***In re Taggart*, 888 F.3d 438 (9th Cir. 2018).**

The Ninth Circuit recently clarified the mental state necessary to trigger the courts' contempt powers in the context of a discharge injunction violation.

The debtor, Bradley Taggart, was a real estate developer. In 2007, Taggart transferred his 25% interest in Sherwood Park Business Center, LLC to his attorney, John Berman, without affording his co-owners an opportunity to exercise their right of first refusal under the operating agreement. The co-owners sued Taggart and Berman in Oregon state court to enforce their right of first refusal. On the eve of trial, Taggart filed a voluntary chapter 7 petition, which stayed the state court proceedings by operation of section 362(a) of the Bankruptcy Code. Taggart ultimately received a discharge in the bankruptcy case.

After the discharge was issued, the co-owners' attorney continued the state court action by serving Taggart with a deposition subpoena. Taggart appeared at the deposition. The state court denied a motion to dismiss Taggart in light of his discharge, but the court declined to do so one the grounds that Taggart remained a necessary party. Instead, the parties agreed that no monetary judgment would be awarded against Taggart.

After trial, the state court unwound the transfer of Taggart's interest in SBPC to Berman and expelled Taggard from SPBC. The state court then invited the parties to petition for attorneys fees. The co-owners sought to recover from Taggart attorneys fees incurred after Taggart's discharge. While that request was pending, Taggart moved to reopen the bankruptcy case and to hold the co-owners in contempt for violating the discharge injunction by seeking an award of attorneys fees against him. In the meantime, the state court awarded post-discharge attorneys fees against Taggart on the grounds that he had "returned to the fray" by continuing to litigate the case after obtaining his discharge.

The bankruptcy court denied Taggart's contempt motion after agreeing with the state court that Taggart had "returned to the fray." On appeal, the district court reversed, finding that Taggart's post-discharge actions did not constitute "returning to the fray." The district court therefore barred the award of attorneys fees. However, on the issue of sanctions for violating the discharge injunction, the district court remanded to the bankruptcy court to determine whether the co-owners' <u>knowingly</u> violated the stay by seeking attorneys fees. On remand, the bankruptcy court found that they had. The co-owners then appealed to the Bankruptcy Appellate Panel, which reversed on the grounds that the co-owners had a good faith basis for believing that the discharge injunction did not apply. Taggart then appealed that decision.

The Ninth Circuit affirmed the BAP. It held that the bankruptcy court erred by applying the wrong legal standard in determining whether the co-owners knowingly violated the discharge injunction. It held that the co-owners' subjective good faith belief that Taggart had exposed himself to post-discharge attorneys fees by "returning to the fray" precluded them from possessing the requisite mental state to be held in contempt. Having found that the co-owners could not be held in contempt, the Ninth Circuit did not address whether the co-owners' request for attorneys fees constituted a violation of the discharge injunction in the first place.

The Supreme Court has granted *certiorari* to hear this case.

***Hill v. Snyder*, -- F.3d --, 2019 WL 1411857 (8th Cir. March 29, 2019).**

The Eighth Circuit recently affirmed the denial of a chapter 7 debtor's discharge where the chapter 7 trustee waited until after the applicable objection deadline to bring his objection on the grounds that the trustee lacked knowledge of the underlying facts at that time, even though the allegations were raised in a Rule 2004 motion filed by a creditor prior to the expiration of the original discharge objection deadline.

The debtor, Chad Hill, had ties to various Florida business entities that were placed into receivership following allegations of fraudulent activity. The receiver believed that Hill may have received proceeds from the fraud or may have otherwise been involved. In December 2014, Hill filed a chapter 7 bankruptcy case in Minnesota. The deadline to object to his discharge was set for March 16, 2015. On March 10, 2015, the receiver requested authority to examine the debtor under Rule 2004 so that he could ascertain the extent of the debtor's involvement in the scheme and moved for an extension of time to object to discharge. The bankruptcy court granted both motions and extended the receiver's discharge objection deadline.

