Benchnotes

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"Solvent-Debtor Exception" Upheld; *Cardelucci* and § 726(a)(5) Do Not Apply to Unimpaired Claims

A debtor's assets sometimes exceed its liabilities. When such a solvent debtor proposes a reorganization plan, that debtor may seek to avoid soliciting certain creditors' votes by leaving those claims "unimpaired" under the plan.[1] Before the enactment of the Bankruptcy Code in 1978, and even before the passage of the Bankruptcy Act of 1898, common law recognized a "solvent-debtor exception" to bankruptcy, which generally required a debtor to pay creditors *some* amount of interest on account of their claims before the debtor could retain any surplus value.

The *PG&E* chapter 11 case was such a solvent-debtor case. The debtor reported nearly $20 billion in surplus of assets over liabilities. Under its plan, the debtor proposed to leave trade creditors "unimpaired" and offered to pay their allowed claims in full, plus post-petition interest at the federal judgment rate of 2.59 percent. The trade creditors objected on the basis that they were entitled to their contractual rates of interest. The bankruptcy court overruled these objections and confirmed the plan. The district court affirmed, and this appeal followed. On Aug. 29, 2022, the U.S. Court of Appeals for the Ninth Circuit addressed the "solvent debtor" issue head on, albeit in a split-panel decision.

In its decision,[2] the majority concluded that neither the Bankruptcy Act nor the Bankruptcy Code abrogated the solvent-debtor exception — that is, the common law doctrine requiring a solvent debtor to pay creditors post-petition interest. The majority went a step further to conclude that lower courts' reliance on *In re Cardelucci*[3] was misplaced, as that decision did not address what rate of post-petition interest should be paid to classes of unimpaired creditors. Rather, *Cardelucci* addressed only the interest rate applicable to *impaired* claims in a chapter 7 liquidation under § 726(a)(5) of the Bankruptcy Code. The majority explained that "[n]o Code provisions — alone or together — unambiguously displace the long-established solvent-debtor exception or preclude supposedly unimpaired creditors from asserting an equitable right to contractual post-petition interest."[4] Specifically, the majority addressed the interplay between §§ 502(b)(2), which precludes the allowance of unmatured interest, and 726(a)(5), which requires the debtor to pay interest at the federal judgment rate for surplus chapter 7 liquidations.[5] The majority further explained that its conclusion "fits comfortably within the text of the Code," including the "statutory vacuum" left as a result of Congress's 1994 repeal of § 1124(3), which prevented the unfair result reached in the *New Valley* decision.[6]

Having concluded that the solvent-debtor exception maintains its vitality despite statutory enumeration, the majority turned to the appropriate interest necessary to ensure that creditors are truly "unimpaired" within the meaning of § 1124(1). The majority explained that *Cardelucci* and § 726(a)(5) did not govern the rate question. Instead, the majority remanded to the bankruptcy court "to weigh the equities and determine what rate of interest plaintiffs are entitled to in this instance."[7] In so doing, the majority cited *Dow Corning*, *Ultra Petroleum* and *Chicago, Milwaukee* for the general propositions that the bankruptcy court does not have "free-floating discretion to redistribute rights in accordance with [their] personal views of justice and fairness,"[8] and that "absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights."[9] Accordingly, the split panel of the Ninth Circuit Court of Appeals reversed decisions of the lower courts to require interest at the federal rate and remanded the case back to the bankruptcy court to determine what rate(s) of interest should be paid to unimpaired trade creditors under the present circumstances.

Claims Agents Hired Under § 156(c) Are Subject to the Code of Conduct for Judicial Employees

Many complex chapter 11 cases utilize the services of a private claims agent to act as the "official custodian of records and docket of the bankruptcy court."[10] In *Madison Square Boys & Girls Club*,[11]

1 A claim is "unimpaired" if the plan "leaves unaltered the legal, equitable, and contractual rights which such claim or interest entitles the holder of such claim or interest." 11 U.S.C. § 1124(1).

