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Case Law Update

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Third Party Releases

In re Le Centre on Fourth, LLC, 17 F.4th 1326 (11th Cir. 2021) (J. Jill Pryor)

A hotel patron who was hit by a hotel valet driver filed suit in state court against several entities connected to the hotel. The hotel property owner filed for chapter 11 protection before the state court action was filed and, during the bankruptcy proceedings, filed a disclosure statement in connection with its proposed reorganization plan. The hotel patron's counsel was served with notices and copies of the plan and disclosure statements explaining that the plan included the release of not only the hotel owner, but also of related non-debtor parties. A confirmation order was issued and thereafter released entities sought to dismiss the state court action and bar claims against them. The hotel patron requested that the bankruptcy court allow the state court action to proceed nominally to reach the entities' insurers and the request was denied because such action would interfere with the bankruptcy plan. The district court affirmed. The Circuit court affirmed and concluded that the creditors received actual notice of third-party releases in the plan and the creditors were not entitled to modify the confirmation order to proceed nominally in state court against released non-debtor third parties.

Rejecting Arbitration Clauses

In re Highland Cap. Mgmt., L.P., No. 19-34054-SGJ11, 2021 WL 5769320 (Bankr. N.D. Tex. Dec. 3, 2021) (Jernigan)

The debtor commenced several adversary proceedings to collect on large promissory notes owed to it. During these proceedings, the note-obligor defendants alleged that an "oral agreement" existed with the debtor that the notes would be forgiven if certain conditions subsequent occurred. As a result, the debtor was granted leave to amend its original complaint in each adversary

proceeding to allege alternate theories of liability, including fraudulent transfers and breach of fiduciary duty. The obligor-defendants countered by filing motions to compel arbitration and to stay litigation altogether in the adversary proceedings, relying on a mandatory arbitration clause in the debtor's limited partnership agreement. The bankruptcy court found that the limited partnership agreement, or at least the arbitration clause, was an executory contract that the debtor rejected in its confirmed chapter 11 plan. The debtor was no longer bound by the provisions of the limited partnership agreement that imposed specific performance obligations. From a unique perspective, the bankruptcy court declined to compel arbitration or stay the adversary proceedings even though the underlying matters were non-core.

Timing of Collateral Valuation

In re S-Tek 1, LLC, No. 20-12241-J11, 2021 WL 5860020 (Bankr. D.N.M. Dec. 9, 2021) (Jacobvitz)

The Subchapter V debtor proposed a plan in which the debtor would retain and use the debtor's collateral in the operation of its business. For plan confirmation, the debtor had to satisfy the fair and equitable requirements in § 1129(b)(2)(A) with respect to the creditor's secured claim, if the claim was impaired and the secured creditor did not accept the treatment proposed under the plan. For purposes of plan confirmation, the question before the court was whether the collateral should be valued as of the filing date, the confirmation date, or some other time. The court found the majority rule to be persuasive and ruled that "valuing the collateral as of the confirmation date is consistent with the last sentence of § 506(a)(1) because it accounts for the purpose of valuation and accommodates the practical prospect of holding the valuation hearing in conjunction with the confirmation hearing." *Id.* at 4.

**Courts are split about the date for valuing collateral when the chapter 11 debtor is cramming down a secured lender. The Fifth Circuit adopted a "flexible approach to valuation timing that allows the bankruptcy court to take into account the development of the proceedings, as the value of the collateral may vary dramatically based on its proposed use under any given plan." *Id. See In re Houston Regional Sports Network LP*, 886 F.3d 523, 528 (5th Cir. 2018). A bankruptcy court within the Eleventh Circuit determined that the petition date is the appropriate valuation date. *See In re Flagler-At-First Assocs., Ltd.*, 101 B.R. 372, 376 (Bankr. S.D. Fla. 1989).

