Westlaw Journal

BANKRUPTCY

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VOLUME 11, ISSUE 3 / JUNE 5, 2014

WHAT'S INSIDE

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WARN ACT

Bankrupt clean-energy provider owes unpaid wages, suit says

A clean-energy company that filed for bankruptcy in early May has been sued in a proposed class-action lawsuit for allegedly failing to give required notice before it terminated hundreds of workers at two facilities in Connecticut.

Wojciechowski v. ClearEdge Power Inc. et al. (In re ClearEdge Power Inc. et al.), No. 14-05043, adversary complaint filed (Bankr. N.D. Cal. May 2, 2014).

Former ClearEdge Power Inc. employee Peter Wojciechowski says the company violated the 60-day pre-termination notice requirement under the Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101.

Wojciechowski brought the complaint in the U.S. Bankruptcy Court for the Northern District of California on May 2, the day after the company and subsidiary ClearEdge Power LLC filed for Chapter 11.

The companies, based in Sunnyvale, Calif., manufacture fuel cells that combine hydrogen fuel and oxygen from the air to produce electricity, heat and water.

REUTERS/Chip East

The May 1 bankruptcy filing was precipitated by instability in the industry and constraints on working capital, according to court records.

CONTINUED ON PAGE 22

COMMENTARY

Collective bargaining agreements: When the end really isn't the end

Bruce Buechler and Jillian Zadie of Lowenstein Sandler LLP discuss whether, and on what basis, bankruptcy courts can modify collective bargaining agreements expiring prior to the petition.

SEE PAGE 3

COMMENTARY

The impact of prime contractor bankruptcy on U.S. government contracts

Evan C. Hollander, Steven S. Diamond and Dana Yankowitz Elliott of Arnold & Porter discuss how the venue of a prime government contractor's bankruptcy proceeding can affect the company's ability to retain the benefits of its federal contracts.

SEE PAGE 6

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Westlaw Journal Bankruptcy

Published since May 2004

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Westlaw Journal Bankruptcy
(ISSN 2155-0689) is published biweekly by Thomson Reuters.

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TABLE OF CONTENTS

Collective bargaining agreements: When the end really isn't the end

By Bruce Buechler, Esq., and Jillian Zadie, Esq.
Lowenstein Sandler LLP

Bankruptcy Code Section 365 allows a debtor to assume or reject an executory contract if certain conditions are met. A fundamental principle of contract law is that when a contract expires by its terms due to the passage of time, the parties are no longer bound by it. Thus, from a bankruptcy practitioner's standpoint, this means after a contract has expired by its own terms, there is no contract to assume or reject under Section 365 (or other applicable sections) of the Bankruptcy Code — or is there?

The common notion that a debtor cannot assume or reject an expired contract is debatable regarding collective bargaining agreements. Section 1113 of the Bankruptcy Code permits a debtor to modify or reject a collective bargaining agreement if the debtor follows certain steps prescribed by the statute.[1] Courts universally agree that this section thus grants a bankruptcy court the authority to modify an unexpired collective bargaining agreement.[2] Courts are split, however, regarding whether a collective bargaining agreement that expired pre-petition falls within the purview of Section 1113.[3]

Section 1113(b)(1) of the Bankruptcy Code provides as follows:

> (b)(1) subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession shall:
>
> (A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and
>
> (B) provide the representative of the employees with such relevant information as is necessary to evaluate the proposal.[4]

Section 1113(c) of the Bankruptcy Code allows a court to approve a debtor's application to reject a collective bargaining agreement only if the court finds:

- The debtor has, prior to the hearing, made a proposal fulfilling the requirements of subsection (b)(1).
- The authorized representative of the employees has refused to accept the proposal without good cause.
- The balance of the equities clearly favors rejection of the agreement.[5]

IN RE 710 LONG RIDGE ROAD

The U.S. Bankruptcy Court for the District of New Jersey recently weighed in on the debate regarding whether a bankruptcy court has authority to modify an expired collective bargaining agreement. In *In re 710 Long Ridge Road Operating Co. II LLC*, the court held that a collective bargaining agreement's "expired" status does not affect a debtor's need or ability to modify or reject the continuing economic terms to ensure survival as a going concern under Section 1113.[6]

Section 1113 of the Bankruptcy Code permits a debtor to modify or reject a collective bargaining agreement if the debtor follows certain steps.


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Each debtor in *710 Long Ridge Road* operated sub-acute and long-term nursing care facilities for the elderly, providing long-term and short-term rehabilitation services. As a result of labor costs under the debtors' collective bargaining agreements with the New England Health Care Employees Union, the debtors suffered significant losses between 2010 and 2012, and ultimately filed for Chapter 11 protection Feb. 24, 2013. Shortly thereafter, the debtors filed a motion seeking an order to reject the continuing economic terms of the expired collective bargaining agreements with the union.

The union, joined by the National Labor Relations Board, opposed the debtors' motion, saying jurisdiction over expired collective bargaining agreements is properly with the NLRB and not the bankruptcy court. Additionally, they said a collective bargaining agreement is an executory contract that, upon expiration, remains in force only as a "statutory obligation" under the National Labor Relations Act. This requires employers to maintain the existing terms and conditions of employment until lawful impasse is reached.[7] More specifically, the union said collective bargaining agreements create a set of obligations that exist only during the term of a contract and, upon expiration by their terms, are no longer viewed as legally binding contractual agreements.

In contrast, the debtors argued that the bankruptcy court has the authority to reject the continuation of the economic terms of the expired collective bargaining agreements. The debtors said the language in Section 1113(a) referring to "collective bargaining agreements," is inclusive of collective bargaining agreements that stay in effect by virtue of the NLRA, despite the expiration of the agreement by its terms. The court in *710 Long Ridge Road* ultimately determined that Section 1113 is applicable to a collective bargaining agreement that expired by its terms pre-petition.

IS AN EXPIRED CBA IRRELEVANT?

The *710 Long Ridge Road* court justified its decision with congressional intent, legislative history, previous NLRB decisions and precedent set by the 2nd U.S. Circuit Court of Appeals.

Regarding congressional intent in drafting Section 1113, the *710 Long Ridge Road* court noted that prior to 1984, courts consistently held that a collective bargaining agreement could be rejected as an executory contract under Section 365 of the Bankruptcy Code. Section 1113 was enacted in response to the U.S. Supreme Court's decision in *NLRB v. Bildisco & Bildisco*, which held that a collective bargaining agreement could be rejected pursuant to Section 365(a) of the Bankruptcy Code.[8]

It followed that in drafting Section 1113, Congress gave the bankruptcy court power to authorize the rejection of a collective bargaining agreement, but only after complying with specific requirements.[9] Based on this reasoning, the bankruptcy court in *710 Long Ridge Road* said congressional intent supports a bankruptcy court's authority to permit a debtor to reject an expired collective bargaining agreement, if necessary to further the purpose of reorganization.

The *710 Long Ridge Road* court said the NLRB itself has held that a debtor may avail itself of Section 1113(c) to reject an expired collective bargaining agreement. The court highlighted the NLRB's decision in *Accurate Die Casting Co.*, where the board set out the appropriate course of action for a debtor wishing to modify or reject the terms of its expired collective bargaining agreement.[10]

> The court held that a collective bargaining agreement's "expired" status does not affect a debtor's need or ability to modify or reject the continuing economic terms.

Specifically, the NLRB said, "to make the changes that [the debtor] sought in a lawful manner, [it] was required by the provisions of Section 1113 to propose them to the union, as the authorized representative of the employees in the unit, and, failing to obtain agreement by the union to such changes, to make application to the bankruptcy court."[11] Therefore, because the NLRB itself has held that a debtor may terminate its obligation to honor the residual effects of its expired collective bargaining agreement by complying with Section 1113(c), the *710 Long Ridge Road* court found the debtor's position appropriate.

The court continued its analysis by demonstrating that allowing rejection of an expired collective bargaining agreement aligns with the legislative history of Section 1113. This reveals that the statute was enacted to provide bankruptcy courts with ultimate authority to modify or terminate a debtor's collective bargaining obligations in order to facilitate an effective reorganization.[12] Given this purpose, the court found that Congress could not have intended to limit such authority only to unexpired collective bargaining agreements.

The court further said Section 1113 governs expired collective bargaining agreements based on language used by the 2nd Circuit in *Kreisberg ex rel. NLRB v. HealthBridge Management LLC*.[13] The 2nd Circuit said the debtor "failed to present sufficient evidence indicating how it would be further adversely affected financially by this temporary order enforcing the prior CBA, under which the parties operated for half a decade and *which may be modified as necessary by the bankruptcy court*."[14]

The *710 Long Ridge Road* court said the 2nd Circuit's language clearly suggests that courts have jurisdiction to modify expired collective bargaining agreements. The court distinguished *710 Long Ridge Road* from *In re Hostess Brands*,[15] a frequently cited case in this context, which held that the language of Section 1113 demonstrates the statute does not apply to expired collective barraging agreements.

The *710 Long Ridge Road* court also distinguished its decision from *Hostess Brands* because the debtor in *Hostess Brands* did not show that continuing the collective bargaining agreement's provisions would present a burden or financial risk to the debtor. The court pointed out that in their present case, the debtors would be forced to immediately liquidate if they were not permitted to reject the collective bargaining agreement.

The court repeatedly said throughout its opinion that adherence to the union's interpretation of the statute would result in the debtors' immediate closure, liquidation and loss of employment for hundreds of workers. On that basis, the court found the reasoning in *Hostess Brands* inapplicable.

UNILATERAL MODIFICATION OF EXPIRED CBAS MADE PRE-PETITION

The court additionally found that unilateral modifications to expired collective bargaining agreements made *pre-petition* fall outside the scope of 11 U.S.C. § 1113(f). Section 1113(f) bars a debtor from unilaterally terminating or altering any provision of a collective bargaining agreement before compliance with the provisions of Section 1113(c).[16]

Although expressly prohibiting unilateral modification, Section 1113 does not provide a remedy for violating the requirement.[17] The NLRB said courts should treat pre-filing "self-help" as per se stripping a debtor of the right to reject a collective bargaining agreement. Or, in the alternative, the courts should take any modifications into account in determining whether a debtor has satisfied the requirements of Section 1113(b)(2).

The *710 Long Ridge Road* court disagreed with the NLRB's proposed remedies. Instead, that court adopted an Indiana bankruptcy court's decision in *In re Indiana Grocery Co.*, holding that pre-petition modifications were not a basis to conclude that a debtor violated Section 1113.[18] Specifically, the *Indiana Grocery* court found that modifications made pre-petition are properly the subject of an NLRB unfair-labor-practice action, over which the bankruptcy court does not have jurisdiction.[19]

In *710 Long Ridge Road*, the debtors unilaterally modified the collective bargaining agreements four years before filing for Chapter 11 protection. The court found these unilateral modifications occurred pre-petition, and because the union did not assert that any post-petition unilateral modifications were made by the debtors, the modifications did not violate the Bankruptcy Code.

