JONES DAY®

VOLUME 19 • NO. 3

MAY–JUNE
2020

ONE FIRM WORLDWIDE®

BUSINESS RESTRUCTURING REVIEW

MOTHBALLING BANKRUPTCY CASES IN THE COVID-19 CRISIS

Dan T. Moss ■ **Mark G. Douglas**

Hourly headlines have chronicled the global financial fallout from the COVID-19 pandemic, ranging from predicting a recession to noting the devastation wrought by volatile markets, shuttered businesses, idled aircraft, furloughed or terminated employees, and expectations (yet to be borne out) that there will be a large uptick in bankruptcy filings across industries. Despite financial aid packages by governments and central banks, the precipitous drop in consumer spending and limited credit availability means that even companies that commenced chapter 11 cases pre-pandemic are finding that their prepetition strategies may be undone by factors beyond their control. This problem particularly impacts nonessential brick-and-mortar retailers, which, in addition to the recent contraction of consumer demand for certain discretionary products, were already confronting a challenging outlook because of the growth of online commerce and other factors.

As courts of law *and equity*, bankruptcy courts have always had the inherent power to delay proceedings by taking matters under advisement—either to allow parties time to reach a consensual resolution or to enable facts and circumstances to evolve. Recently, however, bankruptcy courts were confronted with requests by debtors to temporarily suspend their cases under the courts' equitable powers and a seldom used provision of the Bankruptcy Code: 11 U.S.C. § 305(a). On March 27, 2020, and again on April 30, a New Jersey bankruptcy court temporarily suspended the chapter 11 cases of Modell's Sporting Goods, Inc., and its affiliated debtors (collectively, "Modell's"), which were in the process of conducting going-out-of-business sales. *See In re Modell's Sporting Goods, Inc.*, No. 20-14179 (VFP) (Bankr. D.N.J.) (orders dated Mar. 27 and Apr. 30, 2020). The Delaware bankruptcy court presiding over the chapter 11 cases of restaurant and brewpub chain CraftWorks Parent LLC and its affiliates (collectively, "CraftWorks") and the Virginia bankruptcy court overseeing the chapter 11 cases of home-furnishing retailer Pier 1 Imports Inc. and its affiliates (collectively, "Pier 1") recently granted similar relief, mothballing the debtors' bankruptcy cases (over the objections of landlords and various other creditors) in an effort to weather the COVID-19 storm and, hopefully, preserve value for all creditors. *See In re CraftWorks Parent, LLC*, No. 20-10475 (BLS) (Bankr. D. Del. Mar. 30, 2020); *In re Pier 1 Imports, Inc.*, No. 20-30805 (KRH) (Bankr. E.D. Va.) (orders dated Apr. 2 and Apr. 28, 2020). In short, these debtors were able to persuade the courts that a temporary pause in the proceedings will give them an opportunity to resurrect their prepetition restructuring plans.

At the other end of the spectrum is *In re Art Van Furniture, LLC*, No. 20-10553-CSS (Bankr. D. Del. Mar. 8, 2020). In that case, the pre-pandemic plan of the debtors (collectively, "Art Van")

IN THIS ISSUE

1 Mothballing Bankruptcy Cases in the COVID-19 Crisis

5 Post-*Taggart*, Ninth Circuit BAP Holds That "No Fair Ground of Doubt" Standard Applies to Automatic Stay Violations

8 Use of Cash Collateral to Pay Prepetition Debt Not Prohibited by *Jevic*

12 From the Top in Brief

14 Legislative Update

15 Newsworthy

involved reducing its overall operational footprint and emerging with a rightsized balance sheet. Unfortunately, the case was filed only days before state and local governments issued social-distancing and stay-at-home directives. Art Van sought to follow CraftWorks, Modell's, and Pier 1 and pause the case, but it was unable to propose a viable path forward that garnered the support of Art Van's secured creditors and other stakeholders. Thus, to avoid administrative insolvency, Art Van moved to convert the cases to chapter 7, which the court approved on April 6, 2020.

DISMISSAL OR SUSPENSION OF A BANKRUPTCY CASE UNDER SECTION 305

Section 305 of the Bankruptcy Code provides as follows:

(a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if—
  (1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or
  (2) (A) a petition under section 1515 for recognition of a foreign proceeding has been granted; and
    (B) the purposes of chapter 15 of this title would be best served by such dismissal or suspension.

(b) A foreign representative may seek dismissal or suspension under subsection (a)(2) of this section.

(c) An order under subsection (a) of this section dismissing a case or suspending all proceedings in a case, or a decision not so to dismiss or suspend, is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of title 28 or by the Supreme Court of the United States under section 1254 of title 28.