On June 8, 2015, following the receiver's Rule 2004 examination of the debtor on June 5, 2015, the receiver again moved for an extension of time to object to discharge on the basis the he needed additional time to review the documents produced by the debtor. This time, the chapter 7 trustee also moved for an extension of the discharge objection deadline. Although the chapter 7 trustee did not request an extension prior to the expiration of the original deadline, he argued that he did not have knowledge of the facts relating to the debtor's involvement in the fraud scheme when the original deadline expired. The debtor argued that, based on the receiver's original Rule 2004 motion and extension motion, the chapter 7 trustee had constructive notice of the issue such that his failure to meet the original deadline barred him from bringing an objection. The bankruptcy court disagreed and ultimately denied his discharge.

The debtor then appealed, arguing that the bankruptcy court erred in permitting the chapter 7 trustee's late objection. The district court affirmed on the grounds that the bankruptcy court properly based its ruling on its factual determination that the trustee had neither actual knowledge nor constructive knowledge of sufficient facts to bring an objection to discharge prior to the original deadline.

The Eighth Circuit affirmed the lower courts. While it declined to rule on whether Rule 4004(b)(2)'s reference to "knowledge" included mere constructive knowledge, the Eighth Circuit found that—even if constructive knowledge were sufficient—the receiver's Rule 2004 motion was filed only 6 days prior to the original deadline, which was not enough time for the trustee to properly investigate the issue and file a complaint that could survive Rule 8's heightened pleading standard.

***In re Blasingame*, -- F.3d --, 2019 WL 1466949 (6th Cir. April 3, 2019).**

A recent Sixth Circuit opinion serves as a cautionary tale for creditors seeking to bolster their recovery by pursuing estate causes of action ceded by the trustee: pay attention to the mechanics of obtaining standing or risk destroying the bankruptcy court's jurisdiction over the dispute.

Earl and Margaret Blasingame filed voluntary petitions under chapter 7 in which they claimed de minimis assets and sought to discharge $7.7 million in debt. One of their creditors, Church Joint Venture ("Church") did not believe them and alleged that they were fraudulently hiding assets through various trusts and corporations under the debtors' control. The chapter 7 trustee originally granted Church derivative standing to pursue the assets on behalf of the estate. A few years into that case, the trustee decided to just sell the cause of action to Church outright in exchange for a lump sum payment and a reduction in Church's claim against the estate.

The bankruptcy court then dismissed the case for lack of jurisdiction because the outcome would no longer affect the bankruptcy estate. Church then refiled the case in district court, alleging that the trusts were alter egos of the debtors. The district court dismissed the case on the grounds that, under Tennessee law, the alter ego doctrine did not apply outside the corporate context. Church then filed another complaint in the bankruptcy court, reframing the same underlying facts under a self-settlement theory.

Church purported to be bringing the lawsuit on the trustee's behalf. However, the bankruptcy court again dismissed upon determining that the self-settlement theory constituted a "cause of action" within the meaning of the sale agreement between the trustee and Church, whereby the trustee sold all "claims and causes of action which have been asserted in [the first case]." Since the self-settlement theory had been sold to Church, the court lacked jurisdiction.

On appeal, the Sixth Circuit affirmed. It explained that a "cause of action" consists of "a set of facts giving rise to one or more grounds for legal relief." Since the self-settlement lawsuit was based on the same operative facts as the alter ego lawsuit, the Sixth Circuit agreed that it constituted a cause of action sold under the sale agreement and that the bankruptcy court therefore lacked jurisdiction over the case.

***In re Pettit Oil Company*, 917 F.3d 1130 (9th Cir. March 11, 2019).**

The Ninth Circuit recently weighed in on the extent of a bankruptcy trustee's strong arm powers in the consignment context.