The court decided Section 1113(f) does not apply to any pre-petition unilateral modification to expired collective bargaining agreements by a debtor. Accordingly, only post-petition unilateral modifications will violate the statute.

Although the court clarified the scope of Section 1113(f), it did not address the result of noncompliance with the statute. The court's holding triggers many follow-up questions. For example, what if a debtor modifies or terminates a provision in a collective bargaining agreement on the eve of bankruptcy? It would appear from the court's decision that the petition date is a clear cutoff for unilateral modification.

CONCLUSION

In light of the uncertainty of the applicability of Section 1113 to expired collective bargaining agreements, attorneys must consider the possibility that a court may authorize rejection of an expired collective bargaining agreement if it is necessary for the debtor's reorganization. Case law continues to develop with respect to this issue. Practitioners should remain up-to-date with respect to decisions on this subject, as they may have a profound impact on their clients' abilities to assume or reject collective bargaining agreements. WJ

NOTES

[1] *See* 11 U.S.C. § 1113. A debtor wishing to assume a collective bargaining agreement must also comply with the provisions of Section 365, which governs assumption of executory contracts in general.

[2] *In re Karykeion Inc.*, 435 B.R. 663, 673 (Bankr. C.D. Cal. 2010).

[3] *See Id.* at 675 (holding that Section 1113(c) applies to expired collective bargaining agreements); *see also In re Ormet Corp.*, 2005 WL 2000704, at *2 (S.D. Ohio 2005) (same); *In re Hoffman Bros. Packing Co. Inc.*, 173 B.R. 177 (B.A.P. 9th Cir. 1994) (same); *Accurate Die Casting Co.*, 292 N.L.R.B. 982, 988 (1989) (same). In contrast, *see In re Hostess Brands Inc.*, 477 B.R. 378, 379 (Bankr. S.D.N.Y. 2012) (holding that Section 1113 is only applicable where a collective bargaining agreement exists at the time the Chapter 11 case is filed); *In re Sullivan Motor Delivery Inc.*, 56 B.R. 28, 29, 31 (Bankr. E.D. Wis. 1985) (same); *In re San Rafael Baking Co.*, 219 B.R. 860, 866 (B.A.P. 9th Cir. 1998) (same).

[4] 11 U.S.C. § 1113(b)(1).

[5] 11 U.S.C. § 1113(c).

[6] *See In re 710 Long Ridge Road Operating Co. II LLC et al.*, No. 13-13653, 2014 WL 407528 (Bankr. D.N.J. Feb. 3, 2014).

[7] *See* 29 U.S.C. § 158. An employer violates Section 8(a)(1) and Section (a)(5) of the act if it unilaterally changes a condition of employment that is the subject of negotiation (1962).

[8] *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 521-522 (1984). In Bildisco the Supreme Court found that when a debtor had not assumed the collective bargaining agreement, there was no enforceable contract, and thus a debtor's failure to maintain the continuing economic terms of a collective bargaining agreement was not actionable unfair labor practice.

[9] 11 U.S.C. § 1113.

[10] *Accurate Die*, 292 N.L.R.B. at 988.

[11] *Id.*

[12] *In re 710 Long Ridge Road*, 2014 WL 407528 at *13 (citing 130 Cong. Rec. 8899-900 at 20094 (Daily ed. June 29, 1984) (statement of Sen. Daniel Moynihan)).

[13] *Kreisberg ex rel. NLRB v. HealthBridge Mgmt. LLC et al.*, 732 F.3d 131, 143 (2d Cir. 2013) (emphasis added).

[14] *Id.*

[15] *In re Hostess Brands*, 477 B.R. at 379.

[16] 11 U.S.C. § 1113(f).

[17] *Id.*

[18] *In re Ind. Grocery Co.*, 138 B.R. 40, 47 (Bankr. S.D. Ind. 1990).

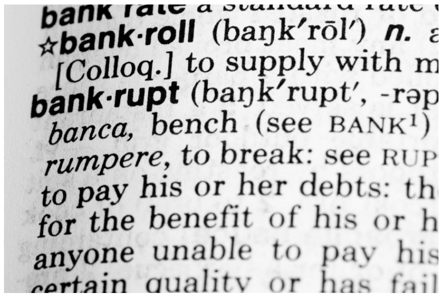
[19] *Id.*

The impact of prime contractor bankruptcy on U.S. government contracts

By Evan C. Hollander, Esq., Steven S. Diamond, Esq., and Dana Yankowitz Elliott, Esq.
Arnold & Porter

In recent years, the U.S. defense industry has seen a decline in revenues and a general deterioration in the financial condition of contractors. These problems, which have resulted from, among other things, the defense drawdown, layoffs and plant closures, have led to a number of contractor bankruptcies, and this trend may well continue. Performance of many defense contracts involves a prime contract, pursuant to which a prime contractor undertakes responsibility to perform the terms of an agreement with the U.S. government. These contracts also involve one or more subcontracts, under which a subcontractor will contract with the prime contractor to perform specific parts of the prime contractor's agreement with the U.S. government. In this article, we explore how the venue of a prime contractor's bankruptcy proceeding can affect the contractor's ability to retain the benefits under its valuable government contracts.

The ability to "cure" defaults and to "assume" and "assign" executory contracts[1] and unexpired leases are among the most significant powers[2] afforded a debtor in its bankruptcy proceeding. Ordinarily, a debtor has the power to override contractual provisions that would otherwise prohibit or restrict the assignment of agreements (anti-assignment provisions), or permit termination or modification of an agreement on the basis of the debtor's bankruptcy filing or financial condition (*ipso facto* provisions). Here we address certain restrictions on the ability of a bankrupt prime defense contractor to override anti-assignment provisions and *ipso facto* provisions in U.S. government defense contracts.



ASSUMPTION, ASSIGNMENT AND REJECTION

"Assumption" is a technical term under the Bankruptcy Code. It does not refer to a debtor's mere continuation of performance under an agreement subsequent to a bankruptcy filing. Rather, assumption is the mechanism by which a debtor, upon notice to creditors, seeks authorization from the bankruptcy court to reaffirm its obligations under an agreement. It requires the debtor to cure monetary and other defaults and prove that it has the wherewithal to continue to honor its contractual obligations on a going-forward basis.[3] The formal assumption of an agreement by a debtor during its bankruptcy proceeding is essentially equivalent to the debtor entering into a new agreement subsequent to the bankruptcy filing.[4]

Assumption is the mechanism by which a debtor, upon notice to creditors, seeks authorization from the bankruptcy court to reaffirm its obligations under an agreement.

Damages resulting from a breach of an assumed agreement are administrative obligations (*i.e.*, expenses incurred in connection with the administration of the bankruptcy proceeding), are given priority over the payment of pre-petition general unsecured claims and must be paid in full, in cash, as a condition in confirmation of a plan of reorganization.[5]

As a result, debtors frequently defer decisions regarding the assumption of contracts and leases until they are compelled to decide, ordinarily at the end of the bankruptcy proceeding, upon plan confirmation.[6] When an agreement provides a debtor with goods, services or leased property at a below-market rate, but the debtor will have no use for the subject property on a going-forward basis, the debtor may ordinarily assign the agreement to a third party for a profit, notwithstanding a contractual provision prohibiting the assignment of the agreement.[7] If an agreement is not valuable to the debtor or to a third party willing to pay to become an assignee, the debtor will ordinarily reject the agreement.[8]



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DEBTOR'S ABILITY TO OVERRIDE ANTI-ASSIGNMENT AND *IPSO FACTO* PROVISIONS

With respect to contractual restrictions on assignment, Section 365(f) of the Bankruptcy Code sets forth the general rule that a debtor may assume and assign an executory contract or unexpired lease, notwithstanding a contractual provision to the contrary that prohibits, restricts or conditions such assignment. The *exception* to this rule is contained in Section 365(c) of the Bankruptcy Code. Section 365(c) provides that a counterparty may enforce a prohibition or restriction on assignment in cases in which an applicable non-bankruptcy law (statutory or case law) exists that would excuse the counterparty from accepting performance from, or rendering performance to, an entity other than the debtor or debtor-in-possession, and the counterparty does not consent to such assumption or assignment.

With respect to *ipso facto* provisions, Section 365(e)(1) of the Bankruptcy Code sets forth the general rule that a provision that would otherwise call for the termination or modification of an executory contract or unexpired lease because of a debtor's bankruptcy filing or financial condition is unenforceable. The *exception* to this rule is contained in Section 365(e)(2) of the Bankruptcy Code. Section 365(e)(2) provides that a counterparty may enforce an *ipso facto* provision, if an applicable non-bankruptcy law (statutory or case law) would excuse the counterparty from accepting performance from or rendering performance to the trustee or an assignee, and the counterparty does not consent to such assumption or assignment.[9]

The opaque language in the Bankruptcy Code's statutory exceptions to the general rules overriding anti-assignment and *ipso facto* provisions has resulted in a split among the circuits regarding the implications of these exceptions on a debtor's rights to *assume* an agreement or to avoid the immediate termination of an agreement upon a bankruptcy filing — even in circumstances in which the debtor has no intention of *assigning* the agreement to a third party.

IMPACT OF THE HYPOTHETICAL TEST ON ANTI-ASSIGNMENT PROVISIONS

Most circuit courts of appeal that have interpreted Section 365(c) of the Bankruptcy Code, including the 3rd, 4th, 9th and 11th circuits, have construed that provision to impose what is known as the "hypothetical test." These courts have held that if an applicable non-bankruptcy law would prohibit or restrict assignment, then the debtor can neither assume nor assign the agreement. These courts focus on the following language in Section 365(c):

> The trustee may not assume *or* assign any executory contract … if … (1)(A) applicable law excuses [the counterparty] from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession …; and (B) [the counterparty] does not consent to such assumption or assignment.[10]

under the agreement during the bankruptcy proceeding.[14]

In cases in which a debtor remains ready, willing and able to perform, it is highly unlikely that a court would conclude that a debtor has no legally cognizable interest in an agreement merely because the agreement is not susceptible to unilateral assumption by the debtor. In fact, in some instances, the issue of assumption may never arise, since the underlying agreement may be fully performed during the administration of the bankruptcy proceeding, prior to the date when the debtor would be compelled to make an assumption determination.

In other instances, the debtor may be able to avoid the assumption issue under an existing agreement with an uncooperative counterparty entirely by transitioning to a new provider of goods and services during the bankruptcy proceeding. Even if there is no viable replacement for essential goods or services provided by an uncooperative counterparty, the bankruptcy estate may benefit from a debtor's continued performance under an agreement during a wind-down process. If any of these factors exist, the debtor's economic interest in the agreement will be obvious, and it is highly unlikely that a court would grant stay relief to allow a counterparty to terminate an agreement prior to the time when the debtor would be compelled to make an assumption determination.

