 3, 2021) (Rosenthal, C.J.).

This consolidated appeal arose from the Bankruptcy Judge David Jones's orders ***preliminarily*** certifying three class actions and approving the proposed settlements. The objecting claimants argued the bankruptcy court erred in preliminarily certifying the class because it did not have a sufficient record for analysis of Rule 23(a) findings or to determine whether the proposed settlements were fair, reasonable, and adequate under Rule 23(e). The settlements resolved three separate class action lawsuits and a lawsuit by the Pennsylvania Attorney General concerning allegations of improperly calculated oil and gas royalties. Nine months into the Debtors' bankruptcy cases, and after extensive mediation, the Debtors, the class action claimants, and the P.A. attorney general reached proposed settlements.

On appeal, the District Court held that the bankruptcy court did not err in preliminarily certifying the classes under Rule 23(a) because: (i) the bankruptcy court had access to the prepetition district court's record and there was no identifiable reason why the bankruptcy court could not at the preliminary level rely on the record; (ii) the failure of class representatives to sign the settlement papers is not a reason to deny certification of the class settlements, especially if none of the named class representatives objected; and (iii) the fact that some of the class members filed proof of claims, while most did not, is not a conflict of interest that undermines the class certification. Finally, the District Court held that the record was sufficient for the preliminary ruling, thereby dismissing the appeal without prejudice to the objecting claimants' rights to reassert the objections at the final hearing.

District Court Approves Final Class Certification.
In re Chesapeake Energy Corp., 2021 WL 4776685, 2021 U.S. Dist. LEXIS 196984 (S.D. Tex. Aug. 23, 2021) (Rosenthal, C.J.).

Before the District Court was a request for final class certification and for final approval of the settlement agreements after plan confirmation, the Court held the following:

- The bankruptcy court retained subject matter jurisdiction postconfirmation to approve the settlement agreements because (i) the dispute arose prepetition, (ii) the debtor is a named litigant and not a third-party, (iii) the parties moved for final approval of the settlements in the bankruptcy court, (iv) the settlements affect the debtors' postconfirmation rights and responsibilities, and (v) the confirmation provides that the bankruptcy court retained jurisdiction.
- Finding the settlement agreements to be fair, reasonable and adequate, final class certification was approved because the classes satisfied the Rule 23(a) and (e) factors: (i) the classes had a sufficient number of claims, (ii) commonality and typicality was shown because both classes presented common factual and legal questions related to the debtors and the royalty payment methodology, and (iii) the class claimants had adequate representation by counsel that were experienced in

both class action and oil and gas disputes, the named plaintiffs approved the settlement agreements, and the record did not reveal any conflicts of interest between the named plaintiffs and the unnamed class members; (iv) the parties were still in the early stages of litigation—the parties hadn't completed motions to dismiss, formal discovery or dispositive motions—despite the case having continued for nearly eight years; (v) majority of the class member who didn't file proof of claims would be precluded from filing individual claims if the settlement isn't approved; (vi) the settlement would provide immediate payment. Ultimately, the settlement agreements were deemed to be fair, reasonable and adequate and were approved.

- The Bankruptcy Court correctly required a second opt-out and was not unduly burdensome from those who previously opted out of the original settlement agreement to ensure that class members understood that their prepetition rights were extinguished.
- The attorney's fees requested were reasonable under the Loadstar and the Percentage calculation methods. Additionally, costs requested by the parties satisfied the Johnson factors and were also reasonable.

Triangular Setoffs Not Permitted for Lack of Mutuality.
In re Fieldwood Energy LLC, Case No. 20-03476, 2022 WL 385919 (Bankr. S.D. Tex. Feb. 8, 2022) (Isgur, J.).

Fieldwood Energy LLC and BP Exploration & Production Inc. entered into two PSAs. Under the Isabela PSA, BP agreed to pay Fieldwood $66 million between 2018 and 2021 for Fieldwood's interest in a certain well. Under the Genovesa PSA, Fieldwood agreed to pay BP $30 million upon completion of another well. During Fieldwood's bankruptcy case, it rejected the Genovesa PSA and transferred the Isabela PSA. BP alleged that it had a right of setoff against Fieldwood arising under the PSAs, despite the transfer of the Isabela PSA to a third party. The PSA itself did not grant a right of setoff, leaving BP to claim a triangular setoff with the third party to the PSA, which the Bankruptcy Court denied for lack of mutuality.