Other provisions of the Bankruptcy Code also authorize the bankruptcy court to dismiss cases filed under chapters 7, 9, 11, 12, and 13. *See* 11 U.S.C. §§ 707, 930, 1112, 1208, and 1307. These provisions permit the court to dismiss a bankruptcy case for "cause" and include nonexhaustive catalogues of the circumstances under which cause exists, many of which involve the debtor's misconduct.

Except for a municipal bankruptcy under chapter 9, to which section 305 does not apply (*see* 11 U.S.C. §§ 103(f) and 901(a)), dismissal of a case under chapters 7, 11, 12, and 13 may be sought under section 305(a) as well. Dismissal under section 305 "is reserved for those rare occasions when both the creditors generally and the debtor itself are better served by dismissal or suspension." COLLIER ON BANKRUPTCY ("COLLIER") ¶ 305.01[1] (16th ed. 2020). Such occasions may include the filing of an involuntary bankruptcy by disgruntled creditors in an out-of-court restructuring, a bankruptcy filing prompted by a two-party dispute between the debtor and a creditor pending in a nonbankruptcy forum, or a bankruptcy filing without any "true bankruptcy purpose (*e.g.*, debt adjustment, breathing spell from creditors, and need for discharge and fresh start)." *Id.* at ¶ 305.02[2] (citing cases). Although a bankruptcy court may revoke an order recognizing a foreign bankruptcy proceeding under chapter 15 pursuant to section 1517(d), section 305(b) is the only provision authorizing the dismissal of a chapter 15 case.

Most courts employ a "totality of the circumstances" test in determining whether to grant relief under section 305. *See In re Northshore Mainland Servs., Inc.*, 537 B.R. 192, 203 (Bankr. D. Del. 2015). Factors relevant to such an inquiry include:

(1) the economy and efficiency of administration;
(2) whether another forum is available to protect the interests of both parties or there is already a pending proceeding in state court;
(3) whether federal proceedings are necessary to reach a just and equitable solution;
(4) whether there is an alternative means of achieving an equitable distribution of assets;
(5) whether the debtor and the creditors are able to work out a less expensive out-of-court arrangement which better serves all interests in the case;
(6) whether a non-federal insolvency has proceeded so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process; and
(7) the purpose for which bankruptcy jurisdiction has been sought.

Id. (citations omitted); *accord In re Monitor Single Lift I, Ltd.*, 381 B.R. 455, 464–65 (Bankr. S.D.N.Y. 2008). These factors are not exclusive. Although "no one factor is more important than another," *In re EB Holdings II, Inc.*, 589 B.R. 704, 727 n.73 (Bankr. D. Nev. 2017), the factors may be given different weight, depending on the circumstances of the case. *Monitor*, 381 B.R. at 465.

Section 305 is entitled "Abstention." However, the relief it authorizes—suspension or dismissal of a case—is distinct from the court's discretion or obligation to "abstain" from hearing a particular "proceeding" in a bankruptcy case (e.g., an adversary proceeding, a contested matter, or another discrete controversy, however denominated) under the permissive and mandatory abstention rules set forth in 28 U.S.C. §§ 1334(c)(1) and 1334(c)(2), which apply when another forum is or may be more appropriate. Abstention under section 305 "is of the entire case and reflects Congress's recognition that there may be situations where creditors and the debtor would be better served outside of bankruptcy." COLLIER at ¶ 305.01[1].

Most decisions regarding relief under section 305 involve dismissal of a bankruptcy case. However, some courts have suspended all proceedings in a case if suspension, rather than dismissal, is in the best interests of the debtor and creditors under the particular circumstances involved. *See, e.g., In re Vega*, 2019 WL 4896938 (Bankr. D.P.R. Oct. 3, 2019) (denying reconsideration of an order suspending a bankruptcy case under section 305(a) until resolution of a dispute regarding a creditor's proof of claim in a nonbankruptcy court); *In re Gen. Aeronautics Corp.*, 594 B.R. 442 (Bankr. D. Utah 2018) (suspension of the involuntary bankruptcy case of a purported debtor for 60 days was