> Section 365(f) of the Bankruptcy Code sets forth the general rule that a debtor may assume and assign an executory contract or unexpired lease, notwithstanding a contractual provision to the contrary that prohibits, restricts or conditions such assignment.

The hypothetical test is premised on the proscription against assumption *or* assignment. These courts conclude that so long as an applicable law prohibits or restricts assignment to a third party, the agreement may be neither *assumed* nor *assigned* by the debtor in its bankruptcy proceeding absent the counterparty's consent, even if the debtor has no intention of assigning the agreement to any such third party.[11]

Application of the hypothetical test to an anti-assignment provision ordinarily will not interfere with a debtor's enjoyment of the benefits of an agreement *prior* to the time when the debtor is compelled to make a determination regarding assumption or rejection,[12] although the inability of the debtor to assume an agreement unilaterally may provide the counterparty with significant leverage in the bankruptcy proceeding.

In some cases, however, courts in hypothetical test jurisdictions have granted a counterparty's request for relief from the automatic stay to terminate its agreement *before* the debtor has moved to assume or reject, reasoning that the debtor did not have a legally cognizable interest in the agreement.[13] This result is unusual, however, and invariably occurs only in situations in which there has been some question of the debtor's ability to perform

Thus, although a debtor in a hypothetical test jurisdiction must proceed with caution, it will ordinarily be permitted to continue to perform under an agreement during the course of a bankruptcy proceeding, even in cases in which applicable law would prohibit the debtor from assigning the agreement to a third party.

Some Chapter 11 debtors in hypothetical test jurisdictions have attempted to avoid the prohibition on unilateral assumption of an agreement subject to applicable non-bankruptcy law that would restrict assignment. These debtors did so by essentially ignoring the issue and by allowing the agreements to "ride through" the bankruptcy proceedings without ever making a determination regarding assumption or rejection. Under the ride-through doctrine, an agreement may pass through a bankruptcy proceeding without being either assumed or rejected. Essentially, the counterparty's claim survives the bankruptcy proceeding. Although some courts in hypothetical test jurisdictions have permitted ride-through, the ultimate efficacy of such approach is uncertain.

At least one court has noted that although an agreement not formally assumed under Section 365(a) of the Bankruptcy Code may ride through the bankruptcy proceedings, the debtor will not be entitled to the benefits of the exceptions to cure contained in Section 365(b)(2), which excuses a debtor from curing certain types of defaults in connection with assumption.[15] As a result, a counterparty to an agreement that has ridden through bankruptcy may be able to terminate the agreement as soon as the debtor emerges from bankruptcy.

In the bankruptcy proceeding of a prime contractor, a question may arise regarding the debtor's ability to assume a valuable government contract in light of the federal Anti-Assignment Act. The Anti-Assignment Act restricts the transfer of any right or interest in a government contract and operates to annul a contract purportedly assigned by a defense contractor to a third party.[16]

The Anti-Assignment Act is not an absolute proscription, however, since there are exceptions under which a government contract can be assigned to a third party.[17] For example, transfers or assignments occurring by "operation of law" are exempt from the Anti-Assignment Act's application, including transfers occurring incidental to corporate mergers, consolidations or reorganizations, assignments by judicial order, transfers by will and intestacy, bankruptcy transfers and assignments for the benefit of creditors.[18]

The Anti-Assignment Act also includes an exception for assignment of the right to payment under a government contract to a financing institution[19] and, of course, the government may consent to assignment, either under what courts have termed the waiver exception[20] or as implemented in the Federal Acquisition Regulation in the case of acquisitions structured as asset purchases, which require a formal novation.[21] Thus, although the Anti-Assignment Act may not be an outright prohibition on assignment given its various exceptions, it clearly restricts a contractor's ability to freely assign a government contract.

Most courts that have considered the issue have concluded that the Anti-Assignment Act is an applicable law prohibiting or restricting assignment[22]; this has resulted in rulings in hypothetical test jurisdictions prohibiting defense contractor debtors from assuming government contracts in bankruptcy.[23]

> The opaque language in the Bankruptcy Code's statutory exceptions to the general rules overriding anti-assignment and *ipso facto* provisions has resulted in a split among the circuits.

However, as previously noted, the application of the hypothetical test to an anti-assignment provision in a government contract should not interfere with a prime contractor debtor's ability to perform under the agreement during the administration of the bankruptcy proceeding. Every effort should be made during the bankruptcy proceeding to obtain the government's consent to assumption of the agreement, although it may be necessary to re-negotiate pricing if the market has moved in the prime contractor debtor's favor since the effective date of the agreement.

IMPACT OF THE ACTUAL TEST ON ANTI-ASSIGNMENT PROVISIONS

Not all courts that have construed Sections 365(c) and 365(e)(2) have agreed that the provisions impose a "hypothetical test" prohibiting the assumption of an agreement in cases in which the agreement could not be assigned to a third party on a non-consensual basis because of an applicable non-bankruptcy law prohibiting or restricting assignment. These courts, including the 1st and 5th circuits and a majority of lower courts, have adopted what has come to be known as the "actual test." These courts have concluded that the exception to the general rule allowing assignment of agreements notwithstanding anti-assignment provisions is only triggered when the debtor *actually* seeks to assign the agreement and is not implicated by an assumption of the agreement by the debtor. These courts focus on the following language in Section 365(c) of the Bankruptcy Code:

> The trustee may not assume or assign any executory contract ... if ... (1)(A) applicable law excuses [the counterparty] from accepting performance from or rendering performance to an entity *other than the debtor or the debtor in possession* ... and (B) [the counterparty] does not consent to *such* assumption or assignment.[24]

The actual test is premised on the interrelation between subparagraphs (A) and (B). In the circuits adopting this test, the courts conclude that the reference to the counterparty's lack of consent to *such* assumption or assignment in subparagraph (B) refers only to an assumption by, or assignment to, an entity *other than the debtor or debtor-in-possession* (as specified in subparagraph (A)).

Since an assumption in and of itself does not involve a transfer to a third party, courts in actual test jurisdictions conclude that the trustee may assume an agreement, as long as the trustee does not *actually* seek to assign that agreement to a third party (*i.e.*, a party other than the debtor or debtor-in-possession) over the objection of the counterparty and in contravention of an applicable non-bankruptcy law prohibiting assignment.[25]

IMPACT OF THE HYPOTHETICAL TEST ON *IPSO FACTO* PROVISIONS

Courts within jurisdictions that have adopted the hypothetical test have concluded that if an applicable non-bankruptcy law would excuse a counterparty from accepting performance from, or rendering performance to, the trustee or an assignee under the agreement, the debtor cannot override a contractual *ipso facto* provision. This is the case even if the debtor has no intention of assigning the agreement to any such third party. These courts focus on the following language in Section 365(e)(2)(A) of the Bankruptcy Code:

> [The debtor's ability to override an *ipso facto* provision] does not apply to an executory contract ... of the debtor, ... if ... applicable law excuses

> [the counterparty] from accepting performance from or rendering performance to the trustee or to an assignee of such contract …; and … [the counterparty] does not consent to such assumption or assignment.[26]

Defense supply and services contracts are governed by the FAR and do not contain *ipso facto* provisions, although such provisions may be included in other government contracts.[27] We are aware of no published decisions in which a court in a hypothetical test jurisdiction has considered the Anti-Assignment Act in determining the enforceability of an *ipso facto* provision against a bankrupt prime defense contractor.

However, those cases analyzing the statute in the context of the anti-assignment provision of Section 365(c) of the Bankruptcy Code leave little doubt that a court would conclude that the Anti-Assignment Act is an applicable law prohibiting or restricting assignment. Therefore, in the event that a particular government contract contained an *ipso facto* provision, this could lead to a draconian result in a case in which a government contract provided for the termination of the agreement upon the prime contractor's bankruptcy filing. Unlike the case of an anti-assignment provision (in which the existence of the Anti-Assignment Act should not interfere with a debtor's enjoyment of the benefits of the agreement prior to assumption), application of the hypothetical test to a properly drafted *ipso facto* provision could well result in the termination of the agreement immediately upon a filing of a voluntary bankruptcy case by a prime contractor.

> The hypothetical test is premised on the proscription against assumption *or* assignment.

If an *ipso facto* provision requires the counterparty to issue a notice of termination to the debtor, the counterparty will be required to file a motion seeking authority to lift the automatic stay in order to issue the notice. In such cases, a debtor may be able to persuade the court to deny the counterparty's motion on the grounds that "cause" does not exist to grant relief from the stay, since the debtor stands ready, willing and able to perform under the agreement, and the counterparty's interests thereunder will remain adequately protected. However, in cases in which the parties have drafted an *ipso facto* provision to be self-executing upon the bankruptcy filing (without requiring the issuance of notice of the termination), a court in a hypothetical jurisdiction would probably conclude that the agreement automatically terminated immediately upon the bankruptcy filing.

IMPACT OF THE ACTUAL TEST ON *IPSO FACTO* PROVISIONS

Courts within jurisdictions that have adopted the actual test have concluded that the exception to the general rule allowing debtors to override contractual *ipso facto* provisions does not apply unless and until the debtor, acting through a trustee, *actually* seeks to assume the agreement, or the debtor *actually* seeks to assign the agreement to a third party. These courts focus on the following language in Section 365(e)(2)(A) of the Bankruptcy Code:

> [The debtor's ability to override an *ipso facto* provision] does not apply to an executory contract … of the debtor, … if … applicable law excuses [the counterparty] from accepting performance from or rendering performance to the trustee or to an assignee of such contract …; *and* … [the counterparty] *does not consent* to such assumption or assignment.[28]

Emphasizing the language in the statute referring to the counterparty's lack of consent to assignment, courts in actual test jurisdictions have found that the *ipso facto* provision exception is not triggered, unless a trustee is appointed to displace the debtor-in-possession and actually proposes to assume the agreement, or the debtor actually proposes to assume and assign the agreement to a third party over the objection of the counterparty.

For example, in *In re Mirant Corp.*, the 5th Circuit considered the Anti-Assignment Act in the context of an *ipso facto* provision in a government contract (albeit not a defense contract and one not governed by the FAR). The 5th Circuit adopted the actual test and concluded that a counterparty could not terminate an executory contract on the grounds that applicable law would prohibit assignment in cases in which the debtor had not actually proposed to assign the agreement to another party.[29]

Thus, in cases in which the actual test applies, so long as a trustee has not been appointed to displace the debtor's management, a debtor will ordinarily be able to stave off the enforcement of *ipso facto* provisions and assume agreements notwithstanding the existence of *ipso facto* provisions and applicable laws prohibiting or restricting assignment.

