Benchnotes

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Second Circuit Gives a Little and Takes a Little from Lenders

The Second Circuit recently handed down a decision that stands to change the landscape of chapter 11 reorganizations in the Second Circuit. The Second Circuit's decision in *Momentive Performance Materials, Inc. v. BOKF, NA (In re MPM Silicones LLC)*[1] addresses several key reorganization issues:

Till Not Applicable if Market Rate Can Be Found

In *Till v. SCS Credit Corp.*,[2] which was decided in the context of determining an appropriate cramdown rate for an auto loan under a chapter 13 reorganization plan, the U.S. Supreme Court adopted an approach that starts with a no-risk prime rate and adjusts it upward based on applicable risk factors. Although decided in the context of a chapter 13 case, bankruptcy courts across the nation have since adopted the formula approach in *Till* in the context of chapter 11 reorganization cases and have routinely rejected alternative approaches posed by lenders, arguing that a higher market-determined rate of interest should guide the appropriate cramdown rate.

In *MPM Silicones*, the Second Circuit rejected the lower court's wholesale adoption of *Till* in a chapter 11 proceeding and instead adopted the two-part approach to cramdown interest rates previously adopted by the Sixth Circuit in *In re American HomePatient Inc.*,[3] which requires that the bankruptcy court first determine whether a market rate can be determined, and only if none can be found should the court then adopt the formula approach in *Till*.[4]

Make-Whole Premium Is Not Enforceable

The Second Circuit further held that the "make-whole" premium due upon bond redemption was not enforceable for the same reason that the Second Circuit had rejected similar premiums for prepayment as espoused in *In re AMR Corp*.[5] The Circuit's view in *AMR Corp.* was that acceleration brought on by a bankruptcy filing merely changed the maturity date to the date of the bankruptcy petition. Payment pursuant to a plan confirmed post-petition cannot by definition be a prepayment (defined as being made prior to maturity).

In *MPM Silicones*, the Second Circuit extended its reasoning in *AMR* to redemption of bonds prior to maturity. Since the debt was accelerated as a result of the chapter 11 filing, the later "redemption" under the plan could not trigger the make-whole premium because the redemption was not at or before maturity.[6]

Equitable Mootness Takes Another Hit

The Second Circuit rejected the debtor's request to dismiss the appeal on grounds of equitable mootness. According to the Second Circuit, the test for whether an appeal should be dismissed for equitable mootness comes down to the four factors previously recognized in *In re Chateaugay Corp.*,[7] including whether (1) effective relief can be granted, (2) relief will not affect the debtor's re-emergence, (3) relief will not unravel intricate transactions and (4) the appellant diligently sought a stay of the plan.[8]

In rejecting the debtor's request for dismissal on grounds of equitable mootness in *MPM Silicones*, the Second Circuit indicated that a special emphasis should be given to the fourth factor and dismissal should not be granted if relief "is at all feasible." Given the scale of the debtor's reorganization and the limited scope of relief on remand, the Second Circuit concluded that relief could be granted without significantly implicating the other three *Chateaugay* factors.[9]

Chapter 13 Trustee Must Refund Statutory Fees After Case Was Dismissed Before Plan Confirmation

In a case of first impression in the Sixth Circuit, Bankruptcy Judge **Mary Ann Whipple** ordered the refund of the statutory fees collected by a chapter 13 trustee before the case was dismissed without confirmation of a chapter 13 plan. In *In re Lundy*,[10] a chapter 13 debtor objected to the trustee's final report and sought reconsideration of an order dismissing the chapter 13 case that provided the trustee was to "refund to the Debtor(s) any funds on hand less statutory fees."[11]

The debtor argued that the trustee should not be entitled to retain its statutory fees because the plain language of 11 U.S.C. § 1326(a)(2) requires the trustee to refund all payments received in the event that a plan is not confirmed.[12] The trustee countered that a chapter 13 trustee is entitled to payment under the statutory mandate of 28 U.S.C. § 586(e).

1 --- F.3d ---, 2017 WL 4772248 (2d Cir. 2017).
2 541 U.S. 465 (2004).
3 420 F.3d 559 (6th Cir. 2005).
4 *MPM Silicones* at *9.
5 750 F.3d 88 (2d Cir. 2013).
6 *Id.* at *11.
7 988 F.2d 322 (2d Cir. 1993).
8 750 F.3d at 13.
9 *Id.* at 14.
10 --- B.R. ---, 2017 WL 4404271 (Bankr. N.D. Ohio 2017).
11 *Lundy* at *2.
12 *Id.* at *5.

In support of her positon, the debtor relied on *Acevedo v. Harrell (In re Acevedo)*[13] and *In re Dickens*,[14] in which the bankruptcy courts found that § 1326 requires that all payments held by a chapter 13 trustee be refunded upon dismissal if a plan has not been confirmed, including statutory trustee fees. The trustee relied on the holding in *Nardello v. Balboa (In re Nardello)*,[15] in which it was held that 28 U.S.C. § 586(e) makes payment of statutory fees mandatory, regardless of whether a plan was confirmed prior to dismissal.