Designation of Record on Appeal.
In re Imperial Petroleum Recovery Corp., 2022 WL 90607 (Bankr. S.D. Tex. Jan. 7, 2022) (Isgur, J.)

Defendants designated a record on appeal under Bankruptcy Rule 8009(a)(2). Plaintiff moved to strike certain items that Defendant had designated for inclusion in the appellate record because the items were not admitted into evidence. Defendants argued for an "inclusive approach" that would allow any items filed with the Bankruptcy Court to be included into the appellate record. Judge Isgur surveyed Fifth Circuit precedent regarding resolving disputes over appellate record designation. He concluded that Bankruptcy Rule 8009 allows an appellant to designate items that the Bankruptcy Court was asked to consider, regardless of whether those items were entered into evidence. Further, items filed in related cases or adversary proceedings must have been presented for the Bankruptcy Court's consideration in reaching the appealed decision. As a result, the defendants must establish that the disputed items were "presented to the Court for consideration, or that good cause exists for the items' inclusion in the appellate record." Bankruptcy Rule 8009(e) cannot be used to supplant the District Court's ability to ascribe evidentiary weight to designated

items. Additionally, the designator may not attempt to create a version of the appellate record that does not reflect its presentation of evidence to the Bankruptcy Court.

Bankruptcy Court Bound by Previous State Court Ruling Regarding Net-profit Interests.
In re Vanguard Natural Resources, LLC, 624 B.R. 400 (Bankr. S.D. Tex. 2020) (Isgur, J.).

Reorganized debtor Vanguard Operating, LLC ("Reorganized Debtor") sought determination that certain net working interests ("NWI") were discharged in its bankruptcy. The holders of the NWI ("NWI Owners") challenged this, asserting that the previous state court litigation finding that the NWI were covenants running with the land bound the Bankruptcy Court to find that the NWI were covenants running with the land and not discharged.

The NWI in question arose from a transfer of land known as the Pinedale Parcel to certain parties for the exploration of oil and gas. An assignment agreement was entered into by those land holders and Novi Oil Company ("Novi"), pursuant to which Novi was provided with the NWI for 5% of the net profits of the realized operation for oil and gas. Novi subsequently transferred its interest in the NWI to the NWI Owners (or their predecessors) over the course of the existence of the Pinedale Parcel. The Pinedale Parcel was a failure and never produced a profit prior to its termination in 1981. The Pinedale Parcel was the divided into two parcels, one of which, the Mesa Parcel, became profitable. Upon this determination of profitability, the NWI Owners sought payment of their respective interest in the NWI, and were denied by the holders of the working interests in the Mesa Parcel ("WI Holders") who asserted that the NWI terminated with the Pinedale Parcel. The NWI Owners then initiated litigation in the state of Wyoming (the "Wyoming Litigation").

The Wyoming District Court disagreed with the WI Holders and found that the successors in interest to the initial holders of the Pinedale Parcel (including Lance, a party to the Wyoming Litigation and predecessor to the Reorganized Debtors' interests in the Mesa Parcel) were liable for payment of the NWI which were covenants running with the land, analogous to a royalty interest, and continued to burden the Mesa Parcel. The ruling was appealed to the Wyoming Supreme Court which also held that the NWI continued to encumber the relevant leases after termination of the Pinedale Parcel, but remanded the case back to the Wyoming District Court for other reasons. On remand the Wyoming District Court issued an amended judgment (the "State Judgment") affirming that the NWI were covenants running with the land which continued to burden the Mesa Parcel, and that this interest was analogous to a royalty interest. No further appeal was made.

Sometime after the Wyoming Litigation, Lance's interests in the Mesa Parcel were transferred to the debtor, which were subsequently transferred to the Reorganized Debtor pursuant to its plan of reorganization ("Plan") and related confirmation order ("Confirmation Order"). The Confirmation Order and Plan contained two clauses that controlled the discharge of the NPI. The vesting clause ("Vesting Clause") provided that, "Pursuant to section 1141(b) and (c) of the Bankruptcy Code, *except as otherwise provided in the Plan*¸ on the effective date all property in each Estate, all Causes of Action, and any property acquired by any of the Debtors pursuant to the Plan shall vest in each applicable Reorganized Debtor, free and clear of all Liens, Claims, charges or other encumbrances." The Plan in turn contained a clause regarding royalty and working interests ("RWI Clause") which stated "all Royalty and Working Interests shall be preserved and

remain in full force. . . with the terms of the granting instruments or other governing documents . . . and no Royalty and Working Interests shall be compromised or discharged by the Plan." Royalty and Working Interests were defined as "working interests granting the right to exploit oil and gas, and certain other royalty or mineral interests, including but not limited to, landowner's royalty interests, overriding royalty interests, net profit interests, non-participating royalty interests, and production payments." Therefore, if the NWI were found to be Royalty and Working Interests under the Plan, they would be exempt from discharge.