The debtor, Pettit Oil Company, distributed bulk petroleum products. In 2013, Pettit and IPC (USA) Inc. ("IPC") entered into a consignment agreement pursuant to which IPC would deliver consigned fuel to Pettit for eventual sale to Pettit's customers. IPC would then pay Pettit a monthly commission. When Pettit filed for bankruptcy, it had in its possession both fuel consigned from IPC, proceeds from sales of IPC fuel that had not yet been paid to IPC, and accounts receivable relating to sales of IPC fuel. Since IPC never perfected its consignment interest by filing a UCC financing statement, Pettit's bankruptcy trustee brought an adversary complaint to avoid IPC's interest under his section 544(a) strong-arm powers.

The bankruptcy court granted summary judgment in the trustee's favor and the bankruptcy appellate panel affirmed.

On appeal, the Ninth Circuit considered whether section 9-319(a) of the Uniform Commercial Code, which grants consignees "rights and title to the goods" also grants the consignee an interest in the proceeds of consigned goods. IPC argued that it section 9-319(a) did not extend to proceeds. It then argued that, because Pettit lacked an interest in the proceeds, the proceeds were not property of its bankruptcy estate, and therefore not subject to the trustee's strong-arm powers.

The Ninth Circuit rejected this reading of section 9-319(a), citing numerous instances of other UCC provisions that clearly were intended to apply to both property and the proceeds of such property even though the word "proceeds" was not used. The court also rejected IPC's argument that its retention of title was dispositive on the grounds that, to avoid the operation of section 544(a), IPC was still required to perfect its interest even though it never transferred title.

Finally, the court rejected IPC's argument that, even if section 9-319(a) did extend to proceeds, the trustee could not retroactively obtain an interest in pre-petition proceeds because section 544 does not contain any "reachback" provision. The court held that, because under section 9-319(a) Pettit's interest in the proceeds was identical to IPC's as of the commencement of the case, the proceeds were therefore property of Pettit's bankruptcy estate and subject to section 544(a) even if they arose from pre-petition sales.

***In re Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018).**

The First Circuit recently weighed in on whether debtors can be required to continue licensing their trademarks after they reject the underlying licensing agreement.

In *Tempnology*, the debtor manufactured athletic apparel designed to remain at low temperatures during exercise and marketed under the "Coolcore" and "Dr. Cool" brands. The debtor's intellectual property portfolio consisted of two issued patents, four pending patents, research studies, and numerous registered and pending trademarks. Prior to filing for bankruptcy, the debtor entered into a co-marketing and distribution agreement with Mission Product Holdings, Inc. The agreement granted Mission distribution rights to certain of the Debtor's products, as well as a nonexclusive license to the Debtor's intellectual property, except for the trademarks. With respect to the trademarks, the agreement gave Mission a "nonexclusive, non-transferable, limited license" for the term of the Agreement to use the Debtor's trademarks for the limited purpose of performing its obligations under the agreement.

After filing for bankruptcy, the Debtor moved to reject its agreement with Mission, arguing that it "suffocated the Debtor's ability to market and distribute its products." Mission objected, arguing that section 365(n) of the Bankruptcy Code enabled Mission to keep both the IP license and the exclusive distribution rights. The bankruptcy court granted the rejection motion subject to a further determination of Mission's rights under section 365(n). Ultimately, the bankruptcy court ruled in favor of the debtor, rejecting the applicability of section 365(n) due to the omission of trademarks from section 101(35A)'s definition of intellectual property. On appeal, the bankruptcy appellate panel agreed that section 365(n) failed to protect Mission's rights to the trademarks. However, applying the Seventh Circuit's lead in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, the BAP held that, under section 365(g), the rejection merely constituted a breach of the agreement, not a termination, because a licensor's breach of a trademark agreement does not cut off a licensee's rights to the trademarks in the nonbankruptcy context.