> A debtor in a hypothetical test jurisdiction must proceed with caution.

Unlike in a hypothetical test jurisdiction, where a self-executing *ipso facto* provision calling for the automatic termination of the agreement upon a bankruptcy filing is likely to be deemed effective, a debtor in an actual test jurisdiction should be able to enjoy the benefits of the agreement. The debtor should be able to circumvent enforcement of an *ipso facto* provision so long as a trustee (rather than a debtor-in-possession) is not seeking to assume the agreement and the debtor does not seek to assign the agreement to a third party.

TERMINATION-FOR-CONVENIENCE PROVISIONS

Another issue that may affect a prime defense contractor's ability to enjoy the benefits of an agreement is the existence of a "termination for convenience" provision. Defense contracts — including those for procurement, construction and research and development — are generally governed by the FAR, which provides that the government can terminate an agreement for convenience.

Although the Bankruptcy Code does not expressly invalidate termination-for-convenience provisions, courts have held that a counterparty may not send a notice of termination without first seeking relief from the automatic stay in the bankruptcy court.[30]

Some courts have held that a provision allowing a party to terminate a contract for convenience is not in itself sufficient cause to grant stay relief and that a counter-party must still meet the requirements of Section 362(d)(1) of the Bankruptcy Code, which requires a movant to establish "cause" to grant relief from the automatic stay.[31] As a result, debtors in both hypothetical and actual test jurisdictions have often been able to persuade the court to deny a counterparty's request to modify the automatic stay to permit the counterparty to terminate the agreement.

Further, debtors in actual test jurisdictions sometimes have been able to preclude a counterparty from enforcing a termination-for-convenience provision on the basis that the counterparty's real reason for termination was the debtor's bankruptcy filing, which runs afoul of Section 365(e)(1) of the Bankruptcy Code.[32] For this reason, it is not unusual for a debtor in an actual test jurisdiction to attempt to draw a counterparty out to explain why it is exercising a termination-for-convenience provision. The debtor may do so on the chance that the counterparty will reveal that its real motivation for exercising the provision is the bankruptcy filing or the debtor's financial condition generally, in violation of Section 365(e)(1).

substantial concessions to the United States in order to obtain the government's consent to the assumption of an agreement under the debtor's plan of reorganization (although, in the ordinary case, it should not interfere with the debtor's enjoyment of the benefits of the agreement during the administration of the bankruptcy proceeding).

Further, in the event that a government contract contained a self-executing *ipso facto* provision triggered upon the contractor's bankruptcy filing, the Anti-Assignment Act will probably result in the automatic termination of the contract if a prime contractor has filed for bankruptcy in a hypothetical test jurisdiction. However, in cases in which the *ipso facto* provision is not self-executing, a prime contractor that files for bankruptcy in a hypothetical test jurisdiction may be able to preclude the government from terminating the agreement. The contractor may do so by persuading the court to deny the government's request to modify the automatic stay (to permit it to issue a notice of termination) on the basis that the debtor stands ready to perform the agreement and because the interests of the government will remain adequately protected while performance is completed. WJ

> Although the Anti-Assignment Act may not be an outright prohibition on assignment given its various exceptions, it clearly restricts a contractor's ability to freely assign a government contract.

CONCLUSION

Although debtors ordinarily have the power to override contractual prohibitions on assignment and to block the enforcement of *ipso facto* provisions, such power is limited in cases in which there exists an applicable non-bankruptcy law prohibiting or restricting assignment. In the case of the bankruptcy of a prime defense contractor, the federal Anti-Assignment Act will generally serve as such an applicable non-bankruptcy law.

In jurisdictions that have adopted the actual test, the existence of the Anti-Assignment Act will serve only to limit the debtor's ability to assign a government contract to third parties, but it will not impair the debtor's ability to enjoy the benefits of the agreement during the bankruptcy proceeding or to assume the agreement in connection with a plan of reorganization.

In jurisdictions that have adopted the hypothetical test, however, the Anti-Assignment Act may impose a significant problem that could require a debtor to provide substantial concessions to the United States (see above).

NOTES

1 The Bankruptcy Code does not define "executory contract." Although courts have utilized a variety of approaches in determining whether a contract is executory, many courts have adopted the Countryman definition, which defines an executory contract as "a contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." Vern Countryman, *Executory Contracts in Bankruptcy: Part I,* 57 Minn. L. Rev. 439, 460 (1973).

2 The automatic stay, arguably the most significant power, is triggered immediately upon the commencement of the bankruptcy proceeding and is a worldwide injunction barring virtually every action against a debtor and its property. *See* 11 U.S.C. § 362(a).

3 *See id.* § 365.

4 *Adamowicz v. Pergament (In re Lamparter Org. Inc.),* 207 B.R. 48, 52 (E.D.N.Y. 1997) ("[T]he power given the debtor in possession or trustee to assume or reject executory contracts is intended to enable him to make a new decision as to the wisdom of the contract in light of the changed circumstances of bankruptcy or conversion, as if he were entering into a new contract.") (quotation omitted).

5 *Adventure Res. Inc. v. Holland,* 137 F.3d 786, 798-799 (4th Cir. 1998) (breach of an assumed executory contract results in an administrative priority claim). There is, however, a statutory limit on post-assumption rejection damages in the case of non-residential real property leases. *See* 11 U.S.C. § 503(b)(7).

6 In 2005, Congress amended the Bankruptcy Code to, among other things, require that a debtor make a decision regarding the assumption of non-residential real property leases on the earlier of plan confirmation or 120 days after an order for relief has been entered in the case (with an extension of up to 90 days for cause). *See id.* § 365(d)(4). In connection with the acceleration of the decision-making process in the case of non-residential real property leases, Congress also added a limitation to the amount of the administrative claim resulting from the debtor's rejection of a previously assumed non-residential real property lease. *See id.* § 503(b)(7).

7 *See id.* § 365(f).

8 Upon rejection, outstanding amounts owed as of the bankruptcy filing, together with damages resulting from the debtor's breach of its ongoing obligations under the agreement, are treated as prepetition general unsecured claims. *See id.* § 365(g).

9 The archetypical example of a contract not assignable under applicable non-bankruptcy law is a personal services contract. Because a personal services contract cannot be assigned to a third party outside of bankruptcy, the counterparty can both reject the debtor's proposed assumption and assignment, and enforce any contractual right to terminate based upon the debtor's bankruptcy filing or financial condition. *See In re Antonelli,* 148 B.R. 443, 448 (D. Md. 1992) (noting that "personal services" contracts cannot be assigned under Section 365(c)).

10 11 U.S.C. § 365(c) (emphasis added).

11 *See RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.),* 361 F.3d 257 (4th Cir. 2004); *Perlman v. Catapult Entm't (In re Catapult Entm't),* 165 F.3d 747 (9th Cir. 1999); *City of Jamestown v. James Cable Partners (In re James Cable Partners),* 27 F.3d 534, 537 (11th Cir. 1994); *In re West Elecs.,* 852 F.2d 79, 83-84 (3d Cir. 1988).

12 *See In re Kazi Foods of Mich.,* 473 B.R. 887 (Bankr. E.D. Mich. 2011) (adopting hypothetical test and denying debtor's assumption motion, which motion was filed nearly four months after the bankruptcy case was first commenced); *In re Access Beyond Techs.,* 237 B.R. 32 (Bankr. D. Del. 1999) (adopting the hypothetical test and denying debtor's assumption motion more than

10 months after the bankruptcy cases were first commenced).

[13] *See West Elecs.,* 852 F.2d at 83-84 (granting stay relief to allow the counterparty to terminate the agreement); *In re Planet Hollywood Int'l,* 2000 WL 36118317, at *10 (D. Del. Nov. 21, 2000) (same); *United States v. TechDyn Sys. Corp. (In re TechDyn Sys. Corp.),* 235 B.R. 857, 864 (Bankr. E.D. Va. 1999) (same).

[14] *See West Elecs.,* 852 F.2d at 80 (counterparty suspended contract because of what it considered to be serious irregularities in debtor's accounting procedures and delivery and payment delinquencies); *Planet Hollywood,* 2000 WL 36118317 at *3 (counterparties asserted that debtors could not cure outstanding defaults or provide adequate assurance of future performance); *TechDyn,* 235 B.R. at 859 n.2 (counterparty asserted that debtor was unable to cure the present defaults or provide adequate assurance of future performance).

[15] *See In re Hernandez,* 287 B.R. 795, 800 (Bankr. D. Ariz. 2002) (allowing the contract to ride through the bankruptcy, but noting that a contract that is not assumed is not entitled to certain benefits afforded by Section 365; these benefits include insulation from *ipso facto* provisions or the right to cure defaults).

[16] 41 U.S.C. § 15(a) ("No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States is concerned."). The statute further provides that "[a]ll rights of action, however, for any breach of such contract by the contracting parties are reserved to the United States." *Id. See also* 48 C.F.R § 42.12.

[17] *Liberty Ammunition Inc. v. United States,* 101 Fed. Cl. 581, 587 (2011) ("courts have recognized a number of exceptions to the Anti-Assignment Act under which a government contract can be validly assigned to another party").

[18] *See Webster v. United States,* 90 Fed. Cl. 107, 116 (2009); *Holland v. United States,* 62 Fed. Cl. 395, 400 (2004); *Johnson Controls World Servs. v. United States,* 44 Fed. Cl. 334, 343 (1999).

[19] 41 U.S.C. § 15(b) (providing an exception where "the moneys due or to become due from the United States … under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company or other financing institution").

[20] *See Liberty Ammunition,* 101 Fed. Cl. at 588.

[21] *See* 48 C.F.R. § 42.1204(a) (the government "may, when in its interest, recognize a third party as the successor in interest to a government contract when the third party's interest in the contract arises out of the transfer of — (1) All of the contractor's assets; or (2) The entire portion of the assets involved in performing the contract"). The FAR further provides that, in the case of an asset purchase, there may be change-of-ownership issues that the parties should address in a formal novation agreement. *Id.* at § 42.1204(b).

[22] *But see Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.),* 440 F.3d 238, 253 (5th Cir. 2006), in which the court adopted the actual test, but noted in dicta that the federal Anti-Assignment Act might not be considered an "applicable law" prohibiting assignment until an actual assignment was proposed that did not fall within the statutory exceptions to the Anti-Assignment Act's general prohibition on the assignment of federal contracts (*e.g.,* the exception for assignment to a financing institution). The 5th Circuit did not consider, however, whether the Anti-Assignment Act might constitute an applicable law restricting assignment. Although the Anti-Assignment Act might not constitute an applicable law prohibiting assignment, given the exceptions to the general prohibition found within the statute and in the case law, the better interpretation of the Anti-Assignment Act is that, at the very least, it constitutes applicable law restricting assignment.