appropriate, given the good-faith efforts of the debtor to settle some of the petitioning creditors' claims, the expense of bankruptcy, the harm it could cause to the debtor, and the likelihood that the debtor would achieve success on another project); *EB Holdings II*, 589 B.R. at 728 (suspending a contested involuntary chapter 11 case pending the resolution of state court litigation to determine the enforceability of a loan agreement that was the basis for the involuntary petitioners' claims); *In re All. Fin. Capital Holdings, Inc.*, 2008 WL 294974 (Bankr. N.D. Cal. Jan. 31, 2008) (suspension of a chapter 11 case to permit settlement efforts to continue in state court); *In re Curtis Papers, Inc.*, 2008 WL 111314 (Bankr. D.N.J. Jan. 9, 2008) (involuntary chapter 7 case suspended to permit completion of an assignment for the benefit of creditors, followed by revocation of the suspension order, conversion of the case to chapter 11, and a bankruptcy auction of the debtor's assets); *In re Cenargo Int'l, PLC*, 294 B.R. 571 (Bankr. S.D.N.Y. 2003) (suspension of a chapter 11 case under the pre-chapter 15 predecessor of section 305(a)(2) in deference to an English insolvency proceeding involving the same debtors); *Matter of Axona Int'l Credit & Commerce Ltd.*, 88 B.R. 597 (Bankr. S.D.N.Y. 1988) (a foreign debtor's involuntary chapter 7 case would be suspended under the pre-chapter 15 predecessor to section 305(a)(2), with the assets of the estate turned over to Hong Kong liquidators for distribution in a Hong Kong winding-up proceeding, where Hong Kong law provided a comprehensive procedure for the orderly and just treatment of all creditors, and the Hong Kong liquidators were best situated to evaluate creditor claims fairly and at minimum expense), *aff'd*, 115 B.R. 442 (S.D.N.Y. 1990), *appeal dismissed*, 924 F.2d 31 (2d Cir. 1991).

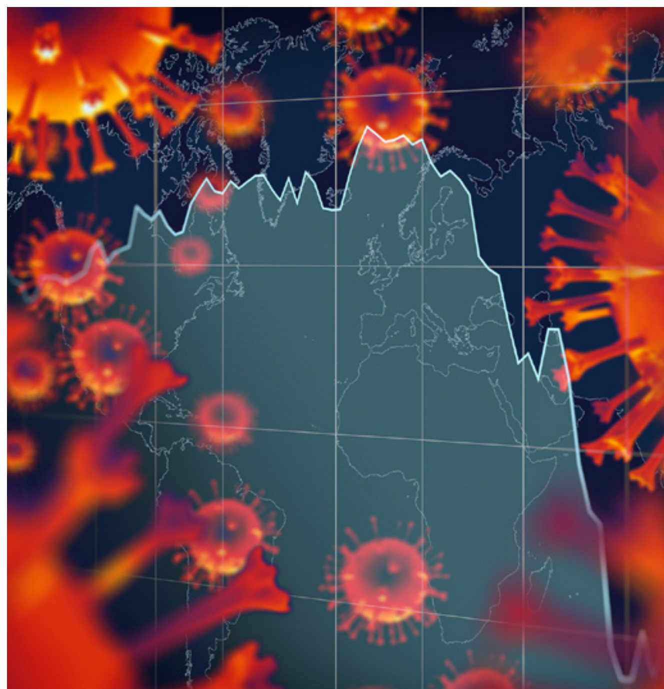
The bankruptcy courts in *Modell's*, *CraftWorks*, and *Pier 1* recently considered requests to suspend chapter 11 cases either entirely or in part because of the COVID-19 pandemic.

MODELL'S

Modell's filed for chapter 11 protection on March 11, 2020, in the District of New Jersey for the purpose of closing all of its 134 sporting goods locations in a controlled liquidation. Unfortunately, the beginning of that process coincided with the onset of the COVID-19 emergency. Because sporting goods stores are not deemed essential businesses, state directives shuttered the company's stores shortly after the bankruptcy filing date, effectively preventing the liquidation sales from proceeding.

In an effort to preserve value for stakeholders and maintain the status quo, Modell's, with the support of its lenders and the official unsecured creditors' committee, sought court authority to suspend its chapter 11 cases for 60 days under section 305(a). In its motion, Modell's stated that, upon the expiration of the COVID-19 emergency, it could resume operating and complete the liquidation process. Several Modell's landlords objected to suspension of the cases, arguing that, without any rent for several months, suspension would effectively make them unprotected forced lenders with little prospect of recouping their losses.

On March 27, the bankruptcy court issued an order suspending the chapter 11 cases until April 30. The order provides, among other things, that during the suspension period: (i) Modell's will cease operating; defer payment of all nonessential expenses, including rent; terminate most store, distribution center, and corporate employees; and operate in accordance with a bare-bones cash collateral budget with limited expenditures; (ii) all deadlines in the bankruptcy case will be extended until further notice; (iii) the automatic stay shall remain in full force and effect; and (iv) Modell's will continue to provide adequate protection to its prepetition lenders.



Certain landlords attempted to appeal the bankruptcy court's order. Modell's claimed the appeal was "frivolous" because suspension orders may not be appealed pursuant to section 305(c) of the Bankruptcy Code.

On April 20, the court granted Modell's request to extend the existing suspension order through and including May 31, 2020.

