MCLE Article: Test Your Knowledge: Recent Developments in Insolvency Law

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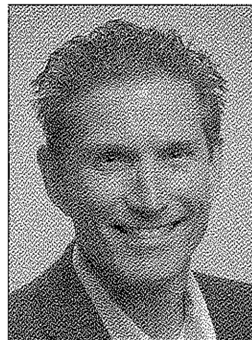

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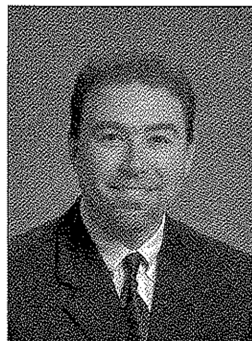

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Welcome to the fifth annual edition of our article covering developments in bankruptcy law. This article comes from a program we present for the Bankruptcy and Commercial Law Section of the Sacramento County Bar Association. Once again, we invite you to test your knowledge of recent developments in the area of insolvency law. Unless otherwise noted, all references are to the Bankruptcy Code. We provide a summary of the facts, issues, and holdings from a mix of recent important and interesting bankruptcy decisions. For MCLE credit, please see the twenty true/false questions at the end of the article. Good luck!

1. Supreme Court Sets Standard of Review for Non-Statutory Insider Determination: *U.S. Bank N.A. v. Village at Lakeridge, LLC*, 583 U.S. ___ (Mar. 5, 2018).

This case clarifies the standard of review for an appellate court on the question of whether a creditor is a non-statutory insider. In bankruptcy, if a creditor is an insider, its vote to approve a chapter 11 plan does not count for purposes of determining whether an impaired class of claims has accepted the plan under § 1129(a)(10). The choices are a *de novo* standard, which is used for questions of law or mixed questions of law and fact, or a clearly erroneous standard, which is used for questions of fact.

In *U.S. Bank v. Village at Lakeridge, LLC*, the bank held a $10 million secured claim against the debtor. The debtor was controlled by MBP Equity Partners, which held a $2.76 million unsecured claim. The debtor's plan had two classes of claims, one with the bank claim and the other with the insider unsecured claim. To confirm the plan, the debtor needed at least one of the two classes to vote in favor of the plan. The bank voted against the plan, so the debtor needed the other class with MBP to vote in favor. But MBP's vote as an insider did not count to meet the requirement that an impaired class accept the plan. MBP sold its $2.76 million unsecured claim for $5,000 to Rabkin, a friend of one of the MBP board members. The sale of the claim to an apparent non-insider would allow the claim to be voted in support of the debtor's plan, which would then qualify as the one accepting impaired class under § 1129(a)(10).

The bank filed a motion to disallow Rabkin's claim for voting purposes because it was a claim of an insider. The bankruptcy court held that Rabkin was not an insider, because Rabkin and the MBP board member did not cohabitate or purchase expensive gifts for each other and Rabkin did not exercise control over the debtor. The bankruptcy court also held, however, that because Rabkin had acquired the claim from an insider of the debtor, Rabkin's claim was an insider claim that could not be counted for plan voting purposes.

On appeal, the Bankruptcy Appellate Panel ("BAP") affirmed the finding that Rabkin was not an insider because of his relationship to the MBP board member, but reversed the bankruptcy court's decision that Rabkin was an insider

because he purchased the claim of an insider. The Ninth Circuit affirmed. Viewing the bankruptcy court's decision as based on a finding that the claim purchase was conducted at arm's length, the Ninth Circuit held that the finding was entitled to clear error review and could not be reversed under that deferential standard.

The Supreme Court granted review on the sole question of the standard of review for an appellate court on the question of whether a creditor is a non-statutory insider. The Supreme Court actually agreed with the Ninth Circuit! The Court held that the clear error standard of review applied in this case for determining non-statutory insider status.

The Court held that there are three things a court must determine when faced with the issue of whether a creditor is a non-statutory insider: The first is the legal test to determine whether someone is a non-statutory insider. This part of the analysis is reviewed under the de novo standard, because it is a purely legal issue. The next part is the factual part of the analysis, addressing questions of who did what, when, or where, how, or why. That, of course, is purely factual, and is reviewed for clear error. The third part is to determine whether the facts satisfy the legal test for conferring non-statutory insider status. This is the so-called "mixed question" of law and fact at the heart of this case, which considered the standard of review that should be applied by a reviewing court at this stage of the analysis.