[23] *See, e.g., West Elecs.,* 852 F.2d 79 (adopting the hypothetical test and concluding that a contract could not be assumed because the Anti-Assignment Act as "applicable law" made assignment impermissible if it would foreclose assignment by the prepetition debtor to another defense contractor); *TechDyn,* 235 B.R. 857; *In re Plum Run Serv. Corp.,* 159 B.R. 496 (Bankr. S.D. Ohio 1993); *United States v. Carolina Parachute Corp. (In re Carolina Parachute Corp.),* 108 B.R. 100 (M.D.N.C. 1989), *aff'd in part and vacated in part on other grounds,* 907 F.2d 1469 (4th Cir. 1990).

[24] 11 U.S.C. § 365(c) (emphasis added).

[25] *See Institut Pasteur v. Cambridge Biotech Corp.,* 104 F.3d 489, 493 (1st Cir. 1997).

[26] 11 U.S.C. § 365(e)(2)(A).

[27] *See infra,* n.30.

[28] 11 U.S.C. § 365(e)(2)(A).

[29] *See In re Mirant Corp.,* 440 F.3d at 247–51 (5th Cir. Feb. 13, 2006). *See also In re Hartec Enters.,* 117 B.R. 865, 872 (Bankr. W.D. Tex. 1990), *vacated by settlement,* 130 B.R. 929 (W.D. Tex. 1991) (adopting the "actual test" because it "better fulfills the purposes" of the Anti-Assignment Act, under which the "prohibition on a transfer is not triggered so long as it is basically the same entity performing under the contract").

[30] *See, e.g., In re Enron Corp.,* 300 B.R. 201, 211-212 (Bankr. S.D.N.Y. 2003) (holding that a contract cannot be terminated without first seeking stay relief, regardless of the existence of a provision in the contract allowing for termination); *In re Redpath Computer Servs.,* 181 B.R. 975, 978 (Bankr. D. Ariz. 1995) (finding that "the Bankruptcy Code neither enlarges the contract rights of a debtor, nor prevents termination of a contract by its own terms," but "[a]n executory contract that is property of the estate can only be terminated after a grant of relief from the stay"). *But see Valley Forge Plaza Assocs. v. Schwartz,* 114 B.R. 60 (E.D. Pa. 1990) (holding that the Bankruptcy Code does not prevent termination of a contract by its own terms, and "the ability to terminate a contract on its terms survives bankruptcy").

[31] *See In re The Elder-Beerman Stores Corp.,* 195 B.R. 1012, 1018 (Bankr. S.D. Ohio 1996) ("The conditions under Section 362(d) govern relief from the stay, and when those conditions are not met, courts have not hesitated to leave the stay intact, even in the presence of 'at will' termination clauses."); *Coaldale Energy LP v. Lehigh Coal & Navigation Co.* (*In re Lehigh Coal & Navigation Co.*), 2009 WL 1657096, at *3-4 (Bankr. M.D. Pa. June 12, 2009) (holding that the debtor's ability to terminate the agreement at will "may not be sufficient to constitute cause to grant relief," but finding that cause existed to grant stay relief on other grounds).

[32] *See In re Nat'l Hydro-Vac Indus. Servs.,* 262 B.R. 781, 786 (Bankr. E.D. Ark. 2001) (holding that a contract termination clause did not enable a bank to terminate on the basis of the debtor's Chapter 11 filing, and noting that "[i]n a commercial contractual relationship, terminable-at-will provisions must be exercised in good faith"); *In re B. Siegel Co.,* 51 B.R. 159, 163 (Bankr. E.D. Mich. 1985) (convenience termination clause does not confer an unrestricted right to cancel a contract, when the only reason for its invocation is the debtor's bankruptcy filing, because this would nullify the remedial policy of Section 365(e)(1)).

Debtor's suit over attempt to collect personal judgment moves forward

A law firm in Indiana must continue to defend against a Fair Debt Collection Practices Act lawsuit after a federal judge found a debtor sufficiently alleged the firm obtained a personal judgment against him after he filed a bankruptcy petition.

***Coulter v. Manley Deas Kochalski LLC*, No. 13-01688, 2014 WL 1891206 (S.D. Ind. May 9, 2014).**

U.S. District Judge Tanya Walton Pratt of the U.S. District Court for the Southern District of Indiana said that because the bankruptcy limited the firm to pursuing an *in rem* judgment only against the debtor's property, the firm may have violated the Fair Debt Collection Practices Act, 15 U.S.C. § 1692.

Ralph Coulter filed a Chapter 13 bankruptcy petition in the U.S. Bankruptcy Court for the Southern District of Indiana in March 2011. He identified Aurora Home Loan Services as a secured creditor in court papers, Judge Pratt's opinion said.

Law firm Manley Deas Kochalski LLC filed a proof of claim on behalf of Aurora. The firm later obtained relief from the automatic stay so it could foreclose on the property that secured the home loan, the opinion said.

When MDK filed the foreclosure action, it sought and obtained an *in personam*, or personal, default judgment against Coulter for the home loan, according to the opinion. It then attempted to collect on the personal judgment, the opinion said.

Coulter responded by suing MDK in the District Court.

The complaint alleged the firm violated the FDCPA by obtaining a personal judgment against him in the foreclosure action, according to the opinion. He claimed this action violated 15 U.S.C. § 1692e because MDK allegedly misrepresented the legal status of the debt, and violated 15 U.S.C. § 1692f because the firm allegedly sought to collect on an obligation not permitted by law, the opinion said.

Coulter claimed that MDK exceeded the scope of the relief granted by the automatic stay when it pursued more than an *in rem* judgment, also known as a judgment against the property, according to the opinion.

MDK moved to have the case dismissed at the pleading stage for failing to state a claim upon which relief could be granted.

Judge Pratt said Coulter sufficiently pleaded a claim under the FDCPA.

MDK sought relief from the automatic stay under 11 U.S.C. § 362(d). The statute generally allows a bankruptcy court to lift the stay for an action against property, so long as the debtor does not have equity in the property and it is not necessary to an effective reorganization, the judge said.

> "Because exceeding the scope of the relief from the automatic stay is unlawful under the Bankruptcy Code, attempts to collect on such obligations are likewise unlawful" under the Fair Debt Collection Practices Act, the judge said.

He noted that controlling case law from the 7th U.S. Circuit Court of Appeals holds that a debtor has a cause of action under the Bankruptcy Code for a claim that a creditor exceeded the scope of relief granted from an automatic stay. *Swanson v. Indiana*, 23 Fed. Appx. 590 (7th Cir. 2001).

The 7th Circuit governs federal courts in Indiana.

"Because exceeding the scope of the relief from the automatic stay is unlawful under the Bankruptcy Code, attempts to collect on such obligations are likewise unlawful under FDCPA," Judge Pratt said. WJ

Attorneys:
Plaintiff: Angie K. Robertson, Philipps & Philipps, Palos Hills, Ill.; Steven J. Halbert, Carmel, Ind.

Defendant: Sarah E. Willms, Manley Deas Kochalski LLP, Indianapolis; Stephanie A. Reinhart, Manley Deas Kochalski LLP, Columbus, Ind.

Related Court Document:
Opinion: 2014 WL 1891206

FDCPA violations

Plaintiff adequately alleged defendant violated two provisions of the Fair Debt Collection Practices Act:

Section 1692e. False or misleading representations

A debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

…

(2) The false representation of—

(A) the character, amount, or legal status of any debt

…

(5) The threat to take any action that cannot legally be taken or that is not intended to be taken.

Section 1692f. Unfair practices

A debt collector may not use unfair or unconscionable means to collect or attempt to collect any debt. Without limiting the general application of the foregoing, the following conduct is a violation of this section:

(1) The collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.

Ohio debt collector fined $282,000 for unauthorized practice of law

The Ohio Supreme Court has fined a debt collection firm and one of its owners more than $282,000 for filing lawsuits without a law license.

Cleveland Metropolitan Bar Association v. Wooten et al., No. 2013-1353, 2014 WL 1813927 (Ohio May 7, 2014).

A five-justice majority of the state high court ruled that a civil penalty of $282,500 was warranted because a local bar association had previously warned the non-attorney that his filing of debt collection lawsuits constituted the unauthorized practice of law.

Two justices voted for a $25,000.

According to the high court's opinion, Derek Wooten became a co-owner of Aaron Derek Carter & Steen, a debt collection company that had been in existence since at least 2008.

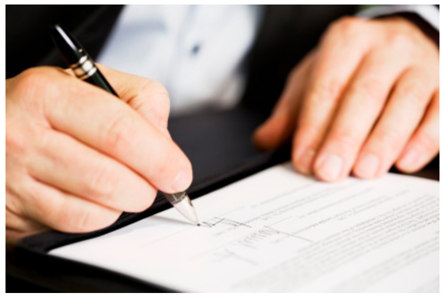
Before joining ADCS, Wooten worked for another collection company where he filed and personally signed state court complaints on behalf of medical and payday-loan companies, the Supreme Court opinion said.

He received a cease-and-desist notice in August 2008 from the Akron Bar Association, indicating he was practicing law without a license, according to the opinion.

Once at ADCS, Wooten and the company continued to file complaints in small-claims or municipal courts, mostly on behalf of check cashing or payday-lending companies, the opinion said, but he claimed to have discontinued the practice of signing the small-claims complaints by early 2009.

The Cleveland Metro Bar Association filed a complaint with Ohio's Board on the Unauthorized Practice of Law in May 2012. The organization subsequently moved for summary judgment, attaching over a hundred certified pleadings signed by Wooten and filed by him and ADCS in local courts.

After ultimately finding 113 cases in which Wooten had engaged in the unauthorized practice of law, the board recommended that



the state Supreme Court impose a $2,500 fine for each violation, for a total of $282,500.

The high court majority accepted the recommended penalty, finding the evidence showed Wooten had signed 113 complaints or pleadings on others' behalf.

"We have consistently held that the practice of law encompasses the drafting and preparation of pleadings filed in the courts of Ohio and includes the preparation of legal documents and instruments upon which legal rights are secured or advanced," the opinion said.

The majority also found the size of the penalty warranted.

Wooten continued to engage in the barred conduct even after he had become aware that signing complaints on others' behalf was not allowed, appeared at default hearings and used a name for his company that resembled that of a law firm, the opinion said.

In addition Wooten and ADCS were ordered to notify clients that they are not authorized to file complaints or represent them in court proceedings.

The majority noted the $2,500-per-offense fine should not be considered as setting a precedent, especially in cases in which only a few acts of the unauthorized practice of law are committed. WJ

Related Court Document:
Opinion: 2014 WL 1813927

Bankruptcy court's denial of debt setoff stands, panel says

By Keith Harris, Senior Content Writer, Westlaw Daily Briefing

A Florida bankruptcy court did not abuse its discretion in ruling that a bank could not set off an award for unfair debt collection practices against a discharged credit card debt, a federal appeals panel in Atlanta has ruled.