Subchapter V Plan Extension

In re Excellence 2000, Inc., 636 B.R. 475 (Bankr. S.D. Tex. 2022) (Rodriquez)

One day after the expiration of the statutory 90-day plan filing deadline, the debtor filed an emergency motion to extend the deadline. The court found that it had discretion to consider the motion, but the debtor failed to prove that "the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable." *Id.* at 480. In determining that the surrounding matter was in the debtor's control, the court denied the motion to extend the deadline to file a plan.

Plan Filing Delays in Subchapter V

In re HBL SNF, LLC, 635 B.R. 725 (Bankr. S.D.N.Y. 2022) (Lane)

The debtor, operating a 160-bed nursing home, was sued prepetition by the landlord, which argued that the lease was therefore terminated prepetition. After the debtor filed a petition under Subchapter V, both the landlord and the lender claimed the right to receive rent payments from the

debtor. The debtor filed a motion to extend the time to file a plan and the lender also moved for relief from the automatic stay intending to foreclose the landlord for alleged default. The court determined that since the lease with the landlord gave the debtor a purchase option, the treatment of the landlord was essential to the plan. Specifically, the state court litigation would decide whether the lease had terminated before the bankruptcy and whether the debtor retained a purchase option. For this reason, the court extended the time to file a Subchapter V plan. Because the lender made it clear in open court and in writing that the debtor would not be a party in the foreclosure action and that the debtor's purchase option would remain intact, the court also concluded that "the contemplated state court action is the most expeditious and economical way to resolve the dispute between two non-debtors. The lender's stay relief motion was also granted.

Converting from Subchapter V to Chapter 7

In re Happy Beavers, LLC, No. 20-14853-JGR, 2022 WL 351045 (Bankr. D. Colo. Feb. 1, 2022) (Rosania)

After the Subchapter V debtor filed its plan of reorganization, all significant creditors filed objections and the court granted a standstill agreement to allow the parties to seek a consensual plan. Efforts to seek a consensual amended plan fell through, and the debtor failed to timely file an amended plan, prompting the Sub V Trustee and the United States Trustee to move for conversion. The debtor presented no evidence of circumstances beyond its control or circumstances for which it should not have been justly held accountable. *Id.* at 3. Under § 1112(b)(1) and (b)(4), the failure to file an amended plan constituted cause for conversion or dismissal. *Id.* The court ultimately decided that, because of the debtor's inability to timely file an amended plan of reorganization, and a continuing loss of diminution of the estate, coupled with

the absence of a reasonable likelihood of rehabilitation, conversion was in the best interests of creditors.

Waiver of Reopening Fee

In re Krihak, 637 B.R. 610 (Bankr. N.D. Ill. 2022) (Goldgar)

The debtor moved to reopen his Chapter 11 case to obtain a discharge. The debtor not only performed but completed his plan obligations and moved to have his discharge entered prior to the motion to reopen. No party objected to either motion and the debtor requested to have the reopening fee waived. However, the court declined to waive the fee since "Congress requires parties filing bankruptcy cases to pay filing fees and has authorized the Judicial Conference of the United States to "prescribe additional fees."" *Id.* at 1. Among them are fees to reopen closed cases, including cases that have been closed without a discharge. Bankr. Ct. Misc. Fee Sched. Item 11.

Subchapter V Plan Timely Filed

In re Majestic Gardens Condo. C Ass'n, Inc., 637 B.R. 755 (Bankr. S.D. Fla. 2022) (Russin)

The debtor raises the questions of whether a calendaring error by debtor's counsel may be "excusable neglect" rendering extension of the 90-day deadline to file a Subchapter V plan or whether this error qualifies as a circumstance for which the debtor should not justly be held accountable justifying extension of the deadline. The debtor did not file the plan until three days after the 90-day deadline due to a calendaring error by counsel's paralegal. The court held that it could not extend the deadline under § 1189(b) and that the facts presented did not justify an extension. *Id.* at 1. "The purported cause of the debtor's delay was counsel's calendaring error…. and the debtor must be accountable for…. rendering relief unavailable." *Id.* at 2.