Well, the Court didn't really give us a concrete answer. It said that not all mixed questions of law and fact are alike. Some require courts to expound on the law, particularly by amplifying or elaborating on a broad legal standard. When that is so—when applying the law involves developing auxiliary legal principles of use in other cases—appellate courts should typically review a decision de novo. Other mixed questions immerse courts in case-specific factual issues, compelling them to marshal and weigh evidence and make credibility judgments. And when that is so, appellate courts should usually review a decision with deference.

Here, the Court found that the question was more factual than legal, so the clear error standard applied by the Ninth Circuit was correct. Interestingly, there is more in the concurring opinions by Justice Kennedy and Justice Sotomayor about whether the Ninth Circuit articulation of the legal test for determining whether a creditor is a non-statutory insider is right. However, the Court did not grant review on that issue.

2. Detailed Findings are Required Before Dismissing a Bankruptcy Case Due to Marijuana Connections: *In re Olson*, 2018 WL 989263 (B.A.P. 9th Cir. Feb. 5, 2018) (unpublished).

Under the federal Controlled Substances Act, 21 U.S.C. §§ 801-904 ("CSA"), it is unlawful to, among other things, "knowingly and intentionally lease, profit from, or make available for use, with or without compensation, any place for the purpose of unlawfully storing, distributing, or using a controlled substance" such as marijuana.

In the *Olson* case, the debtor ("Debtor") was ninety-two years old and legally blind, and resided in an assisted living facility. Her son helped her obtain tenants for, and manage, a small shopping center. One of the tenants ("Tenant") was a marijuana dispensary that was legal under California and local law. The shopping center generated about $18,000 per month in rents, of which about $10,000 per month came from Tenant. The Debtor's son did not do a very good job of helping her pay the mortgage secured by her shopping center, however, and the mortgage went into default.

On the eve of the foreclosure of the mortgage, the Debtor filed chapter 13 to stay the foreclosure. The Debtor entered into a cash collateral agreement with the lender that required her to make "adequate protection" payments of $4,000 per month. The record was not clear as to what rents the Debtor had collected postpetition or how the rents had been applied. The Debtor filed motions to reject the Tenant lease, sell the property, and confirm a chapter 13 plan based upon the sale of the shopping center. Tenant, who alleged that, in addition to the lease, he had an option to purchase the property, filed a motion to dismiss the case on the grounds that his payment of rent to the Debtor violated the CSA. At the hearing on the motion to sell the property and to reject the lease with the Tenant, the bankruptcy court dismissed the case *sua sponte* on the ground that the Debtor's postpetition acceptance of rents from the dispensary business was an ongoing criminal violation that disqualified her from bankruptcy relief. The judge explained that "[t]he Debtor committed the crime of accepting postpetition rent from a marijuana business."

On appeal, the BAP found that the bankruptcy court did not articulate the legal basis for its ruling or make sufficient findings to support its conclusion that the CSA was being knowingly violated. Notably, the bankruptcy court made no bad faith finding, and did not engage in the "totality of

the circumstances" analysis required for dismissal under § 1307(c). Nor did the bankruptcy court make findings that it had dismissed the case pursuant to its inherent power, under § 105(a), to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." The BAP explained that the situation would be different had the debtor sought to continue to distribute marijuana postpetition or were a bankruptcy trustee being asked to accept proceeds of a drug-related business—situations in which federal law would clearly have been violated.

The BAP noted that, in the Debtor's favor, her case and her plan did not necessarily make use of any of Tenant's rents, and it was not certain that the Debtor had knowingly violated the CSA. As explained in the concurring opinion,

> [t]he bankruptcy court here made no finding, however, that the trustee would be administering the proceeds of an illegal business, and there is no evidence in the record that the rents were to be used to fund the plan. A finding explaining how a debtor violates federal law or otherwise provides cause for dismissal is important to avoid incorrectly deeming a debtor a criminal and denying both debtor and creditors the benefit of the bankruptcy laws.

The BAP remanded the case for the bankruptcy court to re-consider the dismissal of the case and make further findings.

3. Supreme Court Interprets Safe Harbor from Avoidance of Fraudulent Transfers: *Merit Management Group, LP v. FTI Consulting, Inc.*, 583 U.S. ___ (Feb. 27, 2018).