The First Circuit reversed the BAP and agreed with the bankruptcy court. In doing so, the court sided with the Fourth Circuit's opinion in *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, rather than the Seventh Circuit's opinion in Sunbeam. The court's main reason for following *Lubrizol* was that it was concerned by the additional burden that would be imposed on debtors if they were required to continue to monitor and control the quality of the trademarked goods after rejecting the trademark license agreement. Additionally, the First Circuit agreed with the bankruptcy court that section 101(35A)'s failure to mention trademarks precluded the applicability of section 365(n) to trademarks.

The Supreme Court has granted *certiorari* to hear this case.

***In re Point Center Financial, Inc.*, 890 F.3d 1188 (9th Cir. 2018).**

In *Point Center Financial*, the Ninth Circuit recently ruled that an appellant's failure to attend and object at a bankruptcy court hearing does not affect whether the appellant has standing to appeal a bankruptcy court order.

The debtor, Point Center Financial, was an originator and servicer of residential and commercial loans. Private investors funded the loans offered by PCF to its customers. In return, the investors would typically receive a fractionalized interest in the loan and in the deed of trust securing the loans. When defaults occurred, PCF would foreclose on the loans and place the property into a new single-purpose limited liability company. The investors would then be given membership interests in the LLC.

In once such instance, PCF formed Dillon Avenue 44, LLC to hold title to property obtained after a foreclosure and gave the membership interests to the applicable investors. After PCF filed for bankruptcy, the court set a deadline for the chapter 7 trustee to assume or reject PCF's executory contracts, including Dillon Avenue 44, LLC's operating agreement. The trustee did not do so. Instead, three months after the deadline, the trustee filed a motion asking for permission to assume the operating agreement retroactively. Since no parties filed objections or appeared at the hearing to oppose the assumption motion, the court granted it. When the investors learned that the operating agreement had been assumed, they filed an emergency reconsideration motion, which the bankruptcy court denied. The investors then appealed the bankruptcy court's written opinion on the assumption motion. At the district court, the trustee moved to dismiss the appeal on the grounds that the investors had not object to or attend the hearing on the assumption motion. The district court agreed and dismissed the appeal for lack of standing.

The Ninth Circuit reversed, noting that, although there was a circuit split on the issue, there were no controlling opinions in the Ninth Circuit addressing whether a person who has a pecuniary interest affected by a bankruptcy proceeding and received adequate notice of a bankruptcy court hearing, but failed to appear and object, may be found to satisfy the "person aggrieved" requirement for appellate standing. The court held that requiring participation in the lower court proceedings as a prerequisite to having appellate standing conflates the basic notion of standing with notions of waiver and forfeiture. Rather, since there was "no question that [the investors] pecuniary interests [were] directly and adversely affected by the bankruptcy court order in question," the court found that the investors qualified as "aggrieved persons" for the purposes of appellate standing.

***In re Picard, Trustee for the Liquidation of Bernard L. Madoff Investment Securities LLC*, 917 F.3d 85 (2d Cir. Feb. 25, 2019).**

The Second Circuit recently held that a trustee for a domestic debtor may recover property initially and subsequently transferred to foreign transferees, so long as the initial transfer originated domestically from a U.S. entity.

The facts arise from the Madoff Ponzi scheme. Many of Madoff's direct investors were feeder funds, which pool money from numerous investors and place it into a master fund (here, Madoff's fund) to invest on their behalf. When an investor wishes to withdraw its money, the master fund transfers money earmarked for the investor to the feeder fund (the initial transferee), which then transfers the money to the investor (the subsequent transferee).

The Madoff liquidating trustee sought to avoid certain withdrawals as actually fraudulent transfers. Complicating the trustee's case was the fact that numerous of the defendants were foreign entities—both the feeder funds themselves and their investors.

The lower courts denied relief. They reasoned that the presumption against extraterritoriality and principles of international comity barred recovering property sent to foreign initial transferees, who in turn sent the money to foreign subsequent transferees.