Denying Compensation in Subchapter V

In re NIR W. Coast, Inc., No. 20-25090-B-11, 2022 WL 1050055 (Bankr. E.D. Cal. Apr. 5, 2022) (Jaime)

A revised application for compensation and reimbursement of expenses for $78,481.92 was before the court. "The underlying issue presented was that…. the law firm represented an interest adverse to the interests of the bankruptcy estate during the term of its employment as the debtor's general bankruptcy counsel." *Id.* at 2. The corporation filed bankruptcy, but the debtor's principal did not. And the law firm's employment application did not disclose that it also represented the debtor's principal. "The connection giving rise to this adverse interest was known when the debtor filed its application to employ…. and it was not promptly disclosed by counsel after it was raised by a creditor and the Subchapter V Trustee during the course of the bankruptcy case." *Id.* "The court found actual conflicts regarding a state court settlement against the debtor and the principal pre-bankruptcy, requiring the law firm…. to divide its loyalty between [the debtor and the principal] by choosing which client it should prefer at the expense of the other." *Id.* at 5. Because the law firm's employment violated § 327(a), the court invoked § 328(c) and Rule 2014(a) to deny all compensation and reimbursement for nondisclosure by the corporate debtor's counsel.

Binding Consent Settlements

Consumer Fin. Prot. Bureau v. Ocwen Fin. Corp., 30 F.4th 1079 (11th Cir. 2022) (Newsom, Marcus)

The plaintiffs filed a complaint in 2013 alleging violations of federal law, and the suit was resolved by a settlement agreement and a formal consent judgment filed in February 2014. *Id.* at

1081. "In short, the consent judgment released [the defendant] from liability for the conduct alleged in the…. complaint and established a three-year period during which [the defendant] had to comply with detailed…. standards []." *Id.* Shortly after the three-year consent term ended, the plaintiffs filed suit again alleging violations of various federal laws occurring since January 2014 to February 2017. The district court granted the defendant's summary judgment motion, reasoning that the res judicata effect of the 2013 action barred the plaintiff from challenging conduct that occurred before the three-year consent term ended. *Id.* at 1082. On appeal, the defendant argued that the res judicata effect of the 2013 action should be controlled by the consent judgment, not the plaintiff's complaint, and that the underlying settlement agreement shows that the parties did not intend to preclude a challenge to any conduct occurring from 2014 onwards. *Id.* at 1081. "The Circuit Court agreed that the preclusive effect of the 2013 action should be determined by the terms of the parties' settlement agreement…. and held that the parties intended to preclude new challenges to conduct covered by the settlement agreement's three-year [standard]." *Id.*

Business Profit Eligibility for Subchapter V

In re RS Air, LLC, No. BAP NC-21-1227-BGT, 2022 WL 1288608 (B.A.P. 9th Cir. Apr. 26, 2022) (Brand, Gan, Taylor)

The creditor appealed the bankruptcy court's orders that overruled the objection to the debtor's Subchapter V election and the objection to confirmation of the plan. "Contending that that the debtor had no profit motive, the creditor based its appeal, and the debtor's Subchapter V ineligibility, on the debtor never being a revenue-generating business. In fact, the creditor argued that the debtor had no…. operations since 2017, no revenue or income since 2012, and no employees." *Id.* at 2. The core issue in this case was whether [the debtor] "engaged in commercial

or business activities" within the meaning of § 1182(1)(A). *Id.* at 5. A majority of courts have held that a debtor need not be "actively operating" on the petition date, but must be "presently" engaged in commercial or business activities on the petition date to satisfy § 1182(1)(A). "The bankruptcy court reasoned that [the debtor] was engaged in commercial or business activities on the petition date by litigating with [the creditor], paying its…. registry fees, remaining in good standing as a Delaware LLC, and filing its tax returns." *Id.* at 6. The Panel agreed and noted "a debtor need not be maintaining its core or historical operations on the petition date, but it must be "presently" engaged in some type of commercial or business activities to satisfy § 1182(1)(A). *Id.* at 5.