

BY HOLLY E. ESTES¹

Transfer of Claim Held by Insider Does Not an Insider Claim Make

In February 2016, the U.S. Court of Appeals for the Ninth Circuit issued its opinion in *In re The Village at Lakeridge LLC*.² The court considered whether a person purchasing a claim from an insider automatically became an insider upon acquiring an insider's claim.³

Prior to *Village*, there was little case law, and no published opinion in the Ninth Circuit, that determined whether an insider's status transferred when the insider sold or assigned its claim to a third party.

In its opinion, the Ninth Circuit held that a "creditor does not become an insider simply by receiving a claim from a statutory insider," and further, that the noninsider assignee's vote should not be excluded under § 1129(a)(10) of the Bankruptcy Code for plan-confirmation purposes.⁴ Accordingly, the court upheld the Ninth Circuit Bankruptcy Appellate Panel's (BAP) decision reversing the bankruptcy court's holding that the transferee automatically became an insider upon acquiring an insider's claim.⁵ Because the transferee was neither a statutory nor non-statutory insider, the court found that the BAP properly reversed the portion of the bankruptcy court's order that excluded the transferee's vote for plan-confirmation purposes, and affirmed the BAP's judgment.⁶

Background

In *Village*, after the debtor filed its disclosure statement and reorganization plan, the board of directors of the debtor's sole member, MBP Equity Partners I LLC, decided to sell MBP's unsecured claim against the estate.⁷ Kathie Bartlett, one of the five members of MBP's board, shared a close business and personal relationship with a claimant, Dr. Robert Rabkin, wholly unrelated to Bartlett's position with MBP.⁸ Bartlett, on behalf of MBP, approached Rabkin with an offer to sell MBP's claim.⁹ Dr. Rabkin acquired MBP's unsecured claim in the amount of \$2.76 million for the sum of \$5,000.¹⁰ His claim was in its own class under

the debtor's disclosure statement and reorganization plan; the only other claim against the estate was the fully secured claim of U.S. Bank National Association in the amount of \$10 million.¹¹

Shortly after acquiring MBP's claim, U.S. Bank deposited Dr. Rabkin,¹² who was questioned about his purchase of MBP's claim and his relationship with the debtor, MBP and Bartlett.¹³ Dr. Rabkin testified that he had little knowledge of the debtor and MBP prior to purchasing the claim, and that he had purchased the claim as a business investment.¹⁴ He had no interest in the debtor other than wanting to receive a return on his investment.¹⁵ In addition, during the course of Dr. Rabkin's deposition, U.S. Bank, through its counsel, offered to purchase Dr. Rabkin's claim first for \$50,000; after Dr. Rabkin stated that he would consider the offer, U.S. Bank increased its offer to \$60,000.¹⁶ Dr. Rabkin considered the offer but failed to respond, and the offer lapsed.¹⁷

At her deposition, Bartlett testified that she had no authority to make decisions for MBP on her own, and that MBP's board decided to sell its claim because MBP could not vote the claim for purposes of confirming the debtor's reorganization plan. The board also believed that there might be a tax advantage in selling the claim.¹⁸

Bankruptcy Court

Prior to plan confirmation, U.S. Bank moved to designate Dr. Rabkin's claim¹⁹ and disallow it for plan-voting purposes.²⁰ U.S. Bank argued that (1) Dr. Rabkin had acquired statutory insider status, (2) Dr. Rabkin was a non-statutory insider, and (3) the assignment of MBP's claim was made in bad faith.²¹ After conducting an evidentiary hearing, the bankruptcy court granted in part and denied in part the motion to designate. The bankruptcy court found that Dr. Rabkin was not a non-statutory insider for the following reasons: (1) Dr. Rabkin



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¹ Any opinions expressed in the article are those of the author, and not the opinion of Walter Wilhelm Bauer.

² *U.S. Bank National Ass'n v. The Village at Lakeridge LLC (In re the Village at Lakeridge LLC)*, 2016 U.S. App. LEXIS 2124 (9th Cir. 2016).

³ *Id.* at 20.

⁴ *Village*, 2016 U.S. App. LEXIS 2124 *20.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* at 6.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 6-7.

¹⁴ *Id.* at 7.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 6.

¹⁹ Dr. Rabkin cast an affirmative vote in favor of the debtor's plan. He was the only unsecured creditor of the debtor, and the debtor relied on his vote as an accepting class pursuant to 11 U.S.C. § 1129(a)(10).

²⁰ *Id.* at 8.