The Second Circuit reversed. It held that the relevant transfers were actually domestic activities, and so the presumption against extraterritoriality and principle of international comity were not even implicated. The lower courts focused on the wrong steps of the transactions—namely, the subsequent transfers between exclusively foreign entities—rather than the initial transfer, which originated domestically from a U.S. bank.

The lower courts' error arose from their focus on section 550 and its focus on transferees in isolation, rather than in conjunction with section 548. The former is "a utility provision" that "help[s] execut[e] the policy of section 548" by authorizing a remedy for avoided fraudulent transfers. *Id.* at 98.

The two provisions therefore must be read "in tandem." *Id.* at 97. Section 550 authorizes recovering property for the overriding purpose of regulating and deterring fraudulent conduct and transfers. Where that fraudulent activity originated on U.S. soil, a sufficient domestic nexus exists to allay concerns about extraterritoriality and international comity, even where foreign transferees are involved.

***In re Titus*, 916 F.3d 293 (3d Cir. Feb. 20, 2019).**

The Third Circuit recently considered how to quantify damages when fraudulent transfers are commingled in accounts held by spouses as tenants by the entireties.

Prior to filing bankruptcy, Titus was personally delinquent on commercial rent payments. The landlord garnished Titus' wages. But Titus deposited all of his wages into an account he held jointly with his wife as tenants by the entireties. She was not liable for the rent payments, and so the landlord could not execute on the joint bank account.

An involuntary chapter 7 case then commenced. The trustee sued Titus and his wife under Pennsylvania law, alleging that the deposits of Titus' wages into the entireties account were fraudulent transfers. The deposits divested Titus of his exclusive control over his wages and frustrated his creditors.

The lower courts found fraudulent transfer liability. The Third Circuit affirmed on liability and explained how to properly quantify damages when fraudulent transfers are commingled as above.

Under Pennsylvania law, fraudulent transfers spent on necessary household expenses may not be avoided. But "it may be impossible to determine what deposit was used for a particular expenditure," and determine if it was necessary or not, "[b]ecause money is fungible." *Id.* at 302.

The court therefore adopted a presumption, which it named the pro rata approach. It directed that courts "should presume that any spending out of an entireties account is made up of a mixture of wage and nonwage dollars in proportion to the overall ratio of wage to nonwage deposits in the account." *Id.* at 307. In other words, if the entireties account was composed of 60% fraudulent transfers (here, the wage deposits), then a court may presume that 60% of the account's expenditures went to non-necessities (which may therefore be avoided).

The Third Circuit noted that this rule is easily workable for lower courts and allows trustees to recover on fraudulent transfer claims when the commingling of funds might otherwise present issues of proof.

At the same time, the Third Circuit clarified that the pro rata approach would "yield" whenever a trustee could actually trace specific deposits to specific spending. *Id.* at 304. The pro rata approach is only necessary when the commingling of fungible assets makes tracing impossible.

***Matter of Ondova Limited Co.*, 914 F.3d 990 (5th Cir. Feb. 4, 2019).**

The Fifth Circuit recently held, in line with numerous other circuit courts, that chapter 11 trustees "are entitled to qualified immunity for personal harms caused by actions that, while not pursuant to a court order, fall within the scope of their official duties." *Id.* at 993.

The case arose out of the erratic behavior of Ondova Limited Company's principal, Jeffrey Baron. Shortly after Ondova filed for chapter 11, the bankruptcy court began to worry that Baron was exposing the debtor to significant administrative expense liabilities by continually hiring and firing attorneys and failing to pay them when postpetition fees and expenses became due. The court found cause to appoint a trustee. Later, the trustee moved to appoint a receiver over Baron and his assets, in order to assure performance on a settlement between the estate and its major creditors. The court granted the motion and appointed a receiver. The Fifth Circuit (in a separate ruling) reversed the appointment of the receiver, on the grounds that the lower court lacked authority to appoint a receiver to control a vexatious litigant and manage his assets, including personal assets unrelated to any dispute in the bankruptcy case or other litigation.