The Reorganized Debtor initiated an adversary proceeding seeking declaratory judgment that the NWI's were discharged, and the NWI Owners argued that the Bankruptcy Court was bound by the State Judgment to find the NWI's were nondischargeable covenants running with the land.

The Bankruptcy Court sided with the NWI Owners, holding that the State Judgment was binding and that the NWI were preserved by the Plan through the RWI Clause. Further, the NWIs were Royalty and Working Interests because under Wyoming law, the NWI are covenants running with the land, identical to royalty interests.

Applying Wyoming preclusion law, the Bankruptcy Court further found that issue preclusion bound it to apply the findings of the State Judgment. *First*, the Bankruptcy Court found that the issues were identical and the determination of the NWI's status as a covenant running with the land was essential to the Wyoming Litigation and State Judgment. *Second*, the court found that the State Judgment was not susceptible to collateral attack. Reorganized Debtor asserted that under Wyoming law, the Wyoming District Court exceeded its jurisdiction on remand in determining that the NWI was a covenant running with the land, and as such the judgment was subject to collateral attack. While noting that a Wyoming judgment may be collaterally attacked if the judgment was rendered without jurisdiction, the Bankruptcy Court found that the Wyoming District Court exceeding the scope of its remand rendered the judgment voidable and not void, and under Wyoming law, voidable judgments are not subject to collateral attack. *Third*, the State Judgment was a final judgment on the merits as Reorganized Debtor's predecessor in interest did not appeal the ruling and it became a final determination that the NWI are covenants running with the land. *Finally*, the Bankruptcy Court found the Wyoming Litigation was a full and fair opportunity to litigate the nature of the NWI, and was actually litigated by Lance

After finding that Reorganized Debtors was precluded from relitigating the nature of the NWI and that it was bound by the State Judgment, the Bankruptcy Court determined that pursuant to the plain language of the Vesting Clause and RWI Clause, the NWI were not discharged as under Wyoming law, they were covenants running with the land which were analogous to royalty interests, and royalty interests were explicitly carved out from discharge under the Plan and Confirmation Order.

Court Holds Net Profit Interests Are Personal Property Covenants And Do Not Attach to Pipeline Right of Way.
Krisjenn Ranch, LLC v. DMA Properties Inc. (In re Krisjenn Ranch, LLC), 629 B.R. 589 (Bankr. W.D. Tex. 2021) (King, J.).

In this case, the Debtor sought a declaration that its promise to pay a net profits interest to DMA Properties, Inc. and Longbranch Energy, LP do not attach and run with a pipeline right of

way ("ROW") owned by the Debtor, and brought claims of tortious interference against the defendants for interfering with the Debtor's sale of the ROW by asserting claim to 20% of the net profits of the ROW.

In analyzing whether the net profits interest constituted a real property covenant running with the ROW, the Bankruptcy Court found that the "intent" element was lacking, as the only evidence that the parties intended a covenant running with the land was "classic" language within the applicable Assignment Agreement that stated the obligation shall "attach and run" with the land. The Bankruptcy Court was not persuaded that this language was dispositive on the question of intent, as it found that other references of "successors and assigns" being bound by the net profits interests referred to successors and assigns of the party obligated to pay the net profits interest rather than successors and assigns of the ROW itself.

The Bankruptcy Court further found that the covenant to pay the net profits interest did not "touch and concern" the land because the net profits are personal property, which were not so closely linked to the land itself that it constituted an interest in land. The net profits interest likewise did not reduce the ROW owner's ability to use, enjoy, or alienate its property interests. The Bankruptcy Court also found that, while it was unclear whether horizontal privity was still required under Texas law, that element was unsatisfied as a result of the fact that the relevant Assignment Agreements did not convey a real property interest in connection with the covenant to pay the net profits interest. Finally, the Bankruptcy Court found that there was insufficient notice of successor to the covenant because the Assignment Agreements did not contain sufficient legal descriptions of the ROW. For the above reasons, it found that the obligation to pay the net profits interest was a personal property covenant that did not run with the land.

