Benchnotes

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"Free and Clear" Just Might Mean Something After All

Two recent appellate decisions, one by the U.S. District Court for the Southern District of New York and the other by the Eighth Circuit U.S. Court of Appeals, suggest that free-and-clear sale orders entered pursuant to 11 U.S.C. § 363 still just might mean *free and clear*.[1] In the *Chrysler* case, the district court affirmed a decision by the bankruptcy court to reopen the bankruptcy case to enforce the sale order pursuant to which substantially all of Chrysler's assets were sold during the early stages of its 2009 bankruptcy.

Asset-purchaser FCA US LLC, f/k/a Chrysler Group LLC ("New Chrysler"), requested that the case be reopened to enforce the free-and-clear provisions of the order against a personal-injury claim, brought long after New Chrysler purchased its assets, by plaintiffs injured when a car manufactured by Chrysler was involved in a serious accident.[2] The § 363 sale order and underlying purchase agreement provided, among other things, that the assets were to be sold free and clear of liabilities for punitive damages in connection with pre-sale Chrysler products.[3]

After affirming the bankruptcy court's decision to reopen the case and the bankruptcy court's determination that the plaintiff's claims are limited by state law to punitive damages, the district court affirmed the decision that the plaintiff's claims were barred by the express terms of the controlling sale order and purchase agreement. The district court found that a transfer of Chrysler's assets "free and clear of existing tort liability was a critical inducement to the Sale." Allowing the plaintiff's claims to proceed "would upend those negotiations and the finality of the Sale Order."[4]

In *In re Veg Liquidation Inc.*,[5] the Eighth Circuit also had occasion to revisit a challenged § 363 sale order. In *Veg Liquidation*, the trustee appointed after a chapter 11 sale and conversion to chapter 7 sought to prosecute claims against members of the unsecured creditors' committee, the debtor's advisors and certain junior lienholders in connection with alleged collusion and wrongdoing by such parties during the auction and bid-selection phases of the sale process.

The court of appeals found that the trustee's allegations contradicted specific findings in the sale order, including that the buyer had "submitted the highest or otherwise best bid for the Acquired Assets at the Auction" and that the consideration offered constituted "the highest and otherwise best offer for the Acquired Assets."[6] An order authorizing a sale free and clear of liens under § 363 "is shielded from collateral attack."[7] In order to sustain the plaintiff's claims, "a court would have to contradict those determinations," which would constitute an impermissible collateral attack on a free-and-clear sale order. Like in the *Chrysler* case, the court of appeals found that the finality accorded to asset sales under § 363 bars such an attack.[8]

Miscellaneous

• *Martineu v. Wier*, --- F.3d ----, 2019 WL 3772151 (4th Cir. 2019) (Fourth Circuit reversed district court holding that former chapter 7 debtor lacked standing to pursue claim to rescind settlement agreement on theory of fraudulent inducement; court of appeals found that district court conflated Article III standing with distinct issue of whether plaintiff/debtor or trustee was "real party in interest"; while debtor may not have been "real party in interest" at time she filed suit, trustee later abandoned claim to debtor, thus restoring her as real party-in-interest as if she had always owned claim; court of appeals also reversed district court's alternative ruling that debtor should be judicially estopped from pursuing claim because her failure to initially disclose claim on her bankruptcy schedules was in bad faith; court of appeals found that district court erred in presuming bad faith merely because debtor was aware of facts that someday might underlie future claim; doctrine of judicial estoppel "does not lend itself to this kind of blanket presumption;" instead, court must consider all facts and circumstances of case);

• *In re Sherwin Allumina Co. LLC*, --- F.3d ----, 2019 WL 3369099 (5th Cir. 2019) (Fifth Circuit held that free-and-clear bankruptcy sale that extinguished easement of Port of Corpus Christi Authority, arm of State of Texas, did not violate Eleventh Amendment; relying on U.S. Supreme Court's decision in *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004), court of appeals held that "the federal court's disposition of a bankruptcy estate, within which a state has interests, where the proceeding is principally *in rem* and avoids coercive judicial process against the state, does not implicate, let alone violate, the Eleventh Amendment");

1 *In re Old Carco LLC*, 2019 WL 2336849 (S.D.N.Y. 2019).
2 *Id.* at *1.
3 *Id.*
4 *Id.* at *7.
5 931 F.3d 730 (8th Cir. 2019).
6 *Id.* at 737.
7 *Id.* (citing *Regions Bank v. J.R. Oil Co.*, 387 F.3d 721 (8th Cir. 2004); *In re Met-L-Wood Corp.*, 861 F.2d 1012 (7th Cir. 1988)).
8 *Id.*