In *Merit Management Group, LP v. FTI Consulting, Inc.*, the U.S. Supreme Court interpreted a little-used "safe harbor" provision of § 546(e) that protects from avoidance as fraudulent transfers certain transfers that involve financial institutions. § 546(e) says that "the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract."

In this case, debtor Valley View Downs attempted to develop a "racino" (a business that has horse racing and casino gambling) in Pennsylvania. Valley View needed both a racing license and a gaming license, and was in competition with Bedford Downs for the only available racing license. Valley View decided to buy out the competition, and purchased Bedford Downs in a $55 million cash-for-stock agreement. Merit Management Group, a 30% owner of Bedford Downs, received payments of $16.5 million for its stock. The payments went through three different financial institutions. Valley View was granted its racing license, but it could not get the gaming license, and ended up in bankruptcy.

A plan of liquidation was confirmed and FTI was appointed trustee of the litigation trust under the plan. FTI sued Merit to get back the $16.5 million Merit had received from Valley View for its stock of Bedford Downs. Defending the transfer, Merit claimed that the transfer was immune from avoidance under § 546(e), which provides that "the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract." Merit argued that the safe harbor provision applied because the transaction FTI sought to avoid involved transfers "by or to" a "financial institution." FTI argued that the safe harbor provisions of § 546(e) did not apply when the financial institution was merely a conduit in the transaction.

The District Court for the Northern District of Illinois agreed with Merit's "plain language reading of section 546(e)" over FTI's "legislative history arguments," and held that the transfer was protected from avoidance because the transfer FTI sought to avoid involved transfers by or to a financial institution. FTI appealed to the Seventh Circuit Court of Appeals. The Seventh Circuit held that § 546(e) does not provide a safe harbor against avoidance of transfers where the financial institution acts as merely a conduit, determined that the financial institutions were mere conduits, and concluded that the safe harbor in § 546(e) did not apply.

The U.S. Supreme Court granted certiorari on May 1, 2017, because of the split in the circuit decisions on the issue: The Second, Third, Sixth, Eighth, and Tenth Circuits had all held that § 546(e) prohibits avoidance of a transfer made by or to a financial institution, without regard for whether the institution has a beneficial interest in the property transferred. The Eleventh Circuit, and now the Seventh Circuit, had held that for § 546(e) to apply, the financial institution cannot be a mere conduit for the transaction. (The Ninth Circuit has never addressed the issue.)

The Court held that the statutory language, the statutory structure, and the context in which it is used all point to the transfer that the trustee seeks to avoid as the relevant transfer for consideration of the § 546(e) safe-harbor criteria. Applying that understanding of the safe-harbor provision to this case yields a straightforward result: FTI sought to avoid the $16.5 million Valley View-to-Merit transfer. FTI did not seek to avoid the component transactions involving the financial institutions by which that overarching transfer was executed. As such, when determining whether the § 546(e) safe harbor saves the transfer from avoidance liability, i.e., whether it was "made by or to (or for the benefit of) a . . . financial institution," the Court must look to the overarching transfer from Valley View to Merit to evaluate whether it meets the safe-harbor criteria. Because the parties did not contend that either Valley View or Merit is a "financial institution" or other covered entity, the transfer falls outside of the § 546(e) safe harbor. The judgment of the Seventh Circuit was affirmed.

4. California Supreme Court Clarifies Irreconcilable Spendthrift Trust Statutes: *Frealy v. Reynolds (In re Reynolds)*, 867 F.3d 1119 (9th Cir. 2017).

One Rick Reynolds unfortunately had limited income and limited credit management skills. But, fortunately, he did have wealthy parents who owned undeveloped real property worth several million dollars. They put the real property into a spendthrift trust ("Trust") for the benefit of their son.

A spendthrift trust precludes creditors from reaching a beneficiary's interest in the trust while the trust property is in the hands of the trustee of the trust. Generally speaking, California probate law allows creditors to reach only 25% of the distributions to a beneficiary, and only to the extent that a distribution is not necessary for the beneficiary's education or support.

The Trust provided that, upon his parents' death, Rick would receive $250,000 immediately, and then $100,000 a year for ten years, and then one-third of the remainder of the Trust's assets. The Trust assets produced no income, so that Trust assets had to be liquidated to make distributions.

Rick's parents died. One day later, Rick filed a chapter 7 petition. (One surmises that he wanted to discharge his debt before he began receiving Trust distributions.) The trustee of the Trust filed an action in bankruptcy court for a declaration of the rights of the bankruptcy trustee in the Trust.