Litigation Funding Arrangement Between the Trustee and Creditor Did Not Violate the Bankruptcy Code's Priority Scheme.
Dean v. Seidel, 2021 WL 1541550, 2021 U.S. Dist. LEXIS 75418 (N.D. Tex. Apr. 20, 2021) (Starr, J.).

The issue raised by this appeal was whether a Chapter 7 bankruptcy trustee may grant a 30% interest in the bankruptcy estate's litigation recoveries to a creditor in the bankruptcy case in exchange for that creditor advancing funds for the litigation, even if the creditor would also be reimbursed for such advances. Under such a funding agreement, the creditor agreed to advance up to $200,000 for litigation fees to prosecute claims against third parties, and in return, the trustee would pay the creditor 30% of all recoveries plus the creditor's pro rata distribution on account of its prepetition claim. The debtors objected, arguing that the funding agreement elevated the creditor to a super creditor, which violated the priority scheme under section 507 and the equality of distribution under § 726. The bankruptcy court approved the funding agreement noting that the trustee had endeavored to obtain favorable terms for financing but had limited options, and approval of such agreement was similar to a § 363 or § 364 transaction. On appeal, the District Court affirmed the Bankruptcy Court's ruling holding that the litigation funding arrangement with the creditor did not violate the Bankruptcy Code's priority scheme. However, the District Court noted that although such agreements are a novel idea, ethical concerns could arise if such funding arrangements were to become widespread.

No Discovery Sanctions Against Liquidating Trustee, Despite Technical Violations of Rule 45(d)(1).
Stermer v. Old Republic National Title Insurance Co. (In re ATIF, Inc.), 622 B.R. 127 (Bankr. M.D. Fla. 2020) (Delano, C.J.).

The Bankruptcy Court declined to issue discovery sanctions against liquidating trustee, even though the trustee's failure to cooperate with a scheduling order resulted in a technical violation of Civil Rule 45(d)(1) by failing to "take reasonable steps to avoid imposing undue burden or expense" on the non-party deponents.

The Bankruptcy Court concluded that the circumstances weighed against sanctions in this case, because: (1) the non-party deponent was a law firm that was interested in the outcome of this adversary proceeding because the trustee was pursuing a separate malpractice action against the law firm based on the same facts; (2) the non-party law firm made its own tactical decisions in responding to the Civil Rule 30(b)(6) deposition notices that led to the additional costs; and (3) the law firm could more easily bear the discovery costs, whereas sanctions against the liquidating trustee "would have a deleterious effect on Debtor's creditors."

Court Holds Non-Debtor Stock Issuer Liable To Non-Debtor Lender For Double-Pledged Stock.
Cross Keys Bank v. Ward (In re Karcredit, L.L.C.), 630 B.R. 14 (Bankr. E.D. La. 2021) (Hodge, J.).

In July 2020, Cross Keys Bank had filed an involuntary chapter 7 petition against Karcredit, LLC. In August 2006, Ronnie Ward guaranteed a $683,825.00 loan made by Caldwell Bank & Trust Company to an entity owned by Ward. To secure the loan, Ward pledged stock shares to Caldwell Bank in Homeland Bancshares, Inc., represented by Certificate 253. In September 27, 2010, Caldwell Bank loaned $424,670.66 to another entity owned by Ward. In conjunction with this second loan, Ward executed another pledge agreement that pledged the stock represented by Certificate 253 as collateral. Later in 2010, Homeland merged with another company. The merger agreement required the cancellation of all former Homeland stock and the reissuance of stock in new Homeland to replace the cancelled stock in former Homeland and provided that only the "holder" of Certificate 253 could surrender the stock for replacement shares. Separately, the language on the face of Certificate 253 said much the same, empowering only a "holder" to surrender or transfer it. In spite of this language, and without requiring Ward to post an indemnity bond, Homeland cancelled Certificate 253 and issued Certificate 495 as a replacement after Ward filed a false lost stock affidavit. Whether as a result of this process or not, Homeland actually knew that Ward had pledged his stock in Homeland to Caldwell Bank as security for a loan no later than July 2016.

