Business Bankruptcy Case Developments - 2018

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A. Jurisdiction and Constitutional Authority

Bankruptcy Rule 8002(a) is Jurisdictional
Kenneth Michael Wright, L.L.C. v. Kite Bros., L.L.C. (In re Kite), 710 Fed. App'x 628 (5th Cir. 2018)(per curiam).

R. Alan Kite, now deceased, filed for bankruptcy protection. Kite Bros., L.L.C. ("Kite Bros.") filed a timely proof of claim for more than one million dollars based upon a December 2013 state court judgment in Louisiana. Kenneth Michael Wright, L.L.C. ("Wright"), an unsecured creditor, objected to the proof of claim and collaterally attacked the state court judgment with a removal argument that had already been rejected by both a state court and federal district court. Following a hearing, the bankruptcy court entered an order denying Wright's objection.

On December 13, 2016, one day after the fourteen days to file a notice of appeal of the court's order, Wright filed an appeal. Kite Bros. filed (a) a motion to dismiss the appeal in the district court because Wright's appeal was untimely under Bankruptcy Rule 8002(a)(1), and (b) a motion for sanctions under Bankruptcy Rules 8020(a) and 9011, 28 U.S.C. § 1927, and the court's inherent authority because the Wright appeal was untimely and frivolous. Wright countered that Rule 8002 was not jurisdictional and its removal argument was not frivolous. The district court (i) granted the Kite Bros.'s motions, imposing sanctions for the frivolous appeal, and granted reasonable costs and attorneys' fees for the Kite Bros.'s appellate defense; and (ii) concluded that it lacked jurisdiction to hear Wright's appeal because it was not timely filed.

The court gave parties until April 17, 2017, to submit a fee application. Kite Bros. filed their fee application timely. Wright missed the deadline and waited more than s week to request additional time to respond, which the court denied. On May 4, 2017, the district court entered sanctions against Wright, and Wright timely appealed the second sanctions order. Further, Kite Bros. filed an additional motion for sanctions against Wright and its counsel, individually.

Because Wright failed to properly raise two of its three appeals claims before the district court, the Fifth Circuit only addressed Wright's assertion that its appeal to the district court was not frivolous. The circuit court confirmed that the fourteen-day deadline for appeals pursuant to Bankruptcy Rule 8002(a) is jurisdictional and noted that Bankruptcy Rule 8002(a) is in fact mandated by Congress because jurisdiction is determined by 28 U.S.C. § 158(c)(2), which incorporates the time limits prescribed in Rule 8002(a). In its per curiam opinion, the Fifth Circuit found Wright's instant appeal to be frivolous; granted sanctions against Wright; denied sanctions against Wright's counsel, individually; and awarded nominal damages of $1 and double costs to Kite Bros.

B. Property of the Estate, the Automatic Stay and Other "First Day" Issues

A State's Pecuniary Reasons to Lift the Stay Cannot be Substituted for Section 362's Police and Regulatory Exception
In re Bloomfield Nursing Operations, LLC, et al., No. 17-42769 (Bankr. N.D. Tex. May 1, 2018)(Mullin, J.)(order denying state of New Mexico's motion for order confirming automatic stay inapplicable to medicaid fraud enforcement action).

Effective November 1, 2012, the ownership of two New Mexico skilled nursing facilities was transferred from Bloomfield Nursing Operations, LLC and its affiliates ("Bloomfield") to Preferred Care, Inc. and its affiliates ("Preferred"). In December 2014, New Mexico's Attorney General brought a primarily pecuniary suit against Bloomfield, Preferred Care, and additional parties in Santa Fe County, New Mexico. The allegations included violations of the New Mexico Fraud Against Taxpayers Act, the New Mexico Medicaid Fraud Act, and New Mexico common law. The only non-monetary relief requested was related to the New Mexico Unfair Practice Act. However, because Bloomfield was no longer operating the two facilities, the requested remedy under the New Mexico Unfair Practices Act was inapplicable to Bloomfield.