The bankruptcy court held that the bankruptcy trustee's rights, standing as a hypothetical judgment creditor, were limited to 25% of the payments from the Trust, notwithstanding a California Probate Code statute that appeared to provide no limit where the Trust made payments from "principal." The BAP affirmed. On further appeal, the Ninth Circuit determined that the Probate Code provisions were irreconcilable, and certified the question to be addressed by the California Supreme Court. That court then issued a decision, *Carmack v. Reynolds*, 391 P.3d 625, 628 (2017), and the matter was sent back to the Ninth Circuit.

The Ninth Circuit, based upon the ruling of the California Supreme Court:

> (a) held that (i) the bankruptcy estate was not limited to 25% of Trust distributions, but was entitled to the full amount of those distributions, because they were all payments of "principal," due to be paid as of the petition date, in the amount of $250,000; (ii) if, however, the Trust instrument specified that the funds were for the support or education of the debtor, the bankruptcy trustee could not access any portion of distributions that the beneficiary needed for his support or education, even out of currently payable principal distributions; and (iii) the bankruptcy estate could reach 25% of expected future payments from the Trust, reduced by the amount, if any, the beneficiary needed to support himself and his dependents; and
>
> (b) remanded the matter to the bankruptcy court to apply the above teachings of the California Supreme Court.

5. A Statement About One Asset Can Be a Statement Respecting a Debtor's Financial Condition for Purposes of Non-Dischargeability: *Appling v. Lamar, Archer, & Cofrin, LLP*, 848 F.3d 953 (11th Cir. 2017).

This case involved whether a debtor's false statement about one of his assets can ever be a statement respecting the debtor's financial condition. § 523(a)(2) contains two different provisions that, if applicable, make a debt incurred

by fraud nondischargeable. § 523(a)(2)(A) provides that a debt is nondischargeable if obtained by false pretenses, false representation, or actual fraud, except if it is a statement respecting the debtor's financial condition. § 523(a)(2)(B) provides that a debt is nondischargeable if it is a materially false statement respecting the debtor's financial condition on which the creditor reasonably relied. However, for the debt to be nondischargeable under § 523(a)(2)(B), the statement has to be in writing. So, the question in this case was whether a false statement by the debtor about one asset constituted a statement respecting the debtor's financial condition such that it had to be in writing to be nondischargeable under § 523(a)(2)(B).

In *Appling v. Lamar, Archer, & Cofrin, LLP*, Appling hired the law firm Lamar, Archer & Cofrin, LLP, to represent him in litigation. Appling's legal fees in the litigation grew to $60,819.97, when the law firm threatened to stop working unless Appling paid the outstanding fees. Appling convinced the law firm to keep working by promising to pay the fees from an expected tax refund of "approximately $100,000."

When Appling filed his tax return, the requested refund was only $60,718, and he received a refund of only $59,851. Appling did not use the money to pay the law firm. When the law firm inquired about the status of the refund money, Appling told them that he had not yet received it.

The legal bill remained unpaid. The law firm eventually sued Appling and obtained a judgment for $104,179.60. Three months later, Appling filed bankruptcy, and the law firm filed a nondischargeability action. The bankruptcy court ruled that because Appling made fraudulent statements on which Lamar justifiably relied, Appling's debt to Lamar was nondischargeable under § 523(a)(2)(A).

The district court affirmed. The district court rejected Appling's argument that, because his statements "respect[ed] . . . [his] financial condition," the statements had to be in writing to be nondischargeable under § 523(a)(2)(B), and that therefore §523(a)(2)(A) did not apply. The district court ruled that "statements respecting the debtor's financial condition involve the debtor's net worth, overall financial health, or equation of assets and liabilities. A statement pertaining to a single asset is not a statement of financial condition."

If the statements about the tax refund were statements "respect[ing] … [his] financial condition," Appling could discharge his debt to Lamar, because the statements were not in writing.[1] If statements regarding the one asset are not considered statements respecting the debtor's financial condition, then a writing is not required, and subsection (A) governs.