CRAFTWORKS

CraftWorks has operated restaurants and brewpubs in more than 330 locations under various names, including Logan's Roadhouse, Old Chicago, Rock Bottom, and Gordon Biersch. After closing 40 underperforming locations, CraftWorks filed for chapter 11 protection in the District of Delaware on March 3, 2020, with a pre-negotiated plan to sell 260 of its best-performing locations for $138 million to senior lender Fortress Investment Group LLC ("Fortress"). That plan was thwarted at the onset of the COVID-19 emergency, when CraftWorks was forced to idle its restaurants and brewpubs because of social-distancing decrees, and

evaporating cash triggered a default under CraftWorks' debt-or-in-possession financing facility. CraftWorks then furloughed most of its 18,000 employees.

On March 20, 2020, CraftWorks, supported by its official unsecured creditors' committee, sought court authority to:

> suspend as much of [its] operations—and related administrative expenses—as feasibly possible and cut expenses to the bare minimum, in hopes of re-starting [its] operations and re-opening [its] stores at some point in the future when the need for restaurants to be closed in order to combat the COVID-19 crisis will hopefully have passed.

The motion sought approval under section 105(a) of the Bankruptcy Code and various other provisions to implement temporary procedures to accomplish that goal for 30 days, subject to an extension of an additional 30 days. Those procedures include mandatory conferences prior to commencing litigation, along with telephonic hearings and streamlined procedures governing the rejection of contracts and leases; requests for modification of the automatic stay; and requests for payment of administrative claims—all with the aim of minimizing administrative expenses.

The bankruptcy court granted the motion on March 30. In its order, the court noted that the relief was warranted in light of the COVID-19 pandemic and related events, "which constitute compelling circumstances to modify procedural rules in the Chapter 11 Cases while balancing the rights of [CraftWorks and its estate], on the one side of the scale, and the rights of creditors and other parties in interest, on the other side of the scale." Although CraftWorks did not expressly rely on section 305(a) as authority for the relief requested in its motion, the court's order provides that "[n]othing herein shall prejudice [CraftWorks'] rights, if any, for relief under section 305 of the Bankruptcy Code and any opposition to such relief by any creditor or party in interest in these Chapter 11 Cases and all such rights are reserved."

On May 20, 2020, the bankruptcy court approved the sale of CraftWorks to Fortress, which submitted a $93 million credit bid and pledged to keep at least 150 restaurants in operation.

PIER 1

U.S. and Canadian home-furnishing chain Pier 1 filed for chapter 11 protection on February 17, 2020, in the Eastern District of Virginia with plans to sell the company. At the time of the filing, Pier 1 had struck a deal with lenders that set a cash recovery price on their claims of $105 million, representing 55 cents on the dollar, from the proceeds of an anticipated bankruptcy auction of the company's assets. Under the agreement, lenders agreed that if there was a bid for Pier 1's assets that generated at least that much, they would automatically support the sale. Otherwise, the lenders would decide whether to take control of Pier 1 or proceed with an auction at which they could credit-bid their debt.

Because of the COVID-19 crisis, Pier 1 temporarily closed all of its stores as well as a number of distribution centers; furloughed employees; and cut wages to preserve liquidity. It also cancelled (or at least postponed) the bankruptcy auction of its assets scheduled for March 30 after no qualified bids were received by the bidding deadline and the lenders opted to swap their debt for equity in the reorganized company.

On March 31, 2020, Pier 1 filed a motion with the bankruptcy court seeking authority under section 105(a) and/or section 305(a) of the Bankruptcy Code to "temporarily cease making or delaying all [] payments" not expressly provided for in a revised budget agreed to with lenders, limiting payments to "critical" expenses and implementing case procedures that would adjourn stay relief and certain other motions for an unspecified, open-ended "limited operations period." In its motion, Pier 1 stated that the challenges from the COVID-19 emergency were "especially acute" for retailers in chapter 11 and asserted that the requested relief "is absolutely vital to the Debtors' efforts to facilitate a going-concern sale or debt-for-equity exchange"—an outcome that "is still a possibility." Such relief, Pier 1 claimed, would give creditors "the best opportunity to have a going-concern partner at the conclusion of these chapter 11 cases." Pier 1 also stated that "[i]t is prudent for these and other debtors to seek the relief requested herein in an effort to maximize value," consistent with the relief granted by the courts in *Modell's* and *CraftWorks* to "mothball" the debtors' operations and minimize expenses.

According to Pier 1, the bankruptcy court could approve its interim budget and permit deferred payments pursuant to its "broad equitable powers" under section 105, which "permits the Court to extend the principles of the Bankruptcy Code to postpetition case administration." However, Pier 1 noted, "[t]o the extent that the Court determines that section 305 is the appropriate basis for relief, the Debtors respectfully request that the Court grant this Motion pursuant to section 305 of the Bankruptcy Code."