After the Fifth Circuit's reversal of the receivership appointment, Baron sued the trustee and his law firm. Baron alleged that the trustee's motion to appoint the receiver amounted to malicious prosecution. Baron complained about the trustee's "decision to seek a receivership over him, alleged falsehoods or misrepresentations during the receivership process, and subsequent use of the receivership to liquidate assets." *Id.* at 993.

The lower courts dismissed Baron's suit, and the Fifth Circuit affirmed.

The Fifth Circuit noted that trustees are considered an "arm of the court," and so they are entitled to absolute immunity for all actions taken pursuant to a court order. *Id.* at 992. Even when trustees do not act explicitly pursuant to a court order, they are entitled to qualified immunity for any actions taken within the scope of their official duties. Trustees only lose their immunity when they act *ultra vires—i.e.*, when their actions "fall outside the scope of their duties as trustees." *Id.* at 993.

Here, the Fifth Circuit concluded that the trustee had acted in good faith throughout the case, meaning that he was entitled to qualified immunity at the least. Even though the court had earlier found that the appointment of the receiver was error, there was nothing to suggest the trustee acted with malice or was otherwise acting outside the scope of his official duties, such that he lost immunity.

Further, the Fifth Circuit determined that the trustee's law firm was entitled to immunity. The court relied on a derivative theory of liability, reasoning that counsel to the trustee is effectively a court appointed officer as well and so should also receive immunity. In addition, the court cited the doctrine of attorney immunity, which immunizes attorneys from suits by non-clients attacking actions the attorneys took to represent other parties.

***Slovak Republic v. Loveridge (In re Eurogas, Inc.)*, 755 F. App'x 825 (10th Cir. Jan. 4, 2019).**

The Tenth Circuit recently clarified the standard of review for a bankruptcy court's order authorizing the abandonment of estate assets. Importantly, the trustee's final decision to abandon is only reversible for an abuse of discretion.

The chapter 7 debtor, Eurogas, had a potential claim to substantial talc deposits in the Slovak Republic. Ownership of the talc assets was unclear and was the subject of an arbitration that was pending at the time the bankruptcy was initiated. The trustee determined that continuing to prosecute the arbitration could cost up to $2 million in fees. However, the estate was deeply insolvent, mainly because of a judgment against the debtor for $113 million.

The creditor who also had the $113 million claim bid $250,000 for the estate's potential interest in the talc deposits. The trustee moved to abandon the estate's claim to the talc deposits, in return for the creditor paying $250,000 and withdrawing its claim against the estate. The bankruptcy court approved the abandonment. It found that the estate's right to the talc assets was unclear and subject to expensive litigation. Further, a release of the largest claim against the estate and $250,000 was more than adequate compensation for abandonment of the potential property interests.

The Tenth Circuit affirmed.

It noted that property of the estate can be abandoned when it is burdensome to the estate. "[D]etermining whether an asset is burdensome to the estate requires the bankruptcy court to look at the big picture and consider an asset's value, encumbrances, and options (or lack thereof) for liquidation. If, overall, abandoning the asset will bring about a better result for creditors than administering it, the asset may be abandoned." *Id.* at 831.

When an appellate court reviews a bankruptcy court order approving abandonment, various standards of review will apply to separate elements of the bankruptcy court's analysis. In order to resolve a request to abandon an asset, "it seems that a bankruptcy court must (1) identify the legal definition of the terms 'burdensome" and "inconsequential,' (2) make findings of fact about the contested asset, (3) determine whether its findings of fact satisfy the legal test for whether an asset is 'burdensome' or 'inconsequential,' and, finally, (4) if it concludes that the property is burdensome or inconsequential, determine if the trustee abused its discretion ('may abandon') by choosing to abandon the asset." *Id.* Step (1) is reviewed *de novo*, steps (2) and (3) are reviewed for clear error, and step (4) is reviewed for an abuse of discretion. *Id.*

Here, abandonment of the property was legally proper on all of the elements set forth above. Primarily, the court focused on the fact that abandonment could potentially bring more money into the estate than otherwise, given the uncertainty about the estate's ownership of the talc deposits and the certainty of expensive litigation regarding the same. Comparing the value of the abandonment ($250,000 in cash and the release of a $113 million claim) with the lack of information on the value of the talc deposits' (and how much it would cost to litigate their ownership), the lower court did not err in finding that abandonment was justified.