The Eleventh Circuit Court of Appeals held that the statutory language was unambiguous, so that the ordinary everyday meanings of its words should be used. Reviewing its dictionary resources, the court stated that "financial condition" means the sum of all assets and liabilities, but it does not follow that the phrase statement "respecting the debtor's . . . financial condition" covers only statements that encompass the entirety of a debtor's financial condition at once. Read in context, the phrase "statement respecting the debtor's . . . financial condition," includes a statement about a single asset. To hold otherwise, the court felt, would be reading the word "respecting" out of the statute. "Respecting" is defined broadly in Webster's Dictionary and the Oxford Dictionary as "[w]ith regard or relation to; regarding; concerning." The court used the example of medical documents, which can "relate to" or "concern" someone's health without describing their entire medical history. Similarly, articles can "reference" the Constitution without quoting its entire text. Likewise, a statement can "respect" a debtor's "financial condition" without describing the overall financial situation of the debtor. So, if the statement is about a single asset or not, but is a statement respecting the debtor's financial condition, it has to be in writing to qualify for nondischargeability under § 523(a).

The U.S. Supreme Court issued its decision affirming the Eleventh Circuit on June 4, 2018, holding that the statutory language makes plain that a statement about a single asset can be a "statement respecting the debtor's financial condition."[2]

6. Ninth Circuit holds that Seller, Who Unwittingly Receives Purchase Price as Part of a Fraudulent Transfer, Was "Initial Transferee" and Not Entitled to a Good Faith Defense: *In re Walldesign Inc.* 872 F.3d 954 (9th Cir. 2017).

The owner ("Bello") of a corporation ("Walldesign") maintained a secret corporate bank account. Over the course of ten years, he skimmed $8 million of his company's income and put it into the separate corporate account, which he used to pay personal and non-company expenses. In one example, another corporation Bello owned, called RU Investments, bought property in St. Helena, California for $220,000 in an arms-length, fair value transaction. Bello

used the property to run a "Bello Family Vineyard" tasting room. The purchase price was paid with a check from Walldesign, as were other payments to the sellers.

Walldesign later filed a chapter 11 petition. The Committee of Unsecured Creditors sued the sellers of the St. Helena property to recover the purchase price as a constructively fraudulent transfer under § 544 and California law. The main allegation was that Walldesign paid for the property but received no consideration (any consideration for the purchase was enjoyed only by Bello personally), and thus it was a fraudulent transfer.

The bankruptcy court granted summary judgment in favor of the sellers, finding that they were *not* "initial transferees," and that, in effect, the funds were transferred first from Walldesign to Bello, and then from Bello to the sellers. Under § 550(b)(1), a subsequent transferee of property that is fraudulently transferred has a complete defense to the avoidance of the alleged fraudulent transfer if the subsequent transferee takes the property for value and in good faith. This defense is not available to an initial transferee. The district court disagreed with the bankruptcy court and held that the sellers were immediate transferees of the purchase price and thus did *not* have a good faith for value defense and were strictly liable to return the funds.

On further appeal, the Ninth Circuit affirmed the district court. The Ninth Circuit held that the proper standard for evaluating whether a party is a transferor is the "dominion test," which "focuses on whether the recipient of funds has legal title to them and . . . [is] akin to legal control." Since Walldesign owned the funds in the secret corporate account, the sellers were initial transferees. The Ninth Circuit, relying on prior precedent, rejected adoption of the "control" test, which requires courts to "view the entire transaction as a whole to determine who truly had control" of the property. Under that test, since Bello—and not Walldesign—had true "control" of the funds, Bello would have been the "initial transferee," and sellers would have been subsequent transferees entitled to a good faith defense.

The Ninth Circuit described the "control" test as the majority rule, but nevertheless rejected it. The Ninth Circuit acknowledged that using the dominion test led to a harsh result in this case, but reasoned that it was not illogical to allocate the risk of fraud to the innocent sellers because they, as parties to the transfer, "generally stand in a better position to guard against corporate fraud than do unsuspecting creditors" not in a position to know that the money paying a personal expense came from a corporate account.

Lesson: Beware if you sell an asset and get paid from an entity other than the buyer.

7. Due on Sale Clause not Necessary in § 1111(b) Election Situation and Consenting Impaired Class Requirement Applies on Per Plan Basis: *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Properties (In re Transwest Resort Props.)*, 881 F.3d 724 (9th Cir. 2018).

