Business Bankruptcy Case Developments - 2017

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A. Jurisdiction and Constitutional Authority

Bankruptcy Court Had Constitutional Authority to Approve Third-Party Releases in a Plan.
In re Millennium Lab Holdings II, LLC, 2017 Bankr. LEXIS 3419 (Bankr. D. Del. Oct. 3, 2017) (Silverstein, J.)

After approving third-party releases as an essential part of a confirmed chapter 11 plan, certain creditors appealed. The district court remanded for a ruling on constitutional authority. Here, the bankruptcy court concluded that it had both statutory authority to confirm a chapter 11 plan, as well as constitutional authority to approve third-party releases as essential components of that plan. In so ruling, the court relied on several post-*Stern* decisions, including (but not limited to) *In re Lazy Days' RV Center Inc.,* 724 F.3d 418 (3d Cir. 2013), where the Third Circuit recognized constitution authority to enter orders on quintessential bankruptcy matters, even where those orders directly or indirectly impact *Stern*-like state court actions. In this case, the bankruptcy court held that *Stern* did not prevent it from entering a final confirmation order on a plan that released the claimants' third-party RICO claims against non-debtor entities.

Fifth Circuit Revisits Post-Confirmation "Arising In" and "Related To" Jurisdiction Questions.
Galaz v. Galaz (In re Galaz), 665 Fed. Appx. 372 (5th Cir. Dec. 12, 2016) (per curiam)

After the bankruptcy court entered orders enjoining the debtor's former spouse (Raul) from enforcing two separate state court orders concerning child support obligations of the debtor, Raul appealed the bankruptcy court orders on grounds that the bankruptcy court lacked jurisdiction. Considering the specific facts and particular procedural history of this case, the Fifth Circuit affirmed, in part, and reversed, in part. Understanding the history is necessary.

Raul and the debtor (Lisa) divorced in 2002. Under the divorce decree, Lisa was ordered to pay medical insurance premiums and certain uncovered medical expenses. In 2007, Lisa filed a chapter 13 bankruptcy case, and in 2008, she stopped paying medical premiums and expenses. Lisa's chapter 13 plan was confirmed in 2008, but the case remained open pending an adversary proceeding against Raul, his father and special purpose entity regarding an alleged fraudulent transfer (which later resulted in a $450,000 judgment in Lisa's favor). In 2009, Raul brought an action in state court to enforce the divorce decree by reimbursing Raul for unpaid medical expenses. That action resulted in a judgment of $9,727.00. Raul then sought relief from the bankruptcy court to compel Lisa's payment of the judgment, but the bankruptcy court temporarily enjoined Raul's collection efforts pending the result of Lisa's action against Raul—reasoning that Lisa might be able to offset Raul's judgment against her own. In 2011, the state court entered a separate order for Lisa to pay half of the daughter's future medical expenses until the daughter turned 18.

Lisa ultimately prevailed in her claims against Raul and his father, but that judgment remained pending on a separate appeal (which was later affirmed in March, 2017).

Lisa completed her chapter 13 plan payments in 2012, and the bankruptcy court granted her discharge. Her case remained open, however, because of the other pending appeal. Three years later, in 2015, Raul moved in the state court to enforce the prior orders from 2009 and 2011. Lisa responded by asking the bankruptcy court to enjoin Raul from continuing to enforce the state court judgments and orders. The bankruptcy court agreed and entered injunctions against Raul. The district court affirmed, and Raul filed this appeal.

The Fifth Circuit Court of Appeals affirmed the bankruptcy court's injunction against enforcement of the 2009 judgment, but reversed the injunction against enforcement of the 2011 order. With respect to the 2009 judgment, the Fifth Circuit held that the bankruptcy court had "arising in" jurisdiction to interpret and implement its own prior orders. In this case, because the bankruptcy court had previously considered and denied Raul's efforts to collect the 2009 judgment, the Court of Appeals concluded that the bankruptcy court maintained at least "arising in" jurisdiction to implement its own prior orders.