Brook v. Chase Bank USA, No. 13-13538, 2014 WL 1910842 (11th Cir. May 14, 2014).

The bankruptcy court acted within its authority in finding that such an offset would be inequitable and would run counter to the debt collection law's purpose, a panel of the 11th U.S. Circuit Court of Appeals said, reversing a federal district court's decision.

REUTERS/Lucas Jackson

A Chapter 7 trustee filed an adversary proceeding against Chase Bank, alleging it had violated the Florida Consumer Collection Practices Act through repeated calls attempting to collect on a debtor's credit card bills.

IMPROPER DEBT COLLECTION

In December 2008 Claudia Acosta-Garriga filed for Chapter 7 relief in the U.S. Bankruptcy Court for the Middle District of Florida.

Although Chase Bank USA held a pre-petition claim for $30,000 in credit card debt, it did not file a proof of claim, and the debt was eventually discharged.

Chapter 7 trustee V. John Brook filed an adversary proceeding against Chase, alleging that the bank had violated the Florida Consumer Collection Practices Act through repeated calls attempting to collect Acosta-Garriga's debt, court documents show.

> The panel agreed with the Bankruptcy Court that allowing a setoff would discourage creditors from complying with the Florida Consumer Collection Practices Act and attorneys from bringing claims under the act.

The Bankruptcy Court ruled for the trustee, finding the bank liable for $1,000, the maximum statutory damages, along with statutorily mandated attorney fees.

The court rejected the bank's request to set off the amount awarded under the FCCPA by the amount of Brook's credit card debt.

The court said a statutory penalty cannot be set off against a discharged debt, adding that the award and the debt did not satisfy Florida's mutuality requirement for setoff and that equities weighed against setting off the award.

On appeal, the U.S. District Court for the Middle District of Florida reversed the Bankruptcy Court's decision, saying Florida prefers a court to enter a single judgment and therefore setoff was required under state law.

The trustee appealed to the 11th Circuit.

BANKRUPTCY COURT DISCRETION

The panel began by noting that Florida law is silent on the question whether an FCCPA award may be set off against a debt incurred prior to a bankruptcy filing.

When no state law requires or prohibits otherwise, "the right to set off debts is within the sound discretion of the bankruptcy court," the panel said.

The panel agreed with the Bankruptcy Court that allowing a setoff would discourage creditors from complying with the FCCPA and attorneys from bringing claims under the act, and would run counter to the act's state claim of regulating consumer collection activities.

The Bankruptcy Court's refusal to reduce the trustee's FCCPA damages and attorney fee award by the amount of the credit card debt owed by Acosta-Garriga before her bankruptcy and discharge was well within its "reasoned and sound discretion," the panel said.

It therefore reversed the District Court decision and remanded for a determination of attorney fees. WJ

Related Court Document:
Opinion: 2014 WL 1910842

High court passes on Chapter 13 lien-stripping appeal

By Keith Harris, Senior Content Writer, Westlaw Daily Briefing

The U.S. Supreme Court has refused to hear an appeal of a federal court ruling that a Chapter 13 debtor who owns property with his non-debtor spouse as tenants by the entireties cannot strip off a valueless second mortgage.

Alvarez et al. v. HSBC Bank USA NA, No. 13-9321, cert. denied (U.S. May 19, 2104).

The debtor had filed a petition for writ of *certiorari* after a panel of the 4th U.S. Circuit Court of Appeals affirmed lower court rulings that when a couple holds property as tenants by the entireties, they cannot avoid a lien on their property unless both spouses filed the bankruptcy petition.

NO LIEN STRIPPING

In September 2010 Jose Alfredo Pineda Alvarez filed for Chapter 13 relief in the U.S. Bankruptcy Court for the District of Maryland. Alvarez and his wife, Meyber, owned a home in Silver Springs, Md., as tenants by the entireties.

According to the 4th Circuit panel's opinion, the property was valued at $442,000 and encumbered by two mortgages. Chase Home Finance, which held a $447,000 first mortgage, filed a proof of claim. HSBC Mortgage Services did not file a proof of claim in support of its $75,000 second mortgage.

The Alvarezes later filed a joint adversary proceeding in the bankruptcy case seeking to avoid the HSBC mortgage. They alleged Chase's claim left no further equity in the property with which to secure HSBC's lien and that a Chapter 13 debtor was permitted to "strip off," or cancel, a valueless second mortgage.

The bankruptcy judge ruled against Alvarez, saying that when a home is owned by a couple as tenants by the entireties, a lien cannot be stripped off if both tenants have not filed a petition for bankruptcy.

DECISION AFFIRMED

On appeal, the U.S. District Court for the District of Maryland noted that the issue "has not been addressed by the [4th Circuit] and is worthy of debate," but ultimately affirmed the Bankruptcy Court's decision.

The 4th Circuit said neither bankruptcy law nor Maryland law "permit[s] a bankruptcy court to alter a non-debtor's interest in property held in a tenancy by the entirety."

The 4th Circuit also affirmed, saying neither bankruptcy law nor Maryland law "permit[s] a bankruptcy court to alter a non-debtor's interest in property held in a tenancy by the entirety."

Alvarez's petition for writ of *certiorari*, filed in June 2013, had argued that "joinder of the non-debtor spouse in a civil case or controversy before the Bankruptcy Court is sufficient to permit the lien avoidance to proceed to judgment." WJ

Creditor fends off 'stressed out' couple's damage claim despite stay violation

By Keith Harris, Senior Content Writer, Westlaw Daily Briefing

A Georgia couple failed to show that a creditor's one-day publication of a foreclosure notice in willful violation of the automatic bankruptcy stay caused the level of injuries that would warrant compensation for emotional distress, a federal appeals panel has ruled in a case of first impression.

Lodge et al. v. Kondaur Capital Corp. et al., No. 13-10919, 2014 WL 1813298 (11th Cir. May 8, 2014).

Though holding for the first time that damages for emotional distress for a willful stay violation are authorized under the Bankruptcy Code as "actual damages," the 11th U.S. Circuit Court of Appeals said evidence that a Chapter 13 debtor and his wife were "stressed out" by the publication did not qualify as such damages.

FORECLOSURE NOTICE PUBLISHED

According to the opinion, Kenneth and Dolores Lodge obtained a loan from First Franklin Financial Corp. in 2000 for $156,800, granting the lender a mortgage on their home in Conyers, Ga. Home Loan Services was the loan servicer.

Five years later Kenneth Lodge filed for Chapter 13 relief in the U.S. Bankruptcy Court for the Northern District of Georgia.

In December 2008 Atlanta law firm McCalla Raymer LLC, acting on behalf of the loan servicer, asked the Bankruptcy Court to lift the automatic stay imposed by the bankruptcy filing to permit the lender to foreclose on the property and collect on the unpaid loan.

First Franklin assigned its interest in the loan to Kondaur Capital Corp., and the law firm subsequently amended the stay-relief motion to list Kondaur as the movant.

The Bankruptcy Court never ruled on this motion and the automatic stay remained in effect throughout Lodge's bankruptcy.

In January 2009 McCalla Raymer, at Kondaur's request, submitted a notice for publication in the Rockdale Citizen, a local newspaper, announcing an April foreclosure sale of the Lodges' property.

The notice was published March 12, for one day only. The same day, the law firm canceled the notice.

Although the Lodges did not see the notice, they learned of its publication after receiving letters from law firms regarding their supposedly impending foreclosure. They did not discover that the sale had been canceled until the following month.

In January 2010 Lodge completed his Chapter 13 plan and received a discharge of his debts, including the mortgage.

The Lodges subsequently sued Kondaur and McCalla Raymer in the U.S. District Court for the Northern District of Georgia asserting willful violation of the automatic stay.

They sought damages under Section 362(k) of the Bankruptcy Code, 11 U.S.C.A. § 362(k), for their alleged emotional distress. That section says that individuals injured by a willful violation of the automatic bankruptcy stay are entitled to recover "actual damages."

The District Court granted the defendants' motion for summary judgment on the damages claim, saying the Lodges had failed to show sufficient injury. The Lodges appealed to the 11th Circuit.

NO EMOTIONAL DISTRESS DEMONSTRATED

The appeals panel began by noting that the 11th Circuit had not previously addressed the question whether damages for emotional distress constitute "actual damages" within the meaning of Section 362(k).

The panel announced that emotional distress was indeed an acceptable basis for such damages, but cautioned that "not every willful violation of the stay merits compensation for emotional distress and … a standard for governing such claims is necessary."

To recover actual damages resulting from emotional distress, a debtor must clearly establish that "significant" emotional distress was suffered and show a causal connection between the stay violation and the distress, the panel said.

> The debtors did not establish a causal connection between the one-day publication of the foreclosure notice and their alleged emotional distress, the panel said.

11 U.S.C. § 362(k)

(1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

(2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor, the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.

However, the Lodges "offered only generalized evidence that they were 'stressed out' and had difficulties interacting with one another and their children," and they presented no evidence corroborating these assertions, the panel.

In addition, the Lodges did not establish a causal connection between the one-day publication of the notice and their alleged emotional distress, the panel said.

Based on these findings, the panel affirmed the District Court's decision. WJ

Related Court Document:
Opinion: 2014 WL 1813298

See Document Section A (P. 25) for the opinion.

Bankrupt consulting firm wants automatic stay extended to suits against personnel

An international management consulting firm that filed a Chapter 11 petition in early May is asking a bankruptcy court in New York to enjoin a former employee from proceeding with pre-petition litigation against certain non-debtor personnel.

TriPlanet Partners LLC v. Roberts (In re TriPlanet Partners), No. 14-22643, adversary complaint filed (Bankr. S.D.N.Y. May 14, 2014).

TriPlanet Partners LLC says in an adversary complaint filed in the U.S. Bankruptcy Court for the Southern District of New York that the Bankruptcy Code's automatic stay should halt the pre-petition litigation against the non-debtors because the company would be on the hook for any damages under an indemnification obligation.

"Because debtor is the party defendant that [former employee Benjamin] Roberts claims short-changed him, a judgment against any non-debtor is effectively a judgment against debtor," the complaint says.

The company's operating agreement obligates TriPlanet to indemnify its non-debtor executives, directors and employees for losses, damages or claims incurred while they acted on behalf of the company. The non-debtors are identified in the complaint as TriPlanet sole member Imed Bennaceur, manager Sophien Bennaceur and the managing director of a company affiliate, Moez Bennaceur.

THE DEBTOR

TriPlanet filed a Chapter 11 petition May 8. It reported estimated assets of $10 million to $50 million against estimated liabilities in the same range, according to court records.

