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## **Business Bankruptcy Case Developments - 2016**

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## **I. ADMINISTRATIVE MATTERS**

### **A. Jurisdiction and Constitutional Authority**

#### ***“Arising In” Jurisdiction Remains Broad, Even if “Related To” Jurisdiction Becomes Narrower Post-Confirmation Jurisdiction.***

*Galaz v. Katona (In re Galaz)*, --- F.3d ---, 2016 U.S. App. LEXIS 19506 (5th Cir. Oct. 28, 2016) (Clement, J.)

The debtor (Katona) began an adversary proceeding in bankruptcy court to enjoin her former father-in-law (Galaz) from pursuing claims against a third-party individual (Oshita). In support of such injunctive relief, the debtor argued that the claims at issue were released as part of a previous settlement agreement that was approved in contemplation of her bankruptcy plan. Galaz argued that he acquired the claims after the plan was confirmed and, thus, was not bound by any prior releases. The bankruptcy court enjoined Galaz from pursuing claims against Oshita, concluding that the settlement approved by the bankruptcy court barred such claims. Galaz appealed on grounds that the bankruptcy court lacked subject matter jurisdiction. The District Court affirmed, and this appeal followed.

The Fifth Circuit affirmed, concluding that post-confirmation jurisdiction existed, and that the prior settlement order barred the defendant (Galaz) from pursuing claims against a third-party (Oshita).

“Even viewed through the narrower lens of post-confirmation bankruptcy jurisdiction, Galaz’s [] claims relate principally to pre-confirmation activity between the parties. There was discord between Oshita and Katona [the debtor] during the reorganization as to the respective ownership interests in WSG. Indeed, that dispute formed the basis of the 2008 Settlement Agreement, which provided funds for Katona to pay off her debts under the plan.”

The Court concluded for that reason that there was “arising in” jurisdiction over the releases provided in the prior settlement agreement, and that Galaz’s efforts to assert control over those released claims fell within the bankruptcy court’s “arising in” jurisdiction. Because “arising jurisdiction” existed, the Court held that the bankruptcy court had statutory and constitutional authority to enter final orders on this “core” proceeding. Finally, on

the merits, the Court concluded under Texas law that the claim assignments received by Galaz were burdened with the releases previously approved by the bankruptcy court. Because an assignee in Texas cannot receive any greater rights than transferred by the assignor, the Court of Appeals agreed with the lower courts that Galaz was bound by the releases approved by the bankruptcy court and, therefore, barred from pursuing claims against Oshita.

#### ***“Related To” Jurisdiction Exists Independent of the Merits of the Underlying Claim.***

*Collins v. Sidharthan (In re KSRP, Ltd.)*, 809 F.3d 263 (5th Cir. 2015) (Haynes, J.)

The debtor owned and operated a hotel in South Padre Island, Texas. The plaintiff (Collins) was an insurance attorney who sought to represent the debtor (KSRP) following a hurricane in 2008, which damaged the hotel. Collins sent an engagement letter to KSRP, which the defendant (Sidharthan) executed on behalf of KSRP. KSRP’s management advised Collins that Sidharthan was authorized to act on KSRP’s behalf, even though Sidharthan was not technically an employee, manager, officer or direct owner of KSRP. Instead, he owned 50% of the debtor’s general partner.

After Collins began pursuing insurance claims for KSRP, he learned that Sidharthan was undermining his efforts and was collecting on the insurance claims without going through Collins. Sidharthan’s attorneys then sent Collins a letter ordering him to cease his representation. Collins responded with a lawsuit against Sidharthan and KSRP in Texas state court, asserting claims for breach of contract and tortious interference. About a week before KSRP filed its bankruptcy case, however, Collins non-suited KSRP and pursued claims only against Sidharthan. Sidharthan removed the lawsuit to bankruptcy court and asserted a cross-claim against KSRP for indemnity.

