Benchnotes

By Anupama Yerramalli, Patrick A. Clisham and Paul R. Hage

Coordinating Editor
Anupama Yerramalli
Kramer Levin Naftalis & Frankel LLP; New York

Coordinating Editor
Patrick A. Clisham
Engelman Berger, PC
Phoenix

Coordinating Editor
Paul R. Hage
Jaffe Raitt Heuer & Weiss; Southfield, Mich.

Anupama Yerramalli is special counsel at Kramer Levin Naftalis & Frankel LLP in New York. Patrick Clisham is managing shareholder of Engelman Berger, PC in Phoenix. Paul Hage is a partner with Jaffe Raitt Heuer & Weiss in Southfield, Mich. Mr. Hage and Ms. Yerramalli are 2017 ABI "40 Under 40" honorees.

E.D. Mich. Determines D&O Policy Is an Executory Contract

The U.S. District Court for the Eastern District of Michigan adopted the recommendation of the bankruptcy court that a directors' and officers' insurance policy (the "D&O policy") is an executory contract in *CMH Liquidating Trust v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. (In re Community Memorial Hospital)*.[1] The D&O policy of Community Memorial Hospital (CMH) expired 10 days after it filed its chapter 11 petition, and thereafter CMH renewed the policy for another 12-month period. As CMH conducted its wind-down, it requested an endorsement to provide for tail or run-off coverage. The carrier agreed to provide the endorsement.[2]

The endorsement provided that the insurer would not be liable for payment if a claim was caused by the bankruptcy or insolvency of the insured or any claims alleging a decrease in value of the company due to its bankruptcy or insolvency.[3] The insurance carrier and the debtor/insured disputed whether the endorsement's bankruptcy and insolvency clauses were valid and enforceable. The CMH liquidating trust asserted breach-of-fiduciary-duty and negligence claims, and therefore also filed the adversary proceeding for a determination as to the validity of the bankruptcy and insolvency clause, which is known as an *ipso facto* clause.

The bankruptcy court issued a report and recommendation finding that the endorsement was not a prohibited *ipso facto* clause because it did not invalidate the entire policy. On appeal, the district court found that an *ipso facto* clause might be triggered, even if only part of the contract was invalidated.[4] Because there were other issues to be decided by the bankruptcy court, the district court remanded for a determination of whether the policy was an executory contract and thereafter whether the bankruptcy and insolvency provision was an *ipso facto* clause.

The issue in this case was whether the tail endorsement was an executory contract — a question that turns on whether it is a pre- or post-petition contract. By its definition, an executory contract must be a pre-petition contract.[5] The insurance carrier argued that the tail coverage was purchased post-petition and therefore could not be a pre-petition executory contract. On the other hand, the CMH liquidating trust contended that the analysis should turn on whether the contractual relationship was continuous and unchanged and therefore should be treated as a pre-petition contract.

Agreeing with *In re Garnas*,[6] the court focused on the automatic renewal that occurs with policies of this nature. The *Garnas* court denied an injunction to prevent a nonrenewal because the policy would have automatically renewed if not for the bankruptcy filing.[7] The bankruptcy court determined that the relationship between the insured and the insurance carrier was continuous and unchanged from pre- to post-petition, and that the policies each contained the endorsement at issue.[8]

The court was clear that the tail coverage was not a separate policy, but rather an endorsement, which is an appendage to a pre-petition contract. For that reason, the language in the endorsement was an unenforceable *ipso facto* clause, and the carrier was not able to deny coverage.[9]

Miscellaneous

• *Jalbert v. Flanagan (In re F-Squared Invest. Mgt. LLC)*, 2019 WL 2051005 (Bankr. D. Del. May 7, 2019) (trustee of liquidating trust brought adversary proceeding to set aside discretionary bonus payments made by debtor as constructive fraudulent transfers; court rejected trustee's argument that, as matter of law, payment of discretionary bonus not tied to previously enunciated metric is *per se* fraudulent conveyance if made while debtor is insolvent; court reasoned that "the common meaning of 'bonus' is that it is 'not a gift or gratuity'; rather, it is in exchange for services 'or on other consideration in addition to or in excess of the compensation that would ordinarily be given'");

• *Reed v. PLT Construction Co. Inc. (In re BFN Operations LLC)*, 2019 WL 2387168 (Bankr. N.D. Tex. June 4, 2019) (construction contractor signed "final payment lien waiver" upon receipt of final payment from owner of project for work performed; three weeks later, owner filed chapter 11 petition and, post-petition, trustee sought to recover payment as preferential transfer; noting split in authority on issue, bankruptcy court held that contractor with right to file construction lien cannot receive preference when it waives such lien rights in exchange for alleged preferential payment; as a result of inchoate lien, court reasoned, contractor would have received payment in full in a hypothetical chapter 7 liquidation);

• *Wells Fargo Bank NA v. Weidenbenner (In re Weidenbenner)*, 2019 WL 1856276 (S.D.N.Y. April

1 *CMH Liquidating Trust v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. (In re Cmty. Mem. Hosp.)*, 2019 U.S. Dist. LEXIS 122278 (E.D. Mich. Southern Div. July 23, 2019).
2 *Id.* at *2-3.
3 *Id.* at *3-4.
4 *Id.* at *6.
5 *Id.* at *7-8.
6 *In re Garnas*, 38 B. R. 221 (Bankr. D.N.D. 1984).
7 *CMH*, 2019 Bankr. LEXIS at *8-9.
8 *Id.* at *10.
9 *Id.* at *12-13.