The bankruptcy court granted Pier 1's motion on April 2 over the objection of several of Pier 1's landlords, which are not being paid rent. By order dated April 28, 2020, the court extended Pier 1's limited-operations period until May 31.

On May 19, 2020, Pier 1 determined that any plans to restructure its business and continue as a going concern were rendered impossible by the continuing COVID-19 crisis. It accordingly sought court authority to wind down its operations and liquidate its assets.

ART VAN

Art Van filed for chapter 11 protection in early March, citing extreme market conditions for the filing and listing more than $200 million in debt. The company filed for bankruptcy with plans to shutter all but 44 of its stores and to sell the remaining stores

as a going concern. However, Art Van closed all 169 of its retail locations on March 19 after the governors of Michigan, Maryland, Pennsylvania, and certain other states imposed restrictions on the operation of nonessential businesses in an effort to slow the advance of COVID-19. The shutdowns stopped the store-closing sales, and Art Van abandoned its plan for a going-concern sale.

In Art Van's April 3, 2020, motion seeking conversion of its chapter 11 cases to chapter 7, the company stated that, although it initially wished to seek court authority "to 'mothball' [its] remaining assets and operations and to suspend substantially all activity in these chapter 11 cases until such time as the broader economic and public safety situations stabilized and hopefully improved," Art Van abandoned this course of action after "no viable path forward in chapter 11 emerged that would garner the support of [Art Van's] senior secured lenders and certain other stakeholders." As noted, the bankruptcy court granted the conversion motion on April 6.

OUTLOOK

In ordinary times—and even during the financial crisis of 2008–2009—bankruptcy courts expect debtors to keep cases moving apace. *See Taggart v. Lorenzen*, 139 S. Ct. 1795, 1803 (2019) ("a chief purpose of the bankruptcy laws [is] to secure a prompt and effectual resolution of bankruptcy cases within a limited period" (internal quotation marks and citations omitted). The relief granted in *Modell's*, *CraftWorks*, and *Pier 1* illustrates that courts recognize the ongoing economic and operational damage wrought by COVID-19. Accordingly, debtors, creditors, other interested parties, and bankruptcy courts may have in section 305(a) a new tool for providing a breathing spell to get past the pandemic as long as the case stakeholders and court are convinced that such a "pause" is not simply a delay tactic to avoid an inevitable liquidation.

While it is impossible to determine when the pandemic will subside, there may come a time when the ongoing interruption to a bankruptcy case is so detrimental—whether, for example, because asset values nosedive or secured creditors' interest accrues at default rates such that there is no value for other creditors—that suspending the case destroys value to all parties-in-interest. Thus, while bankruptcy courts appear to embrace the "wait and see" approach for now, there may come a time when a court requires the debtor to justify the hiatus by demonstrating that there will be viable restructuring options when the case resumes.

Alternatively, as illustrated by *Art Van*, pausing the case may not be a viable option.

POST-*TAGGART*, NINTH CIRCUIT BAP HOLDS THAT "NO FAIR GROUND OF DOUBT" STANDARD APPLIES TO AUTOMATIC STAY VIOLATIONS

Dan T. Moss ■ Mark G. Douglas

In *Taggart v. Lorenzen*, 139 S. Ct. 1795 (June 3, 2019), the U.S. Supreme Court ruled that a bankruptcy court may hold a creditor in civil contempt for attempting to collect on a debt that has been discharged in bankruptcy "if there is *no fair ground of doubt* as to whether the [discharge] order barred the creditor's conduct." However, the ruling did not address whether the same standard should apply to violations of the automatic stay. A Ninth Circuit Bankruptcy Appellate Panel crossed that bridge in *Suh v. Anderson (In re Jeong)*, 2020 WL 1277575 (B.A.P. 9th Cir. Mar. 16, 2020). In a nonprecedential opinion, the three-judge panel applied the *Taggart* standard in upholding a bankruptcy court order granting a chapter 7 trustee's request for contempt sanctions for a willful violation of the stay.

SCOPE OF THE AUTOMATIC STAY WITH RESPECT TO LIEN PERFECTION

Section 362(a) of the Bankruptcy Code provides that, with certain exceptions, the filing of a bankruptcy petition operates as a stay of most creditor collection activities with respect to the debtor or its property, including (as set forth in subsection (a)(4)) "any act to create, perfect, or enforce any lien against property of the estate." One of the exceptions is set forth in section 362(b)(3), which provides that the automatic stay does not apply to:

> any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title.

Sections 546(b) and 547(e)(2)(B) of the Bankruptcy Code address the grace periods granted to creditors under applicable nonbankruptcy law to perfect liens or security interests. *See, e.g.*, U.C.C. § 9-317 (providing that a creditor that files a financing statement with respect to a purchase-money security interest within 20 days after the debtor receives delivery of the collateral has priority over the rights of any intervening lien creditor).