On July 2, 2017, Bloomfield filed for bankruptcy protection; several days later, the New Mexico state court stayed the New Mexico Attorney General's case due to the bankruptcy. In November 2017, Preferred Care and additional defendants in the Santa Fe County case filed for bankruptcy protection.

In April 2018, the bankruptcy court held a hearing on the New Mexico Attorney General's motion to determine whether New Mexico's state court action was subject to the *Bloomfield* bankruptcy automatic stay because it is "an action or proceeding by a governmental unit . . . to enforce such governmental unit's . . . police and regulatory power." 11 U.S.C. § 362(b)(4). The court applied both the "pecuniary purpose test" and the "public policy test" and determined the New Mexico Attorney General's state court action was primarily in search of funds from the defendants and not attempting to deter ongoing conduct that could seriously threaten public safety and welfare. Based upon the totality of the circumstances, including New Mexico's lack of evidence to support its public safety argument, the bankruptcy court held that New Mexico did not satisfy its burden of proof that section 362(b)(4) exception was applicable.

DIP Motion Denied for the Collateral's Insufficient Value and Debtors' Failure to Investigate Additional Financing

In re Laffite's Harbor Dev. I, LP, No. 17-36191-H5-11, 2018 Bankr. LEXIS 2 (Bankr. S.D. Tex. Jan. 2, 2018)(Brown, J.).

Real estate developers on Galveston Island, Texas, borrowed millions secured by all of their assets and begun platting their property to construct luxury vacation homes. When the developers ran out of money and filed their bankruptcy petitions in November 2017, the loan balance outstanding was approximately $11.5 million. Six weeks into their case, the court held a hearing on the debtors' request to (i) employ a selling agent and property manager, and (ii) grant an emergency motion for interim relief to (a) authorize post-petition secured financing, (b) enter into an agreement with the entity providing financing, and (c) other related relief ("DIP Motion"). The court reserved its ruling on the motion to employ and denied the DIP Motion.

The DIP Motion requested court approval to borrow $4 million, with $2.5 million of those funds to be disbursed within two to three months. The terms of the borrowing included granting the lender (i) a priming lien on the property in the bankruptcy estate; (ii) a superpriority claim; (iii) a lien on avoidance actions, subject only to certain administrative expenses; and (iv) a waiver of surcharge under section 506(c). In addition, the debtors' proposed budget included a payment of $72,000 to their principal's management company.

At the hearing the court heard a variety of evidence. First, the court heard testimony on two appraisals of the debtors' property. In February 2016, the current value was $13.363 million, with an anticipated value of more than $20 million upon the completion of the property's 142 lots. However, in October 2017, the liquidation value of the property was $17.225 million, in part because several lots listed for sale in February 2016 had not yet closed. Next, the evidence indicated the debtors' revised business plan consisted of financing lot sales to builders through the EB-5 visa program, allowing foreign nationals to live and work in the United States after making a $500,000 business investment. Third, the evidence indicated that prior to filing their petitions, the debtors completed a deeply discounted sale. Instead of garnering $300,000 per lot, which the debtors' representative testified was the average price, the debtors sold a group of seven lots for $750,000. Finally, the debtors failed to investigate any alternative post-petition financing sources prior requesting approval of the DIP Motion. Thus, the court denied the debtors' DIP Motion.

C. Estate Professionals and Compensation

Employment Applications are Mandatory; Fee-Sharing Arrangements Must Follow Section 504

Wright v. Csabi, et al. (In re Vicky Gribble Wright), 578 B.R. 570 (Bankr. S.D. Tex. 2017)(Rodriguez, J.).

In late 2016, a chapter 13 debtor filed a complaint against three attorneys 9i) to disgorge an unauthorized fee; (ii) seek a turnover of property of the estate; and (iii) for violations of the automatic stay. The court, only addressing the attorneys' liability, found each defendant violated 11 U.S.C. §§ 105, 329, 330, 362, 504, and 542; Bankruptcy Rules 2014(a) and 2016(a); and Local Rule 2014-1(d).

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