A week later, the company filed a complaint seeking to enjoin Benjamin Roberts from continuing to litigate two lawsuits against the three non-debtors.

Roberts began working for TriPlanet in August 2010 when the company entered into a multimillion-dollar service contract with Royal Bank of Scotland in London, the complaint says. He was dismissed in June 2012 when the contract with RBS ended, according to TriPlanet.

He subsequently sued TriPlanet, Imed Bennaceur and Sophien Bennaceur in Connecticut, claiming his employment agreement made him a 25 percent owner of the company, the TriPlanet complaint says. He seeks damages of $15 million, which he claims is his share of TriPlanet's profits, according to the company's complaint.

Roberts later added Moez Bennaceur to the Connecticut action and, in April 2014, brought a separate lawsuit against Sophien and Moez in New York, TriPlanet says.

THE STAY REQUEST

TriPlanet's adversary complaint asks the Bankruptcy Court to enjoin Roberts from taking further action in the litigation against the non-debtors until a reorganization plan is confirmed.

"Because debtor is the party defendant that Roberts claims short-changed him, a judgment against any non-debtor is effectively a judgment against debtor," TriPlanet's complaint says.

The company adds that, because it would bear the cost of paying any adverse judgment against the non-debtors, the pre-petition litigation will divert attention from its reorganization efforts.

TriPlanet seeks to have the automatic stay extended to enjoin Roberts from proceeding against the non-debtors. WJ

Related Court Document:
Complaint: 2014 WL 2170699

See Document Section B (P. 35) for the complaint.

Bankrupt deli gets $36,000 from lender for stay violation

By Keith Harris, Senior Content Writer, Westlaw Daily Briefing

A lender attempting to repossess refrigeration appliances from an Italian deli despite knowledge that the deli owner was protected by an automatic bankruptcy stay must pay the owner $36,000 in damages, a Colorado bankruptcy judge has ruled.

Stellato v. Den-Cut Financial LLC (In re Stellato et al.), No. 12-1207, 2014 WL 1883978 (Bankr. D. Colo. May 9, 2014).

U.S. Bankruptcy Judge Howard R. Tallman of the District of Colorado ordered the lender to pay more than $11,000 for property damage and an additional $25,000 in punitive damages.

ATTEMPTED REPOSSESSIONS OF EQUIPMENT

In January 2011 Anthony Stellato borrowed $58,000 from Den-Cut Financial LLC to purchase restaurant equipment for his business, Stellato's Grocery and Deli Inc, according to the judge's opinion.

Stellato made monthly payments on the loan until September 2011. Den-Cut allowed a temporary deferment, but Stellato was unable to keep current, and the lender demanded payment of the debt in full, the opinion said.

> "[The lender] clearly put its economic objectives ahead of the debtor's rights under the Bankruptcy Code when it usurped this court's role in determining whether the stay applied," the judge said.

On Feb. 6, 2012, four Den-Cut employees appeared at Stellato's saying they intended to repossess the equipment. They began unplugging refrigerators and removing food, the opinion said.

Stellato called the police, who told the Den-Cut representatives they needed a writ of assistance to authorize the repossession and ordered them to leave, the opinion said.

Den-Cut filed a replevin action the same day in state court and about two weeks later, on Feb. 21, received an order for possession. The next day employees again appeared at Stellato's, and again the police ordered them to leave because they still lacked the required writ. Den-Cut received the writ later that day.

That same day Stellato and his wife filed for Chapter 13 bankruptcy, listing the equipment as personal property and listing Den-Cut as a creditor. Den-Cut's attorney received notice of the automatic stay that a bankruptcy filing imposes on attempts to collect from a debtor, according to the opinion.

Two days after the bankruptcy filing, 10 Den-Cut employees appeared at Stellato's, carrying wrenches and a tie-rod, which frightened Stellato, he later testified. He locked the building and left, the opinion said.

In the presence of a sheriff's deputy, the employees cut their way into Stellato's and began removing the equipment, emptying their contents on the floor. Stellato returned roughly an hour later, providing evidence of the automatic stay, and the deputy ordered the Den-Cut employees to stop, the opinion said.

Stellato filed a complaint alleging willful violation of the automatic stay, and the matter proceeded to trial.

The lender admitted in Bankruptcy Court to willfully violating the automatic stay. The only question for the judge to decide was the amount of damages.

DAMAGES AWARDED

Judge Tallman awarded Stellato $5,000 in actual damages due to food spoilage, noting that Del-Cut had taken no action to rectify the damage done by leaving food on the floor.

In addition, the judge ordered Del-Cut to pay $6,000 for the damage caused when its employees broke into Stellato's, saying the debtor had reason to be fearful enough to lock his building and leave the premises.

Turning to punitive damages, the judge rejected the lender's contention that it thought the stay did not apply and thus did not intentionally ignore the law.

"Den-Cut clearly put its economic objectives ahead of the debtor's rights under the Bankruptcy Code when it usurped this court's role in determining whether the stay applied," Judge Tallman said.

In addition to the lender's "intentional disregard" of the stay, Den-Cut's ability to pay the damages, its relative sophistication, its ill will toward the debtor and the lack of provocation all weighed in favor of a punitive damages award, the judge said.

He concluded that an award of $25,000 in punitive damages, or roughly twice the actual damages award, would be sufficient to deter Del-Cut from future stay violations. WJ

Related Court Document:
Opinion: 2014 WL 1883978

Debtors shed income tax debt in partial victory on appeal

By Michael Nordskog, Senior Content Writer, Westlaw Daily Briefing

Two debtors who filed late income tax returns can discharge the tax debt for years in which the state taxing authority had not already assessed their liability, a bankruptcy appeals panel has ruled in partially reversing two Massachusetts bankruptcy court decisions.

Pendergast v. Massachusetts Department of Revenue (In re Pendergast), No. 12-1215; Wood v. Massachusetts Department of Revenue (In re Wood), No. 13-1074, 2014 WL 1800838 (B.A.P. 1st Cir. May 2, 2014).

The relevant Bankruptcy Code provisions favor debtors who cooperate by submitting returns and sharing necessary information before authorities take action, the 1st U.S. Circuit Bankruptcy Appellate Panel said.

Debtors Steven P. Wood and Timothy P. Pendergast filed separate bankruptcy petitions in 2011 and 2012, respectively.

Both debtors had filed delinquent state income tax returns in 2009 to account for multiple previous years in which they had failed to file returns. For some of those years, the Massachusetts Revenue Department had already assessed the debtors' personal income tax liability.

Wood and Pendergast each received a Chapter 7 discharge of their eligible debts and both subsequently filed adversary complaints against the department seeking a ruling that their pre-petition tax debts had been discharged.

SECTION 523(A)'S HANGING PARAGRAPH

The department filed motions for summary judgment in both cases, arguing that Wood's and Pendergast's tax debts were exempt from discharge under Section 523(a)(1)(B) of the Bankruptcy Code, 11 U.S.C.A. § 523(a)(1)(B), because both debtors had filed their tax returns late.

That provision says a debtor cannot discharge a tax debt for which a return was not filed, or was filed late but within two years before the bankruptcy filing.

> Only income tax returns filed after a taxing authority has made its own assessment do not qualify as returns under the hanging paragraph, the panel said.

The agency's argument hinged on the interpretation of the so-called "hanging paragraph" of Section 523(a).

The unnumbered paragraph at the end of Section 523(a)'s numerical list of nondischargeable debts defines "return" as a filing "that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements)."

The department maintained that the late-filed returns did not qualify as a return under the hanging paragraph because neither debtor filed in a timely manner and thus did not satisfy applicable filing requirements under Massachusetts law.

"It followed under this theory that no returns were filed for the years at issue," exempting the tax debts from discharge, the panel said in explaining the department's position.

U.S. Bankruptcy Judge William C. Hillman of the District of Massachusetts granted summary judgment in each case, ruling that the debtors' tax liabilities for all the years in question were nondischargeable.

"While I recognize that there is something unsavory about saying that a 'late-filed return' is not a 'return' under Section 523(a) by virtue of its tardiness, I cannot characterize this result as absurd," Judge Hillman said, acknowledging that other courts have found this reading "does too much violence to the statute."

Both debtors appealed.

POST-ASSESSMENT LATE FILINGS NONDISCHARGEABLE

The BAP affirmed Judge Hillman's decisions in part and reversed in part after determining that only income tax returns filed after a taxing authority has made its own assessment do not qualify as returns under the hanging paragraph. The panel cited the rationale articulated by *In re Gonzalez*, 489 B.R. 1 (Bankr. D. Mass. 2013).

The panel noted information provided by the Revenue Department in *Gonzalez* showing that it treats late-filed returns as it does timely returns, aside from relevant penalties, if it has not previously assessed a taxpayer's liability. However, the department treats a return as an "abatement application" and not a tax return if an assessment has already been made.

The key distinction provided by the hanging paragraph is a taxpayer's cooperation or "self-assessment" in providing information relevant to determining tax liability, the panel said, noting that such actions save a taxing authority's resources.

"[A] late-filed, post-assessment Massachusetts state income tax return does not qualify as a return for discharge purposes," the panel said.

However, Pendergast could discharge his tax debt from the two years for which an assessment had not been imposed, and Wood was eligible to discharge one year's tax debt, the panel concluded. WJ

Related Court Document:
Opinion: 2014 WL 1800838

See Document Section C (P. 38) for the opinion.

Fired lawyer gets to keep bulk of bankruptcy client's retainer

By Keith Harris, Senior Content Writer, Westlaw Daily Briefing

A discharged attorney is entitled to keep $35,000 of a $44,000 retainer he received from a Chapter 11 debtor, despite waiting until after the debtor's case was dismissed before filing his employment application, a California bankruptcy judge has ruled.

In re MJM Management LLC, No. 13-28734, 2014 WL 1884340 (Bankr. C.D. Cal. May 12, 2014).

The lawyer should receive fair compensation despite irregularities with his application, U.S. Bankruptcy Judge Thomas B. Donovan said, though he directed the attorney to hold in a trust fund nearly $10,000 in fees that had not yet been paid to the U.S. Trustee for the case.

DEBTOR'S HOTEL SOLD

Los Angeles-based MJM Management LLC filed for Chapter 11 relief in July 2013 and was represented by attorney Thomas F. Nowland. MJM's primary asset was a $4 million hotel secured by loans totaling $2.2 million.

The following month, EXB Holdings 2 LLC, which held the notes securing the hotel debt, asked the Bankruptcy Court for relief from the automatic stay that a bankruptcy filing imposes on civil actions against a debtor's property.

At a hearing on stay relief, MJM notified Judge Donovan it had been negotiating a sale of the hotel that would permit EXB to be paid in full. The court permitted MJM to pursue the possibility of a sale.