When Homeland's president vouched for the value of this same stock so as to allow CKB to value it as collateral for a guaranty of a loan to the debtor in April 2019, Homeland thus knew that Ward had obtained loans from Caldwell Bank and CKB secured by the same stock. The situation unraveled when Karcredit defaulted, and CKB called the loan. CKB subsequently sued Karcredit and its guarantors to collect a promissory note and enforce the commercial guaranties; Caldwell intervened. In no time at all, two things became clear: Caldwell Bank had lost its first

priority security interest in the stock to CKB due to Ward's double-pledging, and held a wholly unsecured claim due to its failure to file a UCC-1 financing statement.

Faced with two competing claims to the same collateral, the Honorable John S. Hodge of the United States Bankruptcy Court for the Western District of Louisiana began with an inquiry into its subject-matter jurisdiction over this prepetition state court dispute. As discussed *supra*, the bankruptcy court concluded that the "conceivable effect" standard was easily satisfied for one obvious reason: the lender's successful recovery of money or collateral from non-debtor defendant "could result in a dollar-for-dollar reduction of the amount of its claim against the estate."

With its jurisdiction established, the bankruptcy court limned three reasons for holding Homeland, as the corporation that issued the double-pledged shares, liable to Caldwell Bank on the basis of the parties' undisputed statement of uncontested facts. Homeland had first breached the merger agreement by issuing Certificate 495 to Ward, a non-holder of Certificate 253. It had also contravened the provisions of Certificate 253 by issuing Certificate 495 to Ward without requiring either Ward or Caldwell Bank to surrender Certificate 253. And finally, Caldwell Bank, like CKB, was a protected purchaser, defined as the purchaser of a certificated or uncertificated security who gives value, does not have notice of an adverse claim, and obtains control of the security, under Article 8 of the Uniform Commercial Code, as adopted in Louisiana.

The bankruptcy court looked to the UCC for a measurement of damages. Per article 8, Homeland was obligated to honor and register both certificates unless an over-issue would result. If an over-issue would result, the UCC provides that "a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid with interest from the person's demand." Therefore, Homeland was liable to Caldwell Bank for the amount owed to Caldwell Bank by Ward.

Rule 59 Relief Available When Judgment Based Upon Manifest Errors of Fact.
Carmichael v. Balke (In re Imperial Petroleum Recovery Corp.), 2021 WL 933989 (Bankr. S.D. Tex. Mar. 11, 2021) (Isgur, J.).

Plaintiffs in this matter are assignees of substantially all assets of the estate of Imperial Petroleum Recovery Corporation, against which an involuntary bankruptcy petition had been filed in January 2013. In 2014, they sued the defendants claiming that defendants violated the automatic stay with respect to certain of this property, for which a judgment was issued in favor of plaintiffs. That judgment directed the defendants to turnover certain property to the plaintiff as well as to pay damages to plaintiffs pursuant to section 362(k) of the Bankruptcy Code. Defendants filed a Rule 59 motion seeking relief from that judgment on grounds that it required defendants to turn over property that did not exist, and that the amount of damages awarded in the judgment was unsupported by the evidence at trial.

Specifically, defendants were ordered in the judgment to turnover "all assets that the Chapter 7 Trustee conveyed to the Plaintiffs," which supposedly included two pieces of equipment known as "MST 1000 Units." Defendants claimed that they never possessed more than one of these units, and that they complied with their turnover obligations. Defendants further claimed that the damages award was based upon the notion that they retained a second MST 1000 Unit when in fact it was a different piece of equipment that they nevertheless turned over.

The Bankruptcy Court granted relief from the judgment based on manifest errors of fact pursuant to Civil Rule 59(e), including that (i) at the time of assignment to plaintiffs, the Debtor possessed two functional MST 1000 Units, (ii) defendants failed to return an operational MST 1000 Unit to plaintiffs, (iii) defendants failed to return certain MST component parts, and (iv) the damages estimates from plaintiffs' expert represented actual damages caused by defendants' stay violations.

Though the Bankruptcy Court would not revisit a prior determination that defendants had willfully violated the automatic stay (by dismantling a piece of equipment belonging to the Debtor), it reduced the damages award against the defendants, finding that the actual damages suffered by plaintiffs as a result of the stay violation was limited to the labor costs of reassembling the dismantled equipment.