***In re Buccaneer Resources, LLC*, 912 F.3d 291 (5th Cir. Jan. 4, 2019).**

The Fifth Circuit recently determined that a tortious interference claim brought by a debtor's former officer was not property of the estate.

Curtis Burton was Buccaneer Resources' CEO. All of Buccaneer's senior secured debt was financed by Meridian Capital CIS Fund, which asserted a blanket lien over all of Buccaneer's assets. Meridian also appointed or was connected with three of Buccaneer's four directors—the only other director was Burton himself.

Buccaneer filed for chapter 11 and shortly thereafter fired Burton. According to Burton, Meridian was responsible for his termination. He alleged that Meridian desired to control certain Buccaneer assets and to install a new CEO that would serve Meridian's interests. He also claimed that Meridian instructed Buccaneer's board that Meridian would not invest or loan additional money unless Burton was terminated.

Buccaneer's bankruptcy plan released the estate's potential claims against Meridian for $10 million. But Burton sued Meridian in state court. He alleged tortious interference with his employment contract.

Meridian removed Burton's suit to the bankruptcy court. It argued that Burton's claims belonged to Buccaneer's estate and were released in the plan's settlement. The bankruptcy court disagreed, holding that Burton directly owned the tortious interference claim. It remanded the action to state court.

The Fifth Circuit affirmed.

The court recognized that a creditor's standing to bring a claim turns on the distinction between direct and derivative injury. If a creditor seeks to sue third parties for injuries it directly suffered, it may do so. If the creditor's injury "comes about only because of harm to the debtor, then its injury is derivative, and the claim is property of the estate." *Id.* at 293. Only the bankruptcy trustee has standing to assert derivative claims.

The court clarified that a claim is not derivative simply because it arises from events that harmed both the debtor and the creditor. Here, Meridian conceivably harmed both Burton and the debtor by causing Burton's termination and controlling the board to Buccaneer's detriment. However, "a debtor and creditor can have separate claims arising from the same conduct. As long as the injury a creditor is pursuing against a third party does not stem from the depletion of estate assets, the injury is a direct one that does not belong to the estate." *Id.* at 295. Burton therefore had a direct claim, as his injury—wrongful termination—was independent from Meridian's wrongful depletion of estate assets.

***Department of Social Services, Division of Child Support Enforcement v. Webb (In re Webb)*, 908 F.3d 941 (4th Cir. 2018).**

The Fourth Circuit recently held that upon dismissal of a chapter 13 case, the trustee must return to the debtor any postpetition payments the debtor made in support of a proposed plan, even if a creditor levied on those funds.

The debtor filed for relief under chapter 13. During the bankruptcy case, Virginia's Department of Social Services (the "Department") filed a proof of claim for approximately $75,000 in unpaid child support obligations. The debtor also proposed four separate plans to repay his debts. As required by the Bankruptcy Code, the debtor made postpetition payments to the trustee of all amounts set forth in the proposed plans. Over the course of the case, these payments amounted to $3,000. In the end, the Bankruptcy Court found that none of the plans were confirmable. It therefore dismissed the case.

After the dismissal, the Department served a levy upon the trustee. The levy demanded that the trustee send the $3,000 in postpetition payments to the Department, in partial satisfaction of the debtor's child support obligations. The levy also sought to hold the trustee personally liable if he failed to comply. In making its demand, the Department relied upon state law, which allowed it to "serve a notice of levy upon 'any person, firm, corporation, association, political subdivision or department of the Commonwealth.'" *Id.* at 944 (quoting Va. Code Ann. § 63.2–1929).