²¹ *Id.*

did not exercise control over the debtor; (2) Dr. Rabkin did not co-habitate with Bartlett and did not pay Bartlett's living expenses; (3) Dr. Rabkin has never purchased expensive gifts for Bartlett; and (4) Bartlett did not exercise control over or provide expensive gifts to Dr. Rabkin.²²

Although the bankruptcy court found that Dr. Rabkin was not a non-statutory insider and had not purchased the claim in bad faith, it nevertheless concluded that because MBP was a statutory insider of the debtor, Dr. Rabkin (as assignee of the claim) "stepped into [MBP's] shoes" and acquired its statutory insider status when he purchased the claim.²³

As a direct result of its decision, the bankruptcy court further held that Dr. Rabkin's vote to accept the plan could not be considered to determine acceptance of the debtor's plan by an impaired class of claims pursuant to 11 U.S.C. § 1129(a)(10).²⁴ The order was timely appealed.²⁵

BAP

The BAP affirmed in part, reversed in part and vacated in part the bankruptcy court's order.²⁶ It also reversed the finding that Dr. Rabkin had become a statutory insider as a matter of law by acquiring MBP's claim and affirmed the findings that Dr. Rabkin was not a non-statutory insider and that the claim assignment was not made in bad faith.²⁷ In addition, the BAP held that insider status is a fact-intensive inquiry that must be made on a case-by-case basis.²⁸ The BAP reasoned that the transfer or assignment of a claim alone would not change the status of the claimant, so further inquiry was required.²⁹ Because Dr. Rabkin was neither a statutory nor non-statutory insider, the BAP held that his vote accepting the debtor's plan under 11 U.S.C. § 1129(a)(10) would count for plan-confirmation purposes because Dr. Rabkin was an impaired creditor who was not an insider.³⁰ U.S. Bank appealed.

Ninth Circuit Court of Appeals

A fundamental issue on appeal was whether Dr. Rabkin was an insider of the debtor. In order for a bankruptcy court to confirm a reorganization plan, at least one noninsider impaired class of claims under the plan must have cast a vote accepting the plan.³¹ When considering whether someone is an insider for the purposes of 11 U.S.C. § 1129(a)(10), there are two types: statutory and non-statutory insiders.³² "An insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor."³³

A statutory insider, or a *per se* insider, is one defined in 11 U.S.C. § 101(31) of the Bankruptcy Code.³⁴ U.S. Bank

argued that Dr. Rabkin became a statutory insider when he acquired MBP's claim,³⁵ but the Ninth Circuit disagreed.³⁶ The court reasoned that bankruptcy law distinguishes between the status of a claim and that of a claim's holder.³⁷

The term "insider" is a noun referring to a person, rather than an adjective describing a claim.³⁸ The court reasoned that general assignment law — in which an assignee would take a claim subject to any benefits or defects of the claim — did not apply because insider status is not a property of a claim.³⁹ Next, the court held that a factual determination must be made as to whether the transferee is himself an insider.⁴⁰

Whether a creditor is an insider is a fact-intensive inquiry that must be made on a case-by-case basis.⁴¹ Courts cannot bypass the fact inquiry by finding that insider status passes as a matter of law when a claim is acquired from an insider.⁴² The court articulated that the Bankruptcy Code did not intend for a third-party transferee dealing at arm's-length to be foreclosed from voting.⁴³

The Ninth Circuit established the following guidelines in conducting the factual inquiry for insider status. First, a court should begin with the statute.⁴⁴ If the transferee fits within the statutory-insider classification, the inquiry is over.⁴⁵ In *Village*, the Ninth Circuit upheld the BAP's reversal of the bankruptcy court by deciding that Dr. Rabkin was not a statutory insider⁴⁶ and did not become a statutory insider by acquiring a claim from an insider.⁴⁷

The court's next inquiry was whether the bankruptcy court erred in finding that Dr. Rabkin was not a non-statutory insider.⁴⁸ A non-statutory insider, while not explicitly defined in 11 U.S.C. § 101(31), is someone with a sufficiently close relationship with the debtor to fall within the definition.⁴⁹ To be a non-statutory insider, the creditor's closeness with the debtor must be akin to the relationships enumerated in 11 U.S.C. § 101(31), and the assignment of the claim must have been negotiated at less than arm's length.⁵⁰ Some indicium of non-statutory insider status include having or being subject to some degree of control and access to the debtor's insider information, but a court cannot assign non-statutory insider status to a creditor simply because it finds that the creditor and debtor share a close relationship.⁵¹ Instead, a court must conduct a fact-intensive inquiry to determine whether a creditor and debtor share a sufficiently close relationship and negotiated at less than arm's length. An arm's-length transaction is defined as "a transaction between two unrelated and unaffiliated parties[, or] a transaction between two parties, however closely

35 *Id.* at 12.

36 *Id.*

37 *Id.*

38 *Id.* at 13.

39 *Id.* at 12.

40 *Id.* at 12-13 (citing *Concord Square Apartments of Wood Cty. Ltd. v. Ottawa Props. Inc. (In re Concord Square Apartments)*, 174 B.R. 71, 75 (Bankr. S.D. Ohio 1994)).

41 *Id.* at 13 (citing *In re Friedman*, 126 B.R. 63, at 67, 70-71 (B.A.P. 9th Cir. 1991); *Miller v. Schuman (In re Schuman)*, 81 B.R. 583, 586-87 (B.A.P. 9th Cir. 1987) (*per curiam*)).