25, 2019) (reversing bankruptcy court, district court held that bank does not violate automatic stay by imposing temporary freeze on account of chapter 7 debtor pending instructions from trustee regarding where funds should be sent; court rejected debtor's argument that the Supreme Court's holding in *Citizens Bank of Maryland v. Strumpf* (*i.e.*, that administrative freeze on account does not violate § 362(a)(3) because freeze constitutes neither taking of property from debtor nor exercise over debtor's property) is limited to cases where bank had right of setoff);

• *Okla. State Treasurer v. Linn Operating Inc. (In re Linn Energy LLC)*, 2019 U.S. App. LEXIS 18411 (5th Cir. June 19, 2019) (in reversing district court and reinstating bankruptcy court's dismissal of adversary proceeding, Fifth Circuit Court of Appeals reaffirmed that once confirmation order becomes final, party who had opportunity to challenge bankruptcy court's jurisdiction or provision of plan during chapter 11 case cannot later challenge order through collateral attack; in this case, plaintiff filed adversary proceeding two months after confirmation order became final, asserting that debtor possessed — but did not own — almost $1 million in unclaimed property that debtor was required to turn over; court upheld finality of confirmation order, including injunction provision contained in plan, and reinstated dismissal of adversary proceeding, particularly where similarly situated party (Texas Comptroller) did object to plan's treatment of unclaimed property during course of chapter 11 cases and successfully excluded that property from plan);

• *In re Imerys Talc America Inc.*, 2019 U.S. Dist. LEXIS 120572 (Bankr. D. Del. July 19, 2019) (court declined to have "related-to" jurisdiction over state law claims because any relevant indemnification obligation would not result in immediate impact on debtors' estates, shared insurance did not impact estate, nor did identity of interest exist; court focused on fact that additional fact-finding would be needed to determine whether indemnification obligation would be triggered and therefore was not clear indemnity obligation; court thereafter determined that discretionary abstention was appropriate because claims were rooted in state law, removal would cause delay in adjudication and impact on bankruptcy case was not strong because there was not direct claim against debtors resulting from adjudication in bankruptcy court);

• *Swafford v. King, et al.*, Adv. Case No. 16-09012 (Bankr. N.D. Iowa July 10, 2019) (court discharged six of nine of debtors' student loans, determining under Eighth Circuit "totality of the circumstances test" that continuing to pay student loans would impose "undue hardship" on debtors, married couple with three dependent children; applying three-factor test, court concluded that (1) both debtors' limited past, present and future income outweighs their current/future expenses; (2) minimal level of disposable income that could be generated from spending reductions was not enough to cover all outstanding loans; and (3) other relevant facts and circumstances, including fact that debtors could qualify for income-based repayment plans but their current payment would be $0 and their overall student loan debts would continue to grow, coupled with debtors' limited earning capacity, supported court's decision to discharge all but three of debtors' student loans);

• *Pryor v. Town of Smithtown (In re Jadeco Constr. Corp.)*, 2019 Bankr. LEXIS 2076 (Bankr. E.D.N.Y. July 10, 2019) (holding that chapter 7 trustee was entitled to bring fraudulent-conveyance action against town of Smithtown where debtor, a construction company, had performed work after expired contract with town, and trustee sought to recover amounts relating to labor performed and materials provided after such expiration; town argued that due to state court decision determining that contract expired prior to debtor's completion of work, trustee was barred from bringing recovery action under *Rooker-Feldman* doctrine, and principles of *res judicata* and collateral estoppel; bankruptcy court disagreed, stating that those doctrines did not apply to facts at hand, and that Supremacy Clause mandated that right to recover under fraudulent-conveyance theory is unfettered by any state or local laws that potentially conflict with such action);

• *In re Family Pharmacy Inc.*, 2019 WL 2895005 (Bankr. W.D. Mo. July 3, 2019) (court concluded that oversecured creditor was entitled to post-petition interest at nondefault contract rate; although oversecured creditor became entitled to default interest when debtors failed to make its post-petition loan payment, court determined that (1) 18 percent default rate constituted unenforceable penalty under Missouri law and (2) allowing default rate would be inequitable because it would grant oversecured creditor windfall at expense of junior lender, and oversecured creditor did not make claim for default interest until it became apparent that § 363 sale would be more successful than expected);

• *In re Ditech Holding Corp.*, 2019 Bankr. LEXIS 1892 (Bankr. S.D.N.Y. June 24, 2019) (court ruled that compliance with § 345's requirements to collateralize bank accounts, which are meant to ensure that funds are protected for benefit of creditors, must be balanced with potential harm to debtors; court found that small amount that debtors would pay monthly to collateralize accounts was appropriately tailored to protect funds, while complexity and timeline of chapter 11 cases was insufficient to demonstrate cause to waive requirements of § 345); and

• *In re Old BPSUSH Inc.*, 2019 Bankr. LEXIS 1867 (Bankr. D. Del. June 20, 2019) (court ruled that counsel to debtors' former audit committee was required to turn over its entire internal investigation record, including documents that fell under work-product privilege, to liquidating trustee appointed under debtors' chapter 11 plan; in so holding, court first determined that liquidating trustee, as successor to debtors, controlled privileges belonging to independent committee established by corporate debtors and could therefore receive documents previously marked as privileged by committee's separately retained counsel; court then examined whether law firm had to turn over all documents for which it asserted work-product doctrine; noting a split in authority under Delaware law, bankruptcy court adopted "entire file" approach and held that counsel had to turn over all work-product documents, other than those that were firm documents intended for internal law office review and use, and could be characterized as documents containing counsel's mental impressions). abi