This Ninth Circuit case involved two somewhat complicated provisions of the Bankruptcy Code. First, § 1111(b) allows an undersecured creditor under a chapter 11 plan to elect to have its entire claim treated as secured. If the 1111(b) election is not made, a debtor may separate an undersecured claim into a secured claim in the amount of the value of the collateral securing the debt and an unsecured claim for the balance. If the election is made, the debtor's plan has to provide for the payment in full of the debt, and the secured creditor forgoes its unsecured claim. The second provision at issue in this case was the requirement in § 1129(a)(10) that at least one class of claims that is impaired under a chapter 11 plan accept the plan. When multiple debtors are dealt with under a single plan, the question can arise whether the debtor has to have an impaired accepting class for each debtor, or only one, since there is only one plan.

In *In re Transwest Resort Properties*, a group of five related companies owned and operated two hotels. All five companies ("Debtors") filed chapter 11 bankruptcy cases. The five cases were jointly administered, but not substantively consolidated. One lender ("Lender") filed a claim in the bankruptcy for $298 million based on an operating loan secured by both hotels. A mezzanine lender filed a $39 million claim based on a mezzanine loan secured by the membership interests held by two of the Debtors in another two Debtors that actually owned the hotels. The Lender subsequently acquired the mezzanine lender's claim from the mezzanine lender.

The Debtors filed a joint reorganization plan, whereby third-party investor Southwest Value Partners would acquire the operating Debtors for $30 million (the "Plan"). The Lender, whose claim was undersecured, elected to have its entire claim treated as secured pursuant to § 1111(b)(2). The

Plan restructured the Lender's loan to a term of twenty-one years and required monthly interest payments and a bullet payment at the end of the term. The Plan included a due-on-sale clause requiring the Debtors to pay the Lender the outstanding balance of the restructured loan in the event the resorts were sold. However, the due-on-sale clause did not apply if the Debtors sold the resorts between Plan years five and fifteen. The Lender voted against the Plan, but several other impaired classes voted to approve the Plan.

The Lender objected to two aspects of the Plan. First, the Lender objected to the ten-year exception in the due-on-sale clause, contending that the exception in the due-on-sale clause would allow the Debtors to partially negate the benefit of the § 1111(b)(2) election. Second, the Lender asserted that § 1129(a)(10), which requires that at least one impaired class accept the Plan, applies on a "per debtor," not a "per plan," basis. Because the Lender was the *only* class member for the mezzanine Debtors, and did not vote to approve the Plan, the Lender argued that the Plan did not satisfy § 1129(a)(10). The bankruptcy court overruled the Lender's objections and confirmed the Plan.

The district court affirmed, holding that an election under § 1111(b)(2) does not require that a due-on-sale clause be included in the Plan and that § 1129(a)(10) applies on a "per plan" basis.

On the 1111(b) issue, the court found that the Lender's argument that § 1111(b) requires a due-on-sale clause to be included in the Plan was not supported by the text of the statute, and that the language of the statute does not implicitly require the inclusion of such a clause. The court also said that the broader statutory context of chapter 11 further undermines the Lender's position. § 1123 describes the required contents of a chapter 11 plan, and nothing in § 1123 requires the inclusion of a due-on-sale clause in a plan, let alone in a plan proposed following a § 1111(b) election. Instead, § 1123(b)(5) indicates that a plan may "modify the rights of holders of secured claims." This would include the ability to determine whether to include a due-on-sale clause in the documentation of any secured creditors' claims. Further, § 1129(b)(2)(A)(i)(I) requires that, for a plan to be fair and equitable, the holder of a claim must retain the lien securing that claim even when "the property subject to such liens is . . . transferred to another entity." Thus, the statute expressly allows a debtor to sell the collateral to another entity so long as the creditor retains the lien securing its claim, yet the statute does not mention any due-on-sale requirement.

However, the court noted in a footnote that the holding does not imply that "due-on-sale" protection is irrelevant to whether a plan is "fair and equitable" under § 1129(b). Here, the lender had waived any argument that the Plan was not "fair and equitable." The availability of due-on-sale protection certainly will be relevant to whether a plan is confirmable in other reorganizations, however.

On the applicability of the "one accepting impaired class" requirement of § 1129(a)(10), the court relied on the plain language of the statute to find that it applies on a per plan basis, even if the plan is a combined plan of five different debtors. The plain language of the statute supports the "per plan" approach: § 1129(a)(10) requires that one impaired class "under the plan" approve "the plan," and the statutory language neither refers to the creditors of different debtors under "the plan," nor distinguishes between single-debtor and multi-debtor plans. Under its plain language, once a single impaired class accepts "a plan," § 1129(a)(10) is satisfied as to the entire plan. (The court did note that this issue was a matter of first impression among the circuits.)