The bankruptcy court held a two-day bench trial and issued a report and recommendation: (a) denying Collins’s claims against Sidharthan, because there was no contract with Sidharthan, personally, and Sidharthan merely acted within his scope of authority on behalf of KSRP; and (b) rejecting Sidharthan’s indemnity claims as moot, because Collins was not asserting direct claims against KSRP. The district court adopted the report and recommendation, and entered judgment under which Collins received nothing. Collins appealed

the district court's judgment, but argued only that the lower courts lacked "related to" jurisdiction given that the bankruptcy court rejected Sidharthan's indemnity cross-claim against the debtor as moot.

In this decision, the Fifth Circuit affirmed the judgment, concluding the jurisdiction existed even in the absence of a meritorious claim being asserted against the debtor. In so holding, the Court of Appeals expressly rejected "dichotomy" between potentially meritorious claims (over which there would be "related to" jurisdiction), and meritless claims (over which there would be no "related to" jurisdiction because the meritless claims could not have a conceivable effect on the estate). Instead, the Court of Appeals explained that courts must determine their authority to hear cases "as a separate matter from whether that case involves a viable claim."<sup>2</sup> In this case, the Fifth Circuit noted that Sidharthan's cross-claim against the debtor for indemnity "passes muster" even though the merits were ultimately rejected by the trial court. Because Sidharthan's indemnity claim was colorable at the time of removal, the Fifth Circuit concluded that Collin's claims could conceivably impact the administration of the estate and, thus, without considering the merits of the claims, the lower courts had "related to" jurisdiction to adjudicate the dispute. Accordingly, the Fifth Circuit affirmed the lower courts' rulings.

***Court Has Authority to Interpret Plan, Even if Doing So Could Short-Circuit Ongoing State Court Litigation***

*In re Odin Demolition & Asset Recovery, LLC*, 544 B.R. 615 (Bankr. S.D. Tex. 2016) (Bohm, J.)

Defendants in state court filed a motion to reopen a bankruptcy case to have the Bankruptcy Court interpret that plan and determine that the claims asserted against them were barred. The Court concluded that it had jurisdiction and authority to consider and enter final orders on the motion to reopen, because the ruling was critical to the administration of the bankruptcy case and would adjust the debtor-client relationship. Further, the Court found that the parties consented by appearing in person and through pleadings on the motion to reopen, and never once raised an objection to the Bankruptcy Court's constitutional

authority. Thus, under *Wellness International*, the Court concluded that it could enter final orders by consent as well.

***Court Can Enter Interlocutory Summary Judgment Orders, Even Without Constitutional Authority.***

*Hornbeck Offshore Servs., LLC v. ATP Oil & Gas Corp. (In re ATP Oil & Gas Corp.)*, 550 B.R. 325 (Bankr. S.D. Tex. 2016) (Isgur, J.)

Court had subject matter jurisdiction over declaratory judgment action between a statutory lien claimant and the purchaser of the debtor's assets to determine the relative priority of the lien claimant's liens. However, because the dispute was only "related to" the bankruptcy case, concerned only issues of state law, was among non-debtor parties and could not be fully resolved in the context of a claim objection, the Court concluded that lacked constitutional authority (without the parties' consent) to issue final orders.

Instead, the Court concluded that it could grant partial summary judgment, which was merely interlocutory, and not a final order.

***Disputes Over Compensation are "Core" Proceedings, Not Subject to Arbitration.***

*In re Lehman Bros. Holdings*, 2016 U.S. App. LEXIS 18288 (2d Cir. Oct. 6, 2016) (per curiam)

While arbitration clauses are presumed to be enforceable in non-core proceedings, the Bankruptcy Court correctly denied plaintiff's motion to compel arbitration in this case because the adversary proceeding concerning the plaintiff's deferred compensation from the debtor was a "core" proceeding, and arbitration of such claim would "seriously jeopardize" the objectives of the Bankruptcy Code. "Congress simply could not have intended to turn over the determination of the relative priority of claims against the estate and equitable distribution of the estate's assets in the largest SIPA liquidation in U.S. history [to] the financial industry regulatory authority to be decided under the rules of the New York Stock Exchange."

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<sup>2</sup> See *Carter v. Homeward Residential, Inc.*, 794 F.3d 806, 807-09 (7th Cir. 2015).

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