The Fifth Circuit distinguished the 2011 order from the 2009 judgment, however. Unlike the 2009 judgment—which ordered Lisa to pay $9,272.00 for past medical expenses—the 2011 order compelled Lisa

to pay half of her daughter's *future* medical expenses. Moreover, unlike the 2009 judgment, the bankruptcy court had not considered Raul's enforcement of the 2011 order before Lisa completed her plan payments and obtained a discharge. The Court concluded, based on these distinctions, that the bankruptcy court lacked "arising in" jurisdiction to enjoin Raul's enforcement of the 2011 order. And the Court of Appeals also concluded that "related to" jurisdiction was lacking because (i) the 2011 order had no impact on Lisa's bankruptcy plan because Raul's rights accrued well after the 2008 plan was confirmed and mere months before Lisa completed her plan payments, and (ii) the 2011 order could not even have a conceivable effect on the bankruptcy estate because the order was entered so late in the case and the vast majority of the obligations accrued thereunder occurred after the plan was confirmed. Thus, the bankruptcy court's injunction against Raul for enforcement of the 2011 was reversed and vacated.

No "Arising In" Jurisdiction Over Employees' Claims Against Asset Purchaser
Gupta v. Quincy Med. Ctr., 858 F.3d 657 (1st Cir. 2017) (Lipez, J.)

During the bankruptcy case, the court approved an asset purchase agreement that required the purchaser to continue employment compensation and benefits for certain employees following the consummation of the sale. Notwithstanding this provision, on the date of closing, the purchaser notified the employees that it was terminating their employment and would not honor the provision of the asset purchase agreement governing continued compensation. The employees commenced litigation against the purchaser for breach of the asset purchase agreement.

In this decision, the First Circuit concluded that the lower courts lacked jurisdiction over the employees' claims. Specifically, the Court found no "arising in" jurisdiction over the severance claims, even though the dispute arose from the court-approved asset purchase agreement and bankruptcy sale order. "Appellants' claims look like ones that could have arisen entirely outside the bankruptcy context. They are essentially employment disputes that could arise in any asset sale, regardless of whether the sale involved a bankruptcy proceeding." Notably, the employees did not assert any other type of jurisdiction and relied solely on this "arising in" bankruptcy jurisdiction.

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

Comparing and Contrasting the PROMESA Stay to 11 U.S.C. § 362
Peaje Investments LLC v. Garcia-Padilla, 845 F.3d 505 (1st Cir. 2017) (Howard, J.)

In 2016, in response to Puerto Rico's looming debt crisis, Congress enacted the *Puerto Rico Oversight, Management, and Economic Stability Act* (the "*Act*" or "*PROMESA*," the Spanish word for "promise").[1] Among other provisions included in the Act is a temporary bankruptcy-like stay of debt related litigation. In *Peaje*, the First Circuit considered two separate actions for relief for the PROMESA stay. The night before the scheduled hearings on their motions, the District Court denied both motions and cancelled the hearings. While not expressly stated in the denial, the District Court implicitly held that both movants were adequately protected by the continuous replacement of their respective collateral—*i.e.*, future toll revenues and employer contributions.

Of particular interest in this *Peaje* decision is the First Circuit's comparisons between the PROMESA stay provisions and the relevant stay provision of Bankruptcy Code, section 362. First, the Court noted that, under the Bankruptcy Code, "cause" is expressly defined to include lack of adequate protection. No similar provisions exists under PROMESA. This distinction ultimately made no difference, however, because the First Circuit recognized that, even before the enactment of the Bankruptcy Code, the Supreme Court held that creditors were constitutionally entitled to protection of their interests "to the extent of the value of the[ir] property."[2]

[1] *See* 48 U.S.C. §§ 2101-2241
[2] *See Peaje Invs.*, 2017 U.S. App. 529 at *8 (quoting *Wright v. Union Cent. Life Ins. Co.*, 311 U.S. 273, 278, 61 S. Ct. 407, 74 L.Ed. 2d 235 (1982)).

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