8. Ninth Circuit Holds that Discharge Revocation Deadline Is not Jurisdictional: *In re Elliott*, 859 F.3d 812 (9th Cir. 2017).

Mr. Edward Elliott filed a chapter 7 petition, but on his bankruptcy schedules, failed to disclose his ownership of a single-family home. He got a discharge. Fifteen months later, the asset came to the attention of the trustee, who sued the debtor to revoke his discharge and for other relief.

Section 727(e)(1) provides that "[t]he trustee . . . may request a revocation of a discharge . . . under subsection (d)(1) of this section within one year after such discharge is granted." In opposing the trustee's request to revoke his discharge, Elliott never raised the untimeliness of the complaint as a defense.

The bankruptcy court granted summary judgment to the trustee. The court found that Elliott had knowingly and fraudulently failed to disclose his ownership interest in the home, and had knowingly and fraudulently misrepresented where he lived. The court further found that the trustee did not learn of Elliott's fraud until after the discharge had been granted.

The BAP vacated the bankruptcy court's judgment, on the grounds that the trustee had not timely filed her request

for revocation of discharge within the time limit imposed by 11 U.S.C. § 727(e)(1), and that the time limit was jurisdictional.[3]

On further appeal, the Ninth Circuit reversed the BAP. It held that the time limit imposed by § 727(e)(1) is not a jurisdictional constraint. The most common examples of "jurisdictional" time limits are those concerning the time for filing a notice of appeal. In this case, the Ninth Circuit held that § 727(e)(1) is "an ordinary, run-of-the-mill statute of limitations, specifying the time within which a particular type of action must be filed." "Congress did not clearly state that the filing deadline imposed by § 727(e)(1) should be regarded as jurisdictional. Nothing in the text of the provision 'speak[s] in jurisdictional terms.'"

The BAP based its conclusion that the deadline was "jurisdictional" upon its reading of *Kontrick v. Ryan*, 540 U.S. 443 (2004), which held that the time limit specified in Federal Rule of Bankruptcy Procedure 4004 is non-jurisdictional and suggested that statutory deadlines by contrast were jurisdictional. But the Ninth Circuit found that nothing in *Kontrick* says that if a time limit is set by statute it must be regarded as jurisdictional.

A concurring opinion describes the different categories of statutes of limitations: A "jurisdictional" deadline, also called a statute of repose, specifies that after a certain deadline a court no longer has power to act. For example, a product liability claim statute that provides the claims must be brought within twelve years is jurisdictional. On the other hand, a "normal" statute of limitations, such as the statute in this case, is an affirmative defense that can be waived.

A separate consideration, not at issue in this case, was whether a statute of limitations is subject to equitable tolling, which is usually the case, or whether the statute is "mandatory" and thus not subject to equitable tolling.

9. Dissolving Law Firm Has No Property Interest in the Cases that Are in Progress but not Completed at the time of Dissolution: *Heller Ehrman LLP v. Davis Wright Tremaine LLP*, ___ Cal. 4th ___ (Mar. 5, 2018).

As most lawyers probably know, a bankruptcy trustee or debtor can seek to avoid certain transfers of property that occurred prior to the bankruptcy filing as fraudulent transfers. This case involved an attempt by a plan administrator under a confirmed plan of liquidation (with the powers of a trustee) to avoid the waiver of any right to profits in legal cases debtor Heller Ehrman LLP's lawyers took to their new firms after that law firm went out of business. The case wound its way from the bankruptcy court to the Ninth Circuit and then to the California Supreme Court.

In *Heller Ehrman LLP v Davis Wright Tremaine LLP*, the plan administrator under the liquidating chapter 11 plan filed adversary proceedings against the law firms in which Heller's former shareholders had found work after Heller went out of business. Prior to bankruptcy, Heller's dissolution plan included a provision known as a *Jewel* waiver. Named after the case of *Jewel v. Boxer*, the provision purported to waive any rights Heller may have had "to seek payment of legal fees generated after the departure date of any lawyer or group of lawyers with respect to non-contingency/non-success fee matters only." The plan administrator sought to set aside the *Jewel* waiver as a fraudulent transfer of Heller's rights to post-dissolution fees to its former shareholders, and from them, to their new firms.