2 *Ad Hoc Comm. of Holders of Trade Claims v. Pac. Gas and Elec. Co. (In re PG&E Corp.)*, --- F.4th ----, 2022 WL 3712479 (9th Cir. Aug. 29, 2022).

3 285 F.3d 1231 (9th Cir. 2002).

4 *Id.* at *6.

5 The dissent notes that "[t]he Code also implicitly incorporates the solvent-debtor exception in the 'best-interest-of-creditors' test set forth in § 1129(a)(7)(a)(ii)." *Id.* at *17. However, the majority was quick to point out that the plain language of § 1129(a)(7) only incorporates the federal rate requirement under § 726(a)(5) for classes of *impaired* claims that have rejected the plan, not *unimpaired* classes of claims that are deemed to accept the plan without having an opportunity to vote. *Id.* at *9.

6 *See id.* at *10-11 (citing *In re New Valley Corp.*, 168 B.R. 73, 79-80 (Bankr. D.N.J. 1994) (allowing creditor to be classified as "unimpaired" as long as plan paid full principal of claim, without post-petition interest)).

7 *Id.* at *13.

8 *See id.* at *14 (quoting *In re Dow Corning Corp.*, 456 F.3d 668, 679 (6th Cir. 2006)).

9 *See id.* (quoting *In re Ultra Petroleum Corp.*, 943 F.3d 758, 765 (5th Cir. 2019)); *see also In re Ultra Petroleum Corp.*, 624 B.R. 178, (Bankr. S.D. Tex. 2020) (decision on remand, concluding that contractual rates apply).

10 *See* 28 U.S.C. § 156(e).

11 *In re Madison Sq. Boys & Girls Club Inc.*, --- B.R. ---, 2022 WL 3568407 (Bankr. S.D.N.Y. Aug. 18, 2022).

Hon. **Sean H. Lane** considered the propriety of the private agent having a side agreement with a claims broker under which the claims agent receives a portion of the broker's trading commissions in exchange for giving the broker real-time access and providing certain "synchronization services" to the broker. While the court acknowledged the reality that claims-trading occurs without court oversight, the court concluded that such an arrangement ran afoul of 28 U.S.C § 156(c) and could not be approved.

Under the statute, the clerk is to act as the "official custodian[s] of the records and docket of the bankruptcy court."[12] Similarly, courts may utilize services "off the court's premises," provided that "the costs of such ... services are paid for out of the assets of the estates and are not charged to the United States."[13] Because private claims agents are to act as "official custodian[s] of records," the court concluded that they were "subject to the Code of Conduct for Judicial Employees," just like the clerk of court. One such canon applicable to the clerk and any court-appointed claims agent is the duty to avoid impropriety and any appearance of impropriety in all activities.[14]

Under this analysis, the court concluded that the "access agreement" with the broker was improper under 28 U.S.C. § 156(c). To be sure, the court explained that the clerk of court would not be authorized to use its public office for private gain. Here, the claims agent's authority was "derivative of the Clerk's authority," and its obligations and duties under the access agreement "clearly go beyond the § 156(c) Activities."[15] The court recognized that claims agents were frequently retained under § 327(a) of the Bankruptcy Code to provide additional services, such as preparation of schedules or plan-balloting services.

However, the "synchronization services" contemplated under the access agreement were different. First, the debtor did not seek to retain the agent under § 327(a); the only retention requested was pursuant to 28 U.S.C. § 156(c). Second, the access agreement clearly sought to profit from the agent's use of data that belonged to the court. As such, the court denied the application "to the extent the terms of the Access Agreement apply to the claims register in this case."[16]