42 *Id.* at 13-14.

43 *Id.* at 14.

44 *Id.* at 15.

45 *Id.*

46 It was undisputed that Dr. Rabkin did not qualify as a statutory insider in his own right. *Id.*

47 *Id.*

48 *Id.*

49 *Id.* at 12.

50 *Id.* at 16 (citing *Anstine v. Carl Zeiss Meditec AG (In re U.S. Med. Inc.)*, 531 F.3d 1272, 1277 (10th Cir. 2008)).

51 *Id.* at 16-17; see also *Anstine*, 531 F.3d at 1277-1278.

22 *Village at Lakeridge LLC vs. U.S. Bank NA (In re the Village at Lakeridge LLC)*, 2013 Bankr. LEXIS 2329 *7-8, 2013 WL 13977447 (B.A.P. 9th Cir. April 5, 2013).

23 *Village*, 2016 U.S. App. LEXIS 2124 *8. The bankruptcy court based its decision on *In re Applegate Prop. Ltd.*, 133 B.R. 827 (Bankr. W.D. Tex. 1991); *In re Holly Knoll P'ship*, 167 B.R. 381 (Bankr. E.D. Pa. 1994); and the unpublished case of *In re Greer W. Inv. LP*, 81 F.3d 168, 1996 U.S. App. LEXIS 8495, 1996 SW 134293 (9th Cir. March 25, 1996).

24 *Id.*

25 *Village*, 2013 Bankr. LEXIS 2329 *9, 2013 WL 13977447.

26 *Id.* at 37-38.

27 *Id.*

28 *Id.* at 19-20.

29 *Id.* at 21.

30 *Id.* at 24.

31 11 U.S.C. § 1129(a)(10).

32 *Village*, 2016 U.S. App. LEXIS 2124 *11.

33 *Id.* (quoting S. Rep. No. 95-989, at 25 (1978), as reprinted in 1978 U.S.C.A.N. 5787, 5810; H.R. Rep. No. 95-595, at 312 (1977), as reprinted in 1978 U.S.C.A.N. 5963, 6269).

34 *Id.* at 11.

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related they [might] be, conducted as if the parties were strangers, so that no conflict of interest arises.⁵²

U.S. Bank argued that the bankruptcy court erred in finding that Dr. Rabkin was not a non-statutory insider.⁵³ Reviewing the bankruptcy court's finding for clear error, the Ninth Circuit upheld its factual finding⁵⁴ and reasoned that U.S. Bank failed to show that Dr. Rabkin had a relationship with MBP, the debtor or Bartlett comparable to those enumerated in § 101(31).⁵⁵ The evidence showed that Dr. Rabkin had little knowledge of the debtor and MBP prior to acquiring the claim.⁵⁶

In addition, the evidence showed that Dr. Rabkin had no control over the debtor, MBP or Bartlett, and vice versa.⁵⁷ The court found that U.S. Bank failed to show that Dr. Rabkin's close personal and business relationship with Bartlett was sufficiently close to compare it with any category listed in § 101(31).⁵⁸ The evidence also showed that Dr. Rabkin's failure to sell his claim to U.S. Bank for \$50,000, and his vote in favor of the debtor's plan, were done with the understanding that the debtor would amend its plan to increase his payout to an amount comparable to that offered by U.S. Bank.⁵⁹ Next, the court reasoned

that the bankruptcy court properly evaluated the factors to determine whether Dr. Rabkin was a non-statutory insider, including the court's description of why the transaction was conducted at arm's length.⁶⁰

U.S. Bank urged the Ninth Circuit to reverse the BAP, arguing that if it did not, it would create a slippery slope where debtors would begin assigning their claims to third parties in return for votes in favor of the debtor's plan.⁶¹ The court found that U.S. Bank overstated its argument.⁶² The court considered the public policy behind protecting secured creditors' interests in bankruptcy cases, but found that the Bankruptcy Code has a number of safeguards for protecting secured creditors who could be negatively impacted by a debtor's reorganization plan, including the safeguards built into 11 U.S.C. §§ 1129 and 1126(e).⁶³

Where Are We Now?

After *Village*, practitioners in the Ninth Circuit have clarity that the transfer of a claim held by an insider does not transfer with it insider status as a matter of law. Whether a transferee is an insider is a fact-intensive inquiry that must be made on a case-by-case basis. *Village* leaves room for further developments in legislation or case law on what it means to be a non-statutory insider. [abi](#)

52 *Id.* at 16 (citing "transaction," *Black's Law Dictionary* (10th ed. 2014)).

53 *Id.* at 17.

54 *Id.* at 17-18.

55 *Id.* at 17.

56 *Id.*

57 *Id.* at 18.

58 *Id.*

59 *Id.* at 19-20.

60 *Id.* at 19.

61 *Id.* at 14.

62 *Id.*

63 *Id.* at 12-14.

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