Under section 546(b)(1), a bankruptcy trustee's "strong-arm" powers as a lien creditor or hypothetical bona fide purchaser as of the petition date are subject to:

any generally applicable law that—

(A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or

(B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.

Section 547(e)(2)(A) provides that, for the purposes of avoiding a preferential transfer, with certain exceptions, a transfer is made "at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 30 days after, such time."

Taken together, sections 362(b)(3), 546(b)(1), and 547(e)(2)(A) permit a creditor to perfect, or maintain or continue perfection of, its lien or security interest after a bankruptcy filing without violating the automatic stay or risking preference liability, provided the creditor takes these actions within any time period prescribed by applicable nonbankruptcy law. *See* COLLIER ON BANKRUPTCY ("COLLIER") ¶ 362.05[4] (16th ed. 2020).

REMEDIES FOR VIOLATION OF THE AUTOMATIC STAY

Actions taken in violation of the stay are generally void. *See* COLLIER at ¶ 362.12[1] (noting that although a minority of courts find that actions violating the stay are merely voidable, the majority rule is that such actions are void *ab initio*). Section 362(k)(1) of the Bankruptcy Code grants a cause of action for willful stay violations, providing that "an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages."

However, section 342(g)(2) of the Bankruptcy Code provides that a "monetary penalty" may not be imposed on a creditor under section 362(k) for violation of the stay unless the conduct that is the basis for the violation occurs after the creditor has received notice of the filing of the bankruptcy case.

Because section 362(k)(1) refers to an "individual," rather than the "trustee" or the "debtor," the provision has generated a fair amount of controversy concerning whether it can be invoked only by a "natural person," as distinguished from a business debtor, a trustee, a creditor, or another stakeholder. *See* COLLIER at ¶ 362.12[3] (citing and discussing cases and noting that "[t]here is little reason to adopt a tortured reading of the statute in order to provide corporate or partnership debtors or trustees with a remedy for stay violations"). For example, some courts have ruled that a bankruptcy trustee is not "an individual" under section 362(k). *See, e.g., Havelock v. Taxel (In re Pace)*, 67 F.3d 187, 193 (9th Cir. 1995); *In re Fiddler Gonzalez & Rodriguez, P.S.C.*, 415 F. Supp. 3d 297, 301–02 (D.P.R. 2019); *In re Morgenstern*, 542 B.R. 650, 658–59 (Bankr. D.N.H. 2015). However, the unavailability of relief under section 362(k) does not preclude a trustee from seeking the imposition of sanctions as an exercise of the bankruptcy court's civil contempt powers under section 105(a), which provides that the court may "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." *Spookyworld, Inc. v. Town of Berlin (In re Spookyworld)*, 346 F.3d 1, 8 (1st Cir. 2003); *Pace*, 67 F.3d at 193; *Fiddler Gonzalez*, 415 F. Supp. 3d at 302; *In re O'Malley*, 601 B.R. 629, 660 (Bankr. N.D. Ill. 2019).

TAGGART

In *Taggart*, the Supreme Court ruled that a bankruptcy court may hold a creditor in civil contempt for attempting to collect on a debt that has been discharged in bankruptcy "if there is *no fair ground of doubt* as to whether the [discharge] order barred the creditor's conduct." In so ruling, the Court vacated and remanded a ruling by the U.S. Court of Appeals for the Ninth Circuit rejecting a "strict liability" standard and applying a subjective standard under which a creditor may not be held in civil contempt if it has a "good faith belief" that the discharge order does not bar collection, even if that belief is unreasonable.

Section 727(b) of the Bankruptcy Code states that "[e]xcept as provided in section 523 [excepting certain debts from discharge] . . . , a discharge under . . . this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter." Section 524(a)(2) of the Bankruptcy Code provides that a discharge order "operates as an injunction" barring creditors from collecting any debt that has been discharged.

Writing for a unanimous Court in *Taggart*, Justice Breyer explained that the Court's determination was informed by sections 524(a)(2) and 105(a). According to Justice Breyer, "[T]hese provisions authorize a court to impose civil contempt sanctions when there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful under the discharge order."

Sections 524(a)(2) and 105(a), Justice Breyer noted, bring with them "the old soil" of historical equity jurisprudence, which traditionally empowered courts to impose civil contempt sanctions to coerce compliance with an injunction or to compensate a complainant for noncompliance. Because an objective standard has generally been applied to this issue in nonbankruptcy cases, Justice Breyer reasoned that the same "fair ground of doubt" standard should apply in the bankruptcy context. "[C]ivil contempt therefore may be appropriate," he wrote, "when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope."