• *In re Whistler Energy II LLC*, --- F.3d ----, 2019 WL 3369099 (5th Cir. 2019) (Fifth Circuit upheld administrative-priority claim awarded to oil-drilling contractor for services rendered post-petition, despite debtor having subsequently rejected its contract; Fifth Circuit found that administrative request can arise where post-petition services are provided either at direct request of debtor or knowing and voluntary acceptance of such services post-petition; services can also be compensable as administrative claim if its availability is necessary for debtor to conduct business, even if debtor does not ultimately make use of available services);

• *In re Thomas*, --- F.3d ----, 2019 WL 3419379 (5th Cir. 2019) (Fifth Circuit affirmed bankruptcy court determination that 60-year-old debtor suffering from degenerative diabetic condition, who is also unemployed and subsists on public assistance and private charity, did not meet Fifth Circuit's criteria necessary for discharging her student loan debt);

• *In re Cranberry Growers Cooperative*, 930 F.3d 844 (7th Cir. 2019) (Seventh Circuit reversed bankruptcy court decision that payments made by chapter 11 debtor's customers directly to lender constituted "disbursements" of debtor for purposes of calculating U.S. Trustee fees under 28 U.S.C. § 1930(a)(6); court of appeals declined to address debtor's argument that 2018 amendments to quarterly fee schedule under 28 U.S.C. § 1930(a)(6)(B) are unconstitutional because issue was raised by debtor for first time on appeal);

• *In re Sterling*, --- F.3d ----, 2019 WL 3788242 (7th Cir. 2019) (Seventh Circuit affirmed bankruptcy court's decision to hold creditor in contempt for willfully violating discharge injunction in connection with prosecution of debt discharged in chapter 7; creditor had initiated prosecution of debt collection prior to bankruptcy case but failed to inform its own counsel of bankruptcy and discharge after it received notice of same; court of appeals rejected creditor's argument that it should not be held liable for willful violation based on conduct of its counsel taken without creditor's knowledge and where counsel himself lacked knowledge of bankruptcy proceeding; court of appeals held that creditor is responsible for its counsel's actions, particularly where, as here, counsel is acting within scope of its authority; court of appeals further affirmed bankruptcy court determination that counsel for creditor lacked requisite knowledge of discharge and therefore could not have willfully violated discharge order);

• *Borchardt v. State Farm*, --- F.3d ----, 2019 WL 3404202 (8th Cir. 2019) (Eighth Circuit upheld jury verdict denying insureds recovery for personal property claimed as lost in house fire; evidence at trial included debtors' schedules from their prior chapter 13 case, in which debtors valued jewelry lost in fire at small fraction of value later claimed from insurance);

• *In re Washington*, 602 B.R. 710 (B.A.P. 9th Cir. 2019) (BAP reversed bankruptcy court's ruling that creditor holding junior lien on debtor's home but whose claim was discharged as to debtor in prior chapter 7 proceeding, and whose lien was later valued at zero in debtor's subsequent chapter 13 proceeding, could nonetheless assert unsecured claim in chapter 13 case; BAP held that such creditor is precluded from asserting such claim in so-called "chapter 20" case);

• *In re Tronox, et al.*, --- B.R. ----, 2019 WL 33288399 (Bankr. S.D.N.Y. 2019) (bankruptcy court denied motion for remand and abstention in legal malpractice case against counsel that served interests of personal-injury plaintiffs in corporate chapter 11 case; malpractice allegations included claims that counsel failed to object to settlement of certain fraudulent-transfer claims approved by bankruptcy court, proceeds of which were used to pay tort victims; bankruptcy court determined that it had jurisdiction to hear malpractice claims because (1) alleged acts of malpractice occurred during bankruptcy case, (2) alleged misdeeds relate to rights that could only have arisen in bankruptcy case (*i.e.*, avoidance and recovery actions), (3) allegations indicate that at least some of acts occurred in "official" court-approved capacities, (4) claims required interpretations of bankruptcy court rulings, and (5) claims directly implicated integrity of bankruptcy process); and

• *In re Brayan*, 602 B.R. 350 (Bankr. E.D. Mich. 2019) (bankruptcy court denied entry of stipulated order between chapter 7 debtor and trustee converting debtor's case to chapter 13 because stipulated order provided for compensation to chapter 7 trustee, despite chapter 7 trustee having failed to collect or disburse any monies during pendency of chapter 7 case; court ruled that plain language of § 326(a) precludes any such compensation). abi