ALABAMA BUSINESS BANKRUPTCY HODGEPODGE

Bankruptcy at the Beach 2018 – Commercial Panel
Judge Henry Callaway
Jennifer S. Morgan, Law Clerk to Judge Callaway

Judicial estoppel

- *Slater v. U.S. Steel Corp.*, 871 F.3d 1174 (11th Cir. 2017)

By now you are probably familiar with this Eleventh Circuit opinion, which overruled prior cases on the standard for judicial estoppel as it relates to a debtor's failure to disclose a civil lawsuit in bankruptcy. Previous precedent permitted an inference that a debtor-plaintiff intended to make a mockery of the judicial system simply because he failed to disclose a civil claim. Now, a court must look to all the facts and circumstances of the case to decide whether a plaintiff intended to mislead the court. For a recent Alabama case applying *Slater*'s "facts and circumstances" approach and finding that judicial estoppel applied, see *Wholesalecars.com v. Hutcherson*, No. 2:16-cv-00155-KOB, 2018 WL 1509509 (N.D. Ala. Mar. 27, 2018) (debtor is estopped from claiming $117k arbitration award based on unrevealed cause of action but chapter 7 trustee is not).

Administrative expense priority

- *In re New WEI, Inc.*, No. 15-02741-TOM-7, 2018 WL 1115200 (Bankr. N.D. Ala. Feb. 26, 2018)

Former employee of debtor sought administrative expense priority for the payment of a severance benefit that he contended he was due under a prepetition employment agreement with the debtor after his employment was terminated postpetition. He argued that his abiding by the non-disparagement and non-compete clauses in his employment agreement provided value, and thus a benefit to the estate postpetition. The bankruptcy court held that the claim of a creditor arising under a prepetition contract is a general unsecured claim, even if the time for performance occurs postpetition, and that this rule holds true for severance payments that arise from an agreement executed prepetition. It also found that, in any event, the employee did not establish that he provided an actual and necessary benefit to the estate. While the employee may have refrained from disparaging or competing with his former employer, any benefit that his inaction may have bestowed on the estate did not rise to the level of a concrete benefit justifying an administrative expense.

Settlement approval

- *In re Breland*, No. 16-02272-JCO, 2018 WL 1318954 (Bankr. S.D. Ala. Feb. 14, 2018)

Although the *Justice Oaks* factors weighed in favor of approval, the bankruptcy court disapproved without prejudice the trustee's Rule 9019 application to approve compromise as falling below the lowest point of reasonableness due to lack of an independent unbiased appraisal of the subject property and the trustee's failure to market the property.

Creditors' committees

- *In re Breland*, 583 B.R. 787 (Bankr. S.D. Ala. Mar. 15, 2018)

Once the bankruptcy administrator has performed his initial § 1102 statutory duty in soliciting participation on the unsecured creditors' committee and the bankruptcy court has entered an order directing that no committee be formed, the bankruptcy administrator must seek court permission before he may re-solicit participation on the committee. The court has discretion under § 105 to deny permission to form an unsecured creditors' committee where a chapter 11 trustee has been appointed and there is insufficient evidence before the court to indicate that the trustee is inadequately representing creditors' rights.

Remand

- *In re Atherotech, Inc.*, 582 B.R. 251 (Bankr. N.D. Ala. Dec. 20, 2017)

The bankruptcy court remanded to state court a chapter 7 trustee's postpetition case asserting state law claims against the debtor's former officers and directors. The trustee filed a state court complaint, which the defendants removed to bankruptcy court. However, the bankruptcy court found that while it had "related to" jurisdiction over the removed proceeding, remand to state court was warranted. The trustee's claims were based solely on state law and were of the kind typically tried in state court, the parties would be better served by allowing state court to decide familiar state law issues, even though the issues were not particularly difficult or novel, trustee's anticipated but not-yet-filed fraudulent conveyance claim did not support maintaining action in bankruptcy court despite potential for overlapping issues, trustee's demand for jury trial raised possibility of duplication and waste if case were retained in bankruptcy court, different jury panel in federal court meant potential for prejudice if case were not remanded, comity favored remand, and claims were "related to" bankruptcy cases but did not arise out of them.

Section 365: executory contracts

- Doc. No. 61, *In re Moeini Corp.*, No. 17-4073 (Bankr. S.D. Ala. Dec. 6, 2017)

The debtor operated several IHOP restaurants pursuant to a franchise agreement. IHOP terminated the franchise agreement effective in thirty days because of alleged non-monetary defaults (not meeting franchise standards). The debtor filed chapter 11 one day before the effective date and sought to cure the default and assume the franchise agreement under Bankruptcy Code § 365(b).

In the chapter 11 context, assumption of franchise agreements and continued operation of the business is generally an important goal of the franchisee's bankruptcy. However, when a franchise agreement has been terminated for cause prepetition and the termination process is complete with no right to cure when the petition is filed, the debtor does not have a property interest in the franchise on the date of filing and there is no executory contract to assume, even if on the date of filing the debtor remains in possession of the franchised business and continues to use the franchisor's trademark property; the bankruptcy filing does not resuscitate the terminated rights. *See In re Tornado Pizza, LLC*, 431 B.R. 503, 510 (Bankr. D. Kan. 2010). Of note, "[i]f the franchise agreement expires by its own terms or by the mere passage of time after a debtor commences its bankruptcy case, the Bankruptcy Code does not somehow preserve the expired agreement." *Id.* at 515 (citation and quotation marks omitted). The fact that a termination may not be effective until after the filing date does not change this result, if all that remains is the passage of time. The court thus found that the debtor could not assume the franchise agreement and granted IHOP's motion for relief from stay.