The trustee, however, believed he was bound by section 1326 of the Bankruptcy Code, which requires that trustees return postpetition payments to debtors if their chapter 13 plans are not confirmed.

The trustee moved in the Bankruptcy Court for an order determining who was owed the postpetition payments. The Bankruptcy Court ordered the trustee to return the funds to the debtor. Section 1326 of the Bankruptcy Code is clear and unambiguous: "if a plan is not confirmed, the trustee . . . shall return [postpetition] payments . . . to the debtor." 11 U.S.C. § 1326(a)(2). The Bankruptcy Court therefore enforced the plain meaning of the Code. It also noted that, if it ordered the trustee to send the funds to the Department, it would create a "race to the trustee" following the dismissal of chapter 13 cases. *Id.* at 947. That result would contravene the Code and bankruptcy policy.

The District Court and Fourth Circuit affirmed. The Fourth Circuit agreed that the plain meaning of section 1326 required the trustee to return the postpetition payments to the debtor. It also noted that its holding was consistent with section 349, which provides that, immediately upon dismissal of a case, the property of the estate revests in whichever entity held the property prior to the commencement of the case—here, the debtor, not the Department. Finally, the Fourth Circuit held that the state law allowing the Department to levy on the trustee in this circumstance was preempted by section 1326 and the Supremacy Clause.

***In re Franchise Services of North Amer., Inc.*, 891 F.3d 198 (2018).**

The Fifth Circuit recently held that federal bankruptcy law does not preclude shareholders of a company from voting against its proposal to file a voluntary bankruptcy petition, even when those shareholders are also unsecured creditors of the company.

As part of a pre-petition merger transaction, an investment bank formed Boketo, LLC in order to make a $15 million investment in Franchise Services of North America. In return for the investment, Franchise Services granted 100% of its preferred stock to Boketo. The preferred stock was convertible and would equal a 49.76% equity interest if converted. Franchise Services also amended its certificate of incorporation to provide that the company could not file for bankruptcy unless the holders of the preferred stock and common stock, voting as separate classes, both voted in favor of the filing. Finally, Franchise Services agreed to pay various merger-related fees to the parent of Boketo; however, those fees were never paid.

A few years later, Franchise Services filed for chapter 11. It did so without seeking the consent of a majority of its preferred and common shareholders, voting as separate classes.

Boketo filed a motion to dismiss the chapter 11, arguing that Franchise Services lacked the corporate authority to file without Boketo's approval, as the single holder of its preferred stock. Franchise Services countered that the shareholder consent requirement was an impermissible restriction on Franchise Services' right to file for bankruptcy. It also argued that Boketo, as a creditor, could not veto Franchise Service's filing, serving its own self-interest over those of Franchise Service's potential estate.

The lower court granted the motion to dismiss and the Fifth Circuit affirmed.

The Fifth Circuit noted that a debtor must have corporate authority to file a bankruptcy petition in order for that filing to be valid. The court found "no prohibition in federal bankruptcy law against granting a preferred shareholder the right to prevent a voluntary bankruptcy filing just because the shareholder also happens to be an unsecured creditor by virtue of an unpaid consulting bill. It is one thing to look past corporate governance documents and the structure of a corporation when a creditor has negotiated authority to veto a debtor's decision to file a bankruptcy petition; it is quite another to ignore those documents when the owners retain for themselves the decision whether to file bankruptcy."

In other words, federal courts might refuse to approve of creditors forcing entities to waive their bankruptcy rights ex ante, in exchange for forbearance, additional creditor, etc. But federal law does not prohibit vesting creditors with the authority to decide whether a corporation should file for bankruptcy, so long as those creditors also have equity interests and the bankruptcy right might realistically be utilized. Indeed, the Fifth Circuit expressly noted that its opinion was limited, given that the case "involves a bona fide shareholder" and not one whose "equity interest is just a ruse."