The parties filed cross-motions for summary judgment on whether the *Jewel* waiver constituted a transfer of Heller's property and whether any such transfer was a fraudulent transfer. The bankruptcy court ruled in favor of Heller on both issues.

The district court reversed. The court rested its ruling on considerations of law, equity, and public policy. The court reasoned that the Revised Uniform Partnership Act ("RUPA") undermined *Jewel*, in that RUPA contains no provision giving dissolved law firms the right to demand an accounting for profits earned by its former partners under new retainer agreements. The court held that Heller did not have a property interest in the hourly fee matters pending at dissolution. Since Heller did not have a property interest in such matters, there was no fraudulent transfer when the shareholders executed the waiver of the *Jewel* rights.

In Heller's appeal to the Ninth Circuit, the court of appeals asked the California Supreme Court to resolve the question of what property interest, if any, a dissolved law firm has in the legal matters, and therefore the profits, of cases that are in progress but not completed at the time of dissolution.

The court held that under California law, a dissolved law firm has no property interest in legal matters handled on an hourly basis, and, therefore, no property interest in the profits generated by its former partners' work on hourly fee matters pending at the time of the firm's dissolution. The court held that the partnership had no more than an

expectation that it may continue to work on such matters, and that that expectation may be dashed at any time by a client's choice to change lawyers. The firm's expectation—a mere possibility of unearned, prospective fees—does not constitute a property interest. To the extent the law firm has a claim against the new firm, its claim is limited to the work necessary to preserve the legal matters so that they can be transferred to new counsel of the client's choice, to effectuate such a transfer, or to collect on work done pretransfer. The court found that its ruling was consistent with the RUPA provisions. Further, the court held that recognizing a property interest even in hourly matters would also risk impinging on the client's right to discharge an attorney at will, a right that has been recognized in both statute and case law. Thus, there was no fraudulent conveyance, since there was no property interest given up in the waiver of the *Jewel* rights by the Heller shareholders.

10. Ninth Circuit Holds Sale "Free and Clear" under § 363(f) Includes Leases: *In re Spanish Peaks Holdings II, LLC*, 862 F.3d 1148 (9th Cir. 2017).

Spanish Peaks Holdings II, LLC (the "Debtor") leased commercial properties to two insider-controlled tenants on extremely favorable terms. The properties were encumbered by a mortgage. The Debtor (together with related debtors) filed a chapter 7 case. In cooperation with the lender, the chapter 7 trustee made a motion to sell the properties that were subject to the extremely favorable insider leases "free and clear of liens, claims, encumbrances and interests" under § 363(f), subject to overbidding, and without specifying whether the sale was free and clear of the leases.

The insider tenants objected to the motion because it did not recognize their right under § 365(h) to elect to remain in possession under the leases if the leases were rejected. After several hearings, the court approved the sale without ruling on the lease issue. Instead, the bankruptcy court required the parties (tenants, purchaser, and trustee) to address the post-sale status of the leases by separate motion.

The court then ruled that the sale had been free and clear of the leases, and that because the tenants failed to ask for adequate protection under § 363(e), they were not entitled to any relief. The district court affirmed on appeal, and the Ninth Circuit agreed.

The Ninth Circuit, adopting what it said was the minority view, found that the term "interest" in property used in § 363(f) is broad enough to include leases and does not specifically exclude them, and that allowing a sale free and clear of leases harmonizes §§ 363 and 365, which after all addresses distinct situations: sales of property, on the one hand, and assumption and rejection of leases, on the other. The Ninth Circuit reasoned that any sale under § 363(f) is subject to a tenant's right of adequate protection under § 363(e), which could include, in the court's discretion, the right to remain in possession.

It is noteworthy that the opinion at the outset said that it would affirm the ruling *"on the facts of this case."* These facts included insider leases on extremely favorable terms. Further, the bankruptcy case was part of the long and seedy saga of the Timothy Blixseth-related bankruptcies. Under these facts, it was not that troubling that the tenants were, in effect, shut out with no relief, but the ruling has potentially broad impact for other sales when the debtor is a landlord.

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Endnotes

1 11 U.S.C. § 523(a)(2)(B).

2 *Lamar, Archer & Cofrin, LLP v. Appling,* 540 U.S. ___ (2018).

3 *In re* Elliott, 529 B.R. 747, 755 (B.A.P. 9th Cir. 2015).