

Benchnotes

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Intercreditor Agreement Defines Parties' Intentions with Respect to "Payment Over" Provision

In dueling motions to enforce an intercreditor agreement, the U.S. Bankruptcy Court for the District of Delaware looked at the four corners of the agreement to determine that the first-lien secured creditors must be paid in full prior to second-lien creditors receiving a distribution in *In re La Paloma Generating Co.*¹ The first-lien creditor entered into a settlement with the debtors for a credit-bid for assets, receipt of certain cash pledged to it and a release of liens on certain assets for the benefit of unsecured creditors.²

The second-lien creditors had a deficiency claim entitling them to a distribution with the other unsecured creditors, and filed a proof of claim on account of such claim.³ The collateral agent held the distributions to be paid to the second-lien creditors until the intercreditor dispute could be resolved.⁴

The first-lien lender argued that it must be paid in full before the second-lien creditors could receive any distribution. Conversely, the second-lien creditors contended that the first lien lapsed pre-petition and therefore distributions should be made in accordance with the plan, which would have included distributions on account of their filed proof of claim.⁵

The bankruptcy court parsed through the language of the intercreditor agreement. First, the court analyzed the "payment over" provision and determined that the proceeds from a sale of substantially all assets constituted collateral or proceeds of collateral. Second, the court looked at whether the second-lien creditors exercised remedies. The court determined that they had, since the intercreditor agreement specifically authorized the filing of a proof of claim, comparing it to other intercreditor agreements that are silent as to that right. Third, the filing of a proof of claim was an exercise of a remedy related to the collateral because it related to the second-lien claims, which were the subject of the intercreditor agreement. Finally, the court assessed whether the receipt of funds was "in contravention of" the intercreditor agreement and determined that to be the case if the second-lien creditors received a distribution and did not pay such funds over to the first-lien creditor.⁶

After determining that the first-lien creditor satisfied the requirements of the payment-over

provision, the court then looked at the waterfall set forth in the intercreditor agreement. The second-lien creditors argued that they agreed to lien subordination rather than payment subordination.⁷ Rejecting that argument, the court concluded that sophisticated parties had bargained-for rights and remedies in an intercreditor agreement, and their intentions were to subordinate the second-lien claims until the first-lien claims were paid in full.⁸ Therefore, any distributions under the plan received by second-lien creditors should be paid over to the first-lien creditor.

Miscellaneous

• *NuStar Energy Services Inc. v. M/V Cosco Auckland*, 2019 WL 192408 (5th Cir. Jan. 14, 2019) (addressing constitutional standing, Fifth Circuit ruled that creditor lacks standing when reversal of lower court decision would not result in funds flowing to debtor's estate against which such creditor held a claim; creditor had previously been held not to be entitled to maritime lien in other decisions in bankruptcy case; without a lien, creditor sought a recovery on unsecured claim and had not demonstrated that there was "substantial likelihood" that funds would be available and thus there was no redress for subcontractor);

• *In re Verity Health System of Cal. Inc.*, 2018 WL 6828993 (Bankr. C.D. Cal. Dec. 26, 2018) (court held that conditions imposed by attorney general on transfer of hospital in prior transaction are not binding on new purchaser of same assets; conditions were interest in property under § 363(f) and could be sold free and clear by debtor to new purchaser; court further found that attorney general had waived its rights and was equitably estopped from pursuing this argument by filing response in which it stated that it had no objection to sale of property);

• *In re Pirogova*, 593 B.R. 402 (Bankr. S.D.N.Y. Dec. 12, 2018) (in rare decision involving chapter 15 of individual debtor, court determined that Russian insolvency proceeding was neither foreign main or foreign nonmain proceeding; with respect to former, Russia was not debtor's "habitual residence" because debtor did not intend to reside in Russia again, had a U.S. green card and permanent residence status, and lacked evidence of familial ties; with respect to foreign nonmain proceeding, court found that there were not sufficient facts to prove that debtor had an "establishment" in Russia, which

¹ *In re La Paloma Generating Co., et al.*, 2018 WL 6822271 (Bankr. D. Del. Dec. 27, 2018).

² *Id.* at *1.

³ *Id.* at *3.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at *3-7.

⁷ *Id.* at *7.

⁸ *Id.* at *9.

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requires engagement in economic activity as of petition date; utility bills for property in which debtor did not reside either primarily or secondarily were insufficient nor was membership in club, ownership of cars or shares of liquidating company) (for more details on this case, see the article on p. 28);

- *WLC Enterprises Inc. v. Rylant (In re Rylant)*, 594 B.R. 783 (Bankr. D.N.M. 2018) (nondischargeability finding under § 523(a)(6) is rare for intentional breach of contract; defendant's failure to repay plaintiff was orchestrated to obtain restaurant and its equipment from friend; one-sided purchase agreement and subsequent borrowing of funds from plaintiff were determined to have caused willful and malicious injury to plaintiff);

- *U.S. v. Parish Chemical*, 2019 WL 81978 (10th Cir. 2019) (Tenth Circuit affirmed district court's decision to sell property free and clear of encumbrances and authorize distribution of sale proceeds in accordance with lien priority; U.S.'s CERCLA lien was first in time to that of neighboring landowner; Tenth Circuit determined that challenging good-faith-purchaser status was constitutionally moot since no meaningful remedy could be fashioned to undo sale, but considered parties' equitable mootness arguments; circuit court then addressed whether proceeds could be disgorged by U.S. since they were sole recipient and were on notice of dispute, and therefore not an innocent recipient of proceeds, but then declined to determine this issue since lien priority could be adjudicated and court need not expand equitable mootness outside of bankruptcy context through this case; Tenth

Circuit finally determined that CERCLA lien was properly recorded first and any infirmity alleged by landowner for failure to include article number from certified mail receipt was directory, rather than mandatory, requirement for perfection);

- *Geltzer v. Oberlin College (In re Serman)*, 594 B.R. 229 (Bankr. S.D.N.Y. 2019) (court held that payments for education and other living expenses made by debtor/parents for their children over age of majority (as determined by applicable state law) were constructive fraudulent transfers because reasonably equivalent value was not received by parents in exchange for payments; conversely, payments made for minor children satisfy debtor/parents legal obligation to educate their children); and

- *In re Kiley*, Case No. 15-27838 (Bankr. D. Utah Dec. 4, 2018) (at intersection of bankruptcy and divorce law, this decision notes that when determining property of estate, timing is key; divorce was filed pre-petition, but decree was entered post-petition; pre-petition rulings by divorce court governed property rights and property of estate; court determined that debtors' interest in retirement plan as survivor beneficiary was excluded from property of estate because of transfer restrictions under ERISA; however, equitable interest in retirement plan for one-half of value of plan was considered property of estate subject to allocation by divorce court; court also confirmed that payments related to child support were exempt, and alimony payments were also exempt to extent reasonable and necessary to support debtor and her dependents). **abi**

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