Justice Breyer faulted the Ninth Circuit's standard as being inconsistent with traditional civil contempt principles and unfair to "debtors [forced] back into litigation (with its accompanying costs) to protect the discharge that it was the very purpose of the bankruptcy proceeding to provide." He was equally critical of the strict liability standard imposed by the bankruptcy court, noting that such a standard might provoke a flood of costly litigation by risk-averse creditors seeking an advance determination as to the scope of a discharge order.

Finally, Justice Breyer rejected the debtor's argument that a strict liability standard is appropriate because many courts have applied such a standard in remedying violations of the automatic stay. According to Justice Breyer, the specific language regarding sanctions for a stay violation in section 362(k)(1) differs from the more general language of section 105(a). Moreover, he wrote, "The purposes of automatic stays and discharge orders also differ: A stay aims to prevent damaging disruptions to the administration of a bankruptcy case in the short run, whereas a discharge is entered at the end of the case and seeks to bind creditors over a much longer period."

In *Jeong*, a Ninth Circuit Bankruptcy Appellate Panel considered whether the *Taggart* standard should apply to automatic stay violations.

JEONG

Moo and Myoungja Jeong (together, the "debtors") hired Min W. Suh ("Suh") as their attorney for the purpose of filing a joint chapter 7 case in the Central District of California in January 2019. At the time of the filing, the debtors owned a residence encumbered by three deeds of trust: a first-priority deed of trust in favor of an institutional lender; a second-priority deed of trust in favor of Young Soo Oh ("Oh"); and a third-priority deed of trust in favor of Christopher Kwon ("Kwon").

Because the legal descriptions appended to the deeds of trust in favor of Oh and Kwon did not accurately describe the property, the chapter 7 trustee demanded that Oh and Kwon consent to the avoidance and preservation of the liens for the benefit of the estate. However, claiming that he represented Oh and Kwon as well as the debtors, Suh prepared and recorded "corrective" deeds of trust on June 27, 2019, that remedied the defective property descriptions.

The trustee, claiming that postpetition recordation of the deeds violated the automatic stay, filed a motion to impose sanctions on the debtors, Suh, Oh, and Kwon. Suh argued that the actions were permitted under section 362(b)(3), which he claimed permits any and all steps necessary to perfect a security interest against property of the estate without limitation. According to Suh, recordation of the new deeds did not violate the stay because they merely corrected a minor mistake and related back to the pre-bankruptcy date of the original instruments. Finally, because the debtors hired new lawyers after he recorded the corrective instruments, Suh argued that he was not in contempt because he could not have remedied any alleged stay violation.

Before the bankruptcy court convened a final hearing on the contempt motion, the debtors, Oh, and Kwon settled with the trustee by paying $6,000 of the trustee's $10,000 in attorneys' fees and costs and by reconveying the deeds of trust.

The bankruptcy court concluded that Suh's actions amounted to a "clear-cut violation" of the automatic stay. The court accordingly entered an order holding Suh in contempt and imposing compensatory contempt sanctions against him in the amount of $4,000, representing the unpaid amount of the trustee's attorneys' fees and costs. In so ruling, the court found that when Suh recorded the new deeds of trust, he was aware of the automatic stay, he willfully violated the stay, and he "raised no fair ground of doubt that he should not be held in civil contempt." Suh appealed to a Ninth Circuit Bankruptcy Appellate Panel.

THE BANKRUPTCY APPELLATE PANEL'S RULING

A three-judge bankruptcy appellate panel affirmed the award of sanctions.

Citing *Taggart*, the court concluded that the bankruptcy court did not violate its discretion by finding Suh in contempt and relied on the appropriate standard in doing so. Addressing the standard for contempt in connection with an automatic stay violation, the panel noted that:

> We assume that the contempt standard applied to the discharge violation in *Taggart* also applies to a violation of the automatic stay. Neither the parties, nor the bankruptcy court, has suggested that any other standard should apply. Furthermore, application of the same contempt standard for stay violations and bankruptcy discharge violations is consistent with the Ninth Circuit's prior precedent holding that the same contempt standards apply to both violations of the automatic stay and violations of the discharge injunction. *See Zilog, Inc. v. Corning (In re Zilog, Inc.)*, 450 F.3d 996, 1008 n.12 (9th Cir. 2006), *partially overruled on other grounds by Taggart*, 139 S. Ct. at 1802.

The appellate panel rejected Suh's argument that recording the corrective deeds did not violate the automatic stay because, pursuant to sections 362(b)(3) and 546(b), recordation of the deeds related back to the time the original deeds were recorded prepetition. "[N]othing under California law," the court wrote, "gives holders of trust deeds any grace period or right to record corrective trust deeds for the purpose of obtaining priority over an intervening lien creditor or bona fide purchaser." Citing *Taggart*, the appellate panel agreed with the bankruptcy court's determination that "Suh's stay exception theory did not constitute a reasonable ground for Suh to doubt the applicability of the automatic stay to his actions."