During that same hearing, Nowland informed the court he held $54,000 of MJM funds in trust, saying that he had claimed $5,000 as filing fees and the rest was "still our client's money and it belongs to the bankruptcy estate.

The court approved a sale agreement later that month and also granted EXB relief from stay with instructions that the creditor could not foreclose for 30 days.

MJM fired Nowland in September and substituted a new attorney in its case. On the U.S. Trustee's motion, and with no opposition from MJM, the case was dismissed, and the court entered a $9,750 judgment in favor of the U.S. Trustee.

> "This ... explanation is truly a Lewis Carroll caliber fantasy," the judge said.

The sale closed. MJM paid its creditors from a $2.6 million down payment on the hotel, though the U.S. Trustee was not paid.

In January 2014 Nowland, which had filed no motions since his discharge, filed an application asking the court for a retroactive employment order, seeking $52,000 in compensation. The U.S. Trustee and MJM opposed his application.

REASONABLE COMPENSATION

Judge Donovan agreed with the U.S. Trustee that Nowland's application did not comply with published guidelines and had been unreasonably delayed.

The judge also expressed suspicion that the attorney had procrastinated while trying to determine a way to hold on to the funds he still held in trust.

The judge rejected Nowland's argument that because MJM's case had been dismissed, the company had never really been in bankruptcy and there was no bankruptcy estate to which the $44,000 in trust funds could be returned.

"This Nowland explanation is truly a Lewis Carroll caliber fantasy," Judge Donovan said.

Despite these irregularities, Nowland, who had not represented a Chapter 11 debtor prior to this case, is entitled to reasonable compensation, the judge said, allowing the attorney to keep $35,000 of the funds, with the remainder to be returned to MJM.

However, since the trustee had not yet been paid, Judge Donovan required Nowland to keep $9,750 in trust until the U.S. Trustee's judgment was satisfied. WJ

Related Court Document:
Opinion: 2014 WL 1884340

U.S. Bank lacks grounds to toss $200 million fraud suit, brokerage says

A class-action lawsuit accusing U.S. Bank of facilitating the theft of $200 million from now-bankrupt futures commission merchant Peregrine Financial Group should continue, a commodities brokerage says in a recent court filing.

Fintec Group Inc. v. U.S. Bank N.A., No. 13-cv-08076, response brief filed (N.D. Ill. May 13, 2014).

In response to the Philadelphia-based bank's motion to dismiss Fintec Group's complaint, the brokerage says it has standing to sue the institution.

Fintec also says its complaint, filed in the U.S. District Court for the Northern District of Illinois, adequately pleads violations of the Commodity Exchange Act, 7 U.S.C. § 6d.

Fintec Group filed the complaint Nov. 11, accusing U.S. Bank of helping Peregrine CEO and owner Russell Wasendorf Sr. use the futures commission merchant's account at the bank for personal reasons. The account held Peregrine clients' funds, Fintec says.

According to the complaint, Peregrine kept a segregated customer account with U.S. Bank from January 2010 to July 2012. Wasendorf illegally used this account for personal expenses, and the bank knowingly accepted funds from the account as security on a $3 million personal loan and a $6.4 million construction loan, the suit claims.

Wasendorf pleaded guilty in September 2012 to embezzling more than $100 million from the company.

CFTC SUIT

U.S. Bank is facing a similar lawsuit by the Commodity Futures Trading Commission.

U.S. District Judge Linda R. Reade of the Northern District of Iowa declined to dismiss the CFTC's suit Nov. 3, saying the regulator adequately pleaded that U.S. Bank knew certain transactions were not for the benefit of Peregrine's customers. *CFTC v. U.S. Bank N.A.*, 2013 WL 5944179 (N.D. Iowa Nov. 5, 2013).

In that suit, the CFTC accuses Wasendorf and Peregrine, which filed for bankruptcy in July 2012, of defrauding about 24,000 Peregrine clients and misappropriating more than $215 million.

REUTERS/Fred Prouser

The suit accuses U.S. Bank of helping former Peregrine Financial Group CEO Russell Wasendorf Sr. use Peregrine clients' funds for personal expenses. The U.S. Bank Tower in Los Angeles is shown here.

THE INSTANT ACTION

In its complaint, Fintec seeks to certify a plaintiff class of about 500 "introducing brokers" who lost customer funds to Peregrine and have not received their commissions.

An "introducing broker" delegates trading on behalf of clients to another company, such as Peregrine.

According to the suit, U.S. Bank violated the Commodity Exchange Act by keeping Peregrine's segregated client account open even though it knew the funds were not for the benefit of customers.

In support of its case, Fintec says a separate class action currently seeking to recoup customer losses does not seek to recover the brokers' losses. *In re Peregrine Fin. Group Customer Litig.*, No. 12-cv-05546, *complaint filed* (N.D. Ill., E. Div. Dec. 21, 2012).

U.S. Bank moved to dismiss the complaint, arguing that Fintec lacks standing to sue under the CEA and failed to adequately plead that U.S. Bank aided and abetted Wasendorf's fraud.

The brokerage's claims "cannot survive in the absence of pleaded facts sufficient to create a plausible inference that U.S. Bank actually knew of Wasendorf's fraud and knowingly acted to further it," the bank argued.

Fintec says in its response to the dismissal motion that U.S. Bank's arguments are "baseless."

The brokerage has standing to sue under the CEA because it paid a security deposit to Peregrine and placed orders for futures contracts for the sale of commodities with the merchant, the response brief says.

Fintec further asserts that it sufficiently alleged that the bank knew about the fraud and that Fintec only need demonstrate the bank's "conscious avoidance" of the truth. WJ

Related Court Documents:
Complaint: 2013 WL 5974406
Motion to dismiss: 2014 WL 1047834
Response brief: 2014 WL 1994565

Warn Act

CONTINUED FROM PAGE 1

The companies plan to use the bankruptcy process to restructure their finances and operations and sell their assets at auction, court records say.

THE COMPANIES

The ClearEdge companies have an engineering facility in Hillsboro, Ore., and a manufacturing hub in South Windsor, Conn., according to court records.

On April 25, the companies terminated Wojciechowski and over 200 other Connecticut-based employees, the suit says.

Wojciechowski claims the alleged "mass layoff" came without the required 60-day written notice under the WARN Act.

The Connecticut Department of Labor received ClearEdge's WARN Act notice April 25, according to state records.

The suit alleges the companies failed to pay Wojciechowski and other similarly situated employees their wages, bonuses, holiday pay and accrued vacation for 60 days after their terminations and failed to make 401(k) contributions or provide health insurance coverage during the same period.

> The alleged April 25 "mass layoff" came without the required 60-day written notice under the WARN Act, according to the complaint.

The WARN Act

29 U.S.C. § 2104

(a) Civil actions against employers

(1) Any employer who orders a plant closing or mass layoff in violation of section 2102 of this title shall be liable to each aggrieved employee who suffers an employment loss as a result of such closing or layoff for—

(A) back pay for each day of violation at a rate of compensation not less than the higher of—

(i) the average regular rate received by such employee during the last 3 years of the employee's employment; or

(ii) the final regular rate received by such employee; and

(B) benefits under an employee benefit plan described in section 1002(3) of this title, including the cost of medical expenses incurred during the employment loss which would have been covered under an employee benefit plan if the employment loss had not occurred.

Such liability shall be calculated for the period of the violation, up to a maximum of 60 days, but in no event for more than one-half the number of days the employee was employed by the employer.

The suit seeks to recover an allowed wage priority claim of up to $12,450 per class member under the WARN Act and a general unsecured claim equal to the sum of unpaid wages, salary, commissions, bonuses, accrued holiday and vacation pay, and 401(k) contributions for the 60-day period following their terminations.

Wojciechowski also seeks recovery under the Connecticut Wage Law, Conn. Gen. Stat. § 31-76k.

He seeks class certification on behalf of about 250 employees. WJ

Attorney:
Plaintiff: Gail Lin Chung, Outten & Golden, San Francisco

Related Court Document:
Complaint: 2014 WL 2142314

NEWS IN BRIEF

SILICONES PRODUCER GETS OK TO USE $570 MILLION IN DIP FINANCING

Momentive Performance Materials Inc., a global developer and manufacturer of silicones and quartz-based products, has obtained bankruptcy court approval to access $570 million in committed debtor-in-possession financing, according to a May 23 company statement. The ruling enables the company to continue its normal operations while completing a balance sheet restructuring, MPM's president and chief executive officer, Craig O. Morrison, said in the statement. The company filed a Chapter 11 petition in April. At the time, MPM said in a court filing that it had experienced a significant deterioration in its financial performance based, in part, on industry-wide overcapacity, which caused severe price pressure for its basic products. The bankruptcy filing followed an agreement with certain key stakeholders on a restructuring plan that is expected to eliminate more than $3 billion of debt from MPM's balance sheet and enhance liquidity, according to the statement. The company said its operations outside the United States are not a part of the bankruptcy proceedings

***In re MPM Silicones LLC*, No. 14-22503, debtor-in-possession financing approved (Bankr. S.D.N.Y. May 23, 2014).**

MUSICAL INSTRUMENT MAKER WINS BANKRUPTCY SALE APPROVAL

Brass musical instrument maker S.E. Shires Inc. has won approval from the U.S. Bankruptcy Court for the District of Massachusetts to sell its business to Eastman Brass Instruments Inc. The Hopedale, Mass.-based maker of high-end trombones and trumpets filed for Chapter 11 protection April 8 in the face of unpaid tax liabilities owed to the Internal Revenue Service and the state, according to a statement from the company's founder and president, Stephen E. Shires. The company was created in 1995 and has about 40 employees. S.E. Shires said that despite growing demand for its instruments, the company has struggled with profitability because of the costs of labor and raw material and a lack of sufficient capital to fund operations. The court's May 23 order said the nearly $2 million Eastman agreed to pay is the highest and best offer available.

***In re S.E. Shires Inc.*, No. 14-40715, sale approved (Bankr. D. Mass. May 23, 2014).**

NEW BANKRUPTCY FEES ANNOUNCED

Several bankruptcy fees increased June 1 as a result of amendments to the Bankruptcy Court Miscellaneous Fee Schedule, according to a May 19 statement from the Administrative Office of the U.S. Courts. The Judicial Conference of the United States approved the increases in March. Among the changes are a $57 increase in the adversary filing fee in bankruptcy proceedings, from $293 to $350, and the assessment of a new administrative fee structure. The administrative fee, currently set at $46 for all cases, will increase to $75 for Chapter 7, 12 and 13 proceedings, and will increase to $550 for cases filed under Chapters 9, 11 and 15. Married couples who divide a bankruptcy filing into two cases, often because of a divorce or separation that occurs during the pendency of the proceedings, will face separate administrative fees under the amendments.

CASE AND DOCUMENT INDEX