Ultimately, Judge Whipple found that the *Acevedo* and *Dickens* courts got it right and that 11 U.S.C. § 1326(a)(2) and 28 U.S.C. § 586(e) could be harmonized. According to Judge Whipple, § 1326 provides for payment of three types of claims or expenses: (1) administrative claims; (2) chapter 13 trustee statutory fees; and (3) unpaid chapter 7 trustee fees from a previously converted case.[16] Under § 1326, these payments are to be made "[b]efore or at the time of each payment to creditors under the plan."[17] Although the *Nardello* court found that the use of the term "before" in the statute indicated that the plan confirmation was not required to pay statutory fees to a chapter 13 trustee, Judge Whipple rejected this interpretation because the plain language of 11 U.S.C. § 1326(a) requires a trustee to retain all payments made by debtors pursuant to a proposed plan pending plan confirmation. Although 28 U.S.C. § 586 is not so easily construed because it lacks the plain language of § 1326, Judge Whipple reasoned that her interpretation of § 586 came down to the meaning of "collect" where the statute mandates that a trustee "collect such percentage fee from all payments received under plans in the cases under chapter 12 or 1...."[18] Adopting the bankruptcy court's approach in *Acevedo*, Judge Whipple agreed that "collect" is properly interpreted as "collect and hold" and not "collect and apply."[19]

Judge Whipple ultimately concluded that harmonizing the statute required 28 U.S.C. § 586(e)(2) to require that a chapter 13 trustee collect its statutory fees under both confirmed and unconfirmed plans, but to hold such fees pending plan confirmation. If the plan is not confirmed, then 11 U.S.C. § 1326(a)(2) requires all plan payments to be refunded, including the statutory fees held by the trustee after deduction of allowed administrative expenses.[20]

Miscellaneous

• *Phoenician Mediterranean Villa LLC v. Swope (In re J&S Properties LLC)*, 874 F.3d 124 (3d Cir. 2017) (Third Circuit held that trustees are entitled to qualified immunity as government officials and are immune from 42 U.S.C. § 1983 claims when acting to preserve property of bankruptcy estate);

• *Henry v. Official Committee of Unsecured Creditors of Walldesign Inc. (In re Walldesign Inc.)*, 873 F.3d 1060 (9th Cir. 2017) (Ninth Circuit affirmed district court judgment reversing bankruptcy court's dismissal of fraudulent-transfer claims against certain defendants claiming to be subsequent transferees entitled to safe-harbor provisions of 11 U.S.C. § 550(b)(1); defendants each accepted payment directly from debtor company's accounts in satisfaction of personal expenses incurred by debtor's principal; payments, however, were made from secret account opened by principal in debtor's name; issue came down to whether it was principal or defendants that qualified as initial transferees for purposes of § 550; to determine initial transferee, circuit court relied on dominion test as previously adopted by Ninth Circuit in *Universal Service Administrative Co. v. Post-Confirmation Committee of Unsecured Creditors (In re Incomnet)*, 463 F.3d 1064 (9th Cir. 2006); under dominion test as adopted by Ninth Circuit, initial transferee is party that has legal control or title to the funds; because funds paid to defendants flowed directly from debtor, who still held legal title despite secretive nature of the accounts, defendants were initial transferees and not subsequent transferees and could not avail themselves of the safe-harbor provisions of 11 U.S.C. § 550(b)(1));

• *In re Cherrett*, 873 F.3d 1060 (9th Cir. 2017) (Ninth Circuit affirmed BAP's findings that loan incurred by debtor from his employer to purchase home that was negotiated as part of debtor's compensation package constituted non-consumer debt; in reviewing BAP decision under clear error standard, Ninth Circuit found that lower courts did not err in concluding that loan obtained as part of compensation package was for business purposes with respect to his position with new employer and therefore qualified as non-consumer debt obligation under 11 U.S.C. § 707(b); in a dissent by Circuit Judge Jacqueline Nguyen, Judge Nguyen argued that Ninth Circuit panel applied wrong standard and should have reviewed BAP decision under *de novo* review standard and suggested that purchase of home as residence is for consumer purpose *per se*);

• *In re Hamilton-Conversan*, --- B.R. ---, 2017 WL 4417566 (Bankr. E.D.N.C. 2017) (bankruptcy court held that chapter 7 case must be dismissed under application of 11 U.S.C. § 707(b)(1) for presumption of abuse and 11 U.S.C. § 707(b)(3) under totality-of-circumstances test; court found that chapter 7 case failed means test after debtor failed to present evidence supporting limited portion of nonfiling spouse's income that debtor claimed should be included in means testing under 11 U.S.C. § 707(b)(1); moreover, court found that filing was abusive under totality-of-circumstances test because nonfiling spouse had substantial income and would otherwise avoid all liability for shared household expenses incurred); and

• *In re Gleason*, --- B.R. ---, 2017 WL 4508844 (Bankr. N.D.N.Y. 2017) (bankruptcy court found that debtor did not carry his burden to discharge student loans under "undue hardship test" as enunciated in *Brunner v. New York State Higher Educ. Serv. Corp.*, 831 F.2d (2d Cir. 1987); specifically, debtor failed to carry his burden in establishing third prong of the *Brunner* test (*i.e.*, that he has made good-faith effort to repay his student loans when 90 percent of debtor's obligations comprised of student loans) and primary purpose of bankruptcy was to discharge student loans, and debtor had access to IRA and 401k assets; while it is true that such assets might be exempt, these assets might still be considered in determining whether debtor has ability to pay something). abi

13 497 B.R. 112 (Bankr. D.N.M. 2013).
14 513 B.R. 906 (Bankr. E.D. Ark. 2014).
15 514 B.R. 105 (D.N.J. 2017).
16 *Lundy* at 6.
17 11 U.S.C. § 1326(b).
18 11 U.S.C. § 586(e)(2).
19 *Lundy* at *7.
20 *Id.* at 9.