Miscellaneous

• *In re Builders Holding Co*., --- F.4th ----, 2022 WL 2980761 (1st Cir. 2022) (First Circuit reversed bankruptcy court's grant of summary judgment in favor of trustee and against bank that accomplished setoff against funds deposited to debtor's account in error; bankruptcy court initially granted summary judgment in favor of trustee on grounds that bank would not have been able to set off the funds had debtor not filed bankruptcy as otherwise required by 11 U.S.C. § 553; sole basis for bankruptcy court's ruling was local statute that denied setoff rights where transfer was made in error; in reversing bankruptcy court, First Circuit distinguished bank from recipient of the funds (*i.e*., the debtor) and held that statute only initially precludes debtor from keeping funds, not third-party creditor setting off against funds deposited into debtor's account);

• *In re Gasson*, --- F.4th ----, 2022 WL 3007921 (2d Cir. 2022) (Second Circuit affirmed denial of discharge for debtor that conducted all of his business through entity nominally owned by his wife but beneficially owned, controlled and operated by debtor himself in effort to shield assets from his creditors; although formation of company took place years earlier, debtor's concealment was ongoing and therefore fell within statutory one-year lookback period for denial of discharge under 11 U.S.C. § 727(a)(2)(A));

• *In re USA Gymnastics*, 40 F.4th 775 (7th Cir. 2022) (Seventh Circuit ruled that late-filed claim by sexual assault victim could not be allowed as timely where victim was not readily ascertainable to receive actual notice of bankruptcy case and was entitled only to constructive notice, sufficiency of which was not otherwise contested);

• *In re Falcon V LLC*, --- F.4th ----, 2022 WL 3274174 (5th Cir. 2022) (Fifth Circuit affirmed bankruptcy court's determination that surety bonds are not executory contracts; in case at hand, debtor's obligations to provide additional security for surety bonds issued pre-bankruptcy were discharged under its chapter 11 plan; surety argued that surety bond should be treated as executory contract that was automatically assumed under chapter 11 plan as confirmed; court rejected this argument, holding that mere fact that debtor had limited obligations to continue to pay bond premiums and indemnify surety for payments made did not make agreement executory; moreover, agreement was not executory because surety would not be excused from performance of its obligations even if debtor failed to perform);

• *In re Gulfport Energy Corp. v. Federal Energy Regulatory Commission*, 41 F.4th 667 (5th Cir. 2022) (Fifth Circuit held that series of orders entered by Federal Energy Regulatory Commission (FERC) aimed at requiring debtor to perform its regulated energy contracts with FERC notwithstanding debtor's anticipated rejection of contracts pursuant to 11 U.S.C. § 365(a) were unlawful as being contrary to rights afforded debtors under Bankruptcy Code, and ordered them vacated);

• *In re Village Apothecary Inc*., --- F.4th ----, 2022 WL 3365131 (6th Cir. 2022) (in issue of first impression for Sixth Circuit, court of appeals determined that bankruptcy court may consider results obtained when determining reasonable compensation of trustee and its counsel in bankruptcy under 11 U.S.C. § 330(a)(3); in case at hand, professionals filed for approval of fees exceeding 99 percent of recoveries obtained through their work; court of appeals found that bankruptcy court's reduction of such fees by 50 percent was appropriate given results obtained from counsel's efforts; according to Sixth Circuit, § 330 instructs court to consider "all relevant factors," including any and all factors whether or not enumerated in statute itself);

• *In re Helmstetter*, --- F.4th ----, 2022 WL 3274099 (7th Cir. 2022) (Seventh Circuit affirmed decision determining that debtor lacked Article III standing to appeal order approving trustee's settlement of certain causes of action because

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12 28 U.S.C. § 156(e).
13 28 U.S.C. § 156(c).
14 *See In re Madison Sq. Boys & Girls Club Inc.*, --- B.R. ---, 2022 WL 3568407 at *5.
15 *Id.* at *6.
16 *Id.* at *8.

debtor's allegation that it would recover surplus proceeds through litigation was speculative at best; debtor's speculative notion that there would be surplus recovery if litigation were to be prosecuted was not enough to establish standing and confer jurisdiction on court);