In this case, the debtor also argued that IHOP's termination of the subject franchise agreements was invalid pursuant to the terms of the agreements. The bankruptcy court abstained from the purely state law issue of whether the franchise agreements had been validly terminated prepetition, and the district court ultimately found that the termination was valid.

- Doc. No. 24, *In re Sage*, No. 17-02699 (Bankr. S.D. Ala. Aug. 29, 2017)

Termination of a commercial lessee's right of possession does not in itself terminate the lease. Debtor lessee could thus cure default and assume lease.

Section 523(a): exceptions to discharge

- Doc. No. 47, *BancorpSouth Bank v. Shahid*, AP No. 16-3009 (Bankr. N.D. Fla. Nov. 3, 2016), *aff'd*, *BancorpSouth Bank v. Shahid*, No. 3:16cv621-RV/EMT (N.D. Fla. 2017), available at Doc. No. 60 in the bankruptcy case. The debtor did not appeal the district court's ruling to the Eleventh Circuit and the underlying adversary proceeding was subsequently closed.

Fraudulent transfers allegedly made by debtor after judgment on guaranty entered against him did not support claims for non-dischargeability under Bankruptcy Code §§ 523(a)(2) or (6) when creditor did not have an interest in the transferred properties, and debt was "obtained" by promissory notes, not later alleged fraudulent transfers.

In addition to the district court's affirmance, at least one other court has adopted *Shahid*'s reasoning. *See In re Wilson*, No. 16-3068, 2017 WL 1628878, at *8 (Bankr. N.D. Ohio May 1, 2017) (citing *Shahid* with approval); *see also In re Vanwinkle*, 562 B.R. 671, 677-78 (Bankr. E.D. Ky. 2016) (reaching same conclusion as *Shahid*).

- Doc. No. 29, *SE Property Holdings, LLC v. Gaddy*, AP No. 17-54 (Bankr. S.D. Ala. Jan. 5, 2018) (currently on appeal to district court)

A fraudulent transfer in itself does not create a new injury to an individual creditor by the debtor/transferor and thus cannot support a § 523(a)(2) or (6) claim. Such fraudulent transfers are an offense against all creditors, present and future.

The plaintiff-creditor did not contend that the underlying debt based on guaranty agreements was obtained by fraud or was anything other than a standard contract debt. Instead, it relied on the U.S. Supreme Court's decision in *Husky International Electronics, Inc. v. Ritz*, 136 S. Ct. 1581 (2016), to argue that the debtor's alleged fraudulent transfer "scheme" after incurring the underlying debt entitled it to have its debt declared nondischargeable under § 523(a)(2). However, while *Husky* potentially expanded the universe of § 523(a)(2) causes of action against transferees, the debtor here was the alleged transferor and alleged to have fraudulently transferred his own assets to the detriment of all creditors. Furthermore, *Husky* did not eliminate the "obtained by" requirement of § 523(a)(2).

Section 544: "triggering creditor"

- Doc. No. 66, *Andrews v. Graham Holding Co., et al.*, AP No. 17-82 (Bankr. S.D. Ala. Feb. 14, 2018)

Section 544 allows the trustee to essentially step into the shoes of a lien creditor to avoid certain transfers. For § 544 purposes, a so-called "triggering" or "golden" creditor is "(1) an unsecured creditor, (2) who holds an allowable unsecured claim under section 502 [of the Bankruptcy Code], and (3) who could avoid the transfers at issue under applicable (i.e., state) law." *See MC Asset Recovery, LLC v. S. Co.*, No. 1:06-CV-0417B, 2006 WL 5112612, at *3 (N.D. Ga. Dec. 11, 2006). While in the past a trustee may not have had to identify a triggering creditor in his/her § 544 complaint, *Twombly/Iqbal* jurisprudence now makes it "necessary to include specific allegations to support this element of the claim." *See, e.g., In re Rollaguard Sec., LLC*, 570 B.R. 859, 881 n.11 (Bankr. S.D. Fla. 2017); *see also id.* at 881-82. The trustee must identify by name a specific triggering creditor or creditors. *See id.* at 811 & 811 n.11.

Importantly, there "must be a specific triggering creditor identified for each alleged transfer[, although i]t is possible that the same creditor or creditors may serve this purpose for a number of transfers." *See id.* at 881 n.12.

Still to be decided: must each "triggering creditor" have filed a proof of claim?

Section 727(a)(2)(A): debtor who acts with intent to hinder, delay, or defraud

- Doc. No. 102, *Beach Community Bank v. Fruitticher*, AP No. 15-3015 (Bankr. N.D. Fla. Dec. 27, 2017) (currently on appeal to district court)

The bankruptcy court granted summary judgment in favor of the creditor bank denying the debtor a discharge pursuant to Bankruptcy Code § 727(a)(2)(A), which provides in pertinent part that "[t]he court shall grant the debtor a discharge, unless . . . the debtor, with intent to hinder, delay, or defraud a creditor . . . , has transferred . . . property of the debtor, within one year before the" petition date. As an initial matter, regardless of whether funds the debtor transferred prepetition would have been exempt under state law, they were clearly property of the debtor, which is all that § 727 requires.

The debtor admitted transferring funds from his personal account to a bank account in the name of his wife's trust to avoid garnishment of his personal account. Nonetheless, the debtor also argued that he did not act with the requisite intent to hinder, delay, or defraud because he believed at the time of the transfers that the transferred funds were exempt. The bankruptcy court disagreed and declined to effectively allow a debtor to decide exemptions for himself for § 727(a)(2) purposes. The debtor may not have had an intent to defraud, but his admission that he transferred funds to avoid garnishment of his bank account constituted "intent to hinder or delay" creditors under § 727(a)(2)(A).