• *In re Laney*, --- F.4th ----, 2022 WL 3500194 (7th Cir. 2022) (Seventh Circuit affirmed bankruptcy court's ruling allowing creditor to amend its proof of claim to add attorneys' fees after confirmation of debtor's chapter 13 plan; court of appeals found no error in concluding that fees in question were incurred appropriately in response to debtor's own proceedings and were compensable under terms of underlying financing agreement);

• *In re Kassas*, --- F.4th ----, 2022 WL 3023604 (9th Cir. 2022) (in case of first impression, Ninth Circuit held that any debt owed by attorney to his clients or to California State Bar for restitution payments made to his clients is subject to discharge under chapter 7; court of appeals concluded that debtor's payment obligations were for compensation for actual pecuniary loss, and therefore are not subject to exception from discharge under 11 U.S.C. § 523(a)(7));

• *In re Moon*, --- B.R. ----, 2022 WL 2951490 (Bankr. D. Nev. 2022) (bankruptcy court awarded damages including award of debtor's attorneys' fees and punitive damages in amount of $500,000 against mortgage-servicing agent for its multiple willful violations of automatic stay during pendency of debtor's chapter 13 proceeding and following debtor's discharge);

• *In re Greenhouse*, --- B.R. ----, 2022 WL 2348167 (Bankr. S.D. Fla. 2022) (on review of motion to enforce order of dissolution entered by state court during pendency of debtor's subchapter V proceeding that purported to order distribution of certain assets to debtor's former spouse, bankruptcy court found that order was enforceable as to debtor's exempt assets, including his health savings and individual retirement accounts, but declined to order distribution of otherwise nonexempt investment assets; ordering distribution of nonexempt investment assets was outside of state court's jurisdiction during pendency of bankruptcy proceedings);

• *In re 5171 Campbells Land Co. Inc.*, --- B.R. ----, 2022 WL 2915294 (Bankr. W.D. Pa. 2022). (bankruptcy court denied motion to dismiss adversary proceeding filed by chapter 11 plan administrator and held that extension of time provisions of 11 U.S.C. § 108(a) applied to causes of actions brought by chapter 11 plan administrator; notwithstanding plain language of § 108(a) extending statutes of limitations for "the trustee," these rights extend to plan administrator because § 1123(b)(3) allows party other than debtor or trustee to fulfill role of representative of estate if chapter 11 plan so provides; plan at issue specifically provided that plan administrator would have all the powers of debtor and trustee to prosecute estate claims, and that such claims were preserved); and

• *3M Occup'l Safety LLC v. Those Parties Listed on Appendix A to the Complaint (In re Aearo Techs. LLC)*, --- B.R. ---, 2022 WL 3756537 (Bankr. S.D. Ind. Aug. 26, 2022) (bankruptcy court denied 3M's (the nondebtor parent) request to extend the stay or enjoin litigation of thousands of MDL plaintiffs under §§ 362(a)(1), 362(a)(3) and 105(a); recognizing that other courts had granted similar injunctive relief, court declined to follow suit due to absence of specific Seventh Circuit precedent adopting the Fourth Circuit's more expansive reasoning in *A.H. Robins Co. Inc. v. Piccinin*, 788 F.2d 994 (4th Cir. 1986) (concluding that § 362(a)(1) can apply to stay claims against nondebtor parties if there is such identity between debtor and nondebtor third party that judgment against nondebtor would in effect be judgment against debtor); similarly, court found record insufficient to extend stay under § 362(a)(3) (an act to exercise control over property of the estate), finding "no threat of inequitable distribution of insurance proceeds" when considering 3M's uncapped agreement to fund debtor's litigation liabilities; finally, court declined to impose an injunction under § 105(a), concluding that record demonstrated low likelihood of actual financial impact on estate in absence of stay; here again, court explained that Seventh Circuit's narrower definition of "related-to" jurisdiction was distinguishing factor not present in *LTL*, *Aldrich Pump* and *Bestwall*, where those courts granted injunctive relief). abi