The appellate panel also ruled that the bankruptcy court did not abuse its discretion by directing Suh to pay the outstanding balance of the trustee's attorneys' fees and costs as a compensatory civil contempt sanction. Finally, although the appellate panel concluded that the trustee could not recover attorneys' fees and costs incurred in defending Suh's appeal under section 362(k) (citing *Pace*, 67 F.3d at 193), it held that he could recover such fees and double costs under Rule 8020(a) of the Federal Rules of Bankruptcy Procedure, which authorizes a district court or a bankruptcy appellate panel to "award just damages and single or double costs to the appellee" if the court determines that an appeal is frivolous.

OUTLOOK

Jeong is not the only case finding that the *Taggart* standard applies to willful violations of the automatic stay. For example, in *Tate v. Fairfax Village I Condominium*, 2020 WL 634293, at *3 n.2 (Bankr. D.D.C. Feb. 10, 2020), the court cited *Taggart* in finding a willful violation of the stay in a chapter 13 case and imposing sanctions under section 362(k)(1).

Other courts have been more equivocal on the issue. *See, e.g., In re Franklin*, 2020 WL 570092, at *8 (Bankr. M.D.N.C. Jan. 24, 2020) (in a chapter 13 case involving a request for automatic stay violation sanctions under section 362(k), noting the distinction between a discharge injunction and the automatic stay and stating that "[e]ven if the standard in *Taggart* applied to § 362(k), no reasonable creditor objectively could have believed [the creditor's] actions in this case did not violate the automatic stay"); *In re Spiech Farms, LLC*, 603 B.R. 395, 408 n.22 (Bankr. W.D. Mich. 2019) (in a chapter 7 case, stating that "[t]his court does not read *Taggart* to change the Sixth Circuit's standard for determining whether a creditor can be held in contempt for violating the automatic stay") (citation omitted).

In *In re Bello*, 612 B.R. 389 (Bankr. E.D. Mich. 2020), the court, without mentioning *Taggart*, found that creditors in a chapter 11 case willfully violated the automatic stay and were subject to sanctions under section 362(k) by filing a motion seeking the appointment of a receiver of a nondebtor corporation wholly owned by the chapter 11 debtor because the creditors knew about the bankruptcy case and deliberately filed the receivership motion). Similarly, in *Chavez-Villasenor v. U.S. Dep't of Educ. (In re Chavez-Villasenor)*, 2020 WL 2062274 (Bankr. D. Or. Apr. 9, 2020), the court, without mentioning *Taggart*, found that the defendant willfully violated the automatic stay under section 363(k) when the government's computer system erroneously set off a postpetition tax refund against a prepetition debt.

These courts' differing approaches are unsurprising, in light of Justice Breyer's statements in *Taggart* concerning the differences in language between sections 362(k)(1) and 105(a) and the differences in purpose between the discharge injunction in section 524, which binds creditors over an extended period of time, and the automatic stay in section 362(a), which is of limited duration. Courts and commentators will surely continue to debate whether there should be a different standard applied to violations of the automatic stay, either willful (and therefore subject to section 362(k)(1)) or otherwise.

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USE OF CASH COLLATERAL TO PAY PREPETITION DEBT NOT PROHIBITED BY *JEVIC*

Charles M. Oellermann ■ Mark G. Douglas

The ability of a bankruptcy trustee or a chapter 11 debtor-in-possession ("DIP") to use "cash collateral" during the course of a bankruptcy case may be vital to the debtor's prospects for a successful reorganization. However, because of the unique nature of cash collateral, the Bankruptcy Code sets forth special rules that apply to the nonconsensual use of such collateral to protect the interests of the secured creditor involved. The U.S. Bankruptcy Court for the Eastern District of Washington examined these requirements in *In re Claar Cellars, LLC*, 2020 WL 1238924 (Bankr. E.D. Wash. Mar. 13, 2020). The court authorized a debtor to use cash collateral over the objection of a secured creditor because it found that the creditor's interest in the collateral was adequately protected. Moreover, the court concluded that the use of such collateral to pay in part a prepetition, allegedly secured debt owed to an affiliated debtor did not violate the U.S. Supreme Court's prohibition in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), against distributions that deviate from the Bankruptcy Code's priority scheme in the context of a "structured dismissal" of a chapter 11 case.

USE, SALE, OR LEASE OF ESTATE PROPERTY OUTSIDE ORDINARY COURSE

Section 363(b)(1) of the Bankruptcy Code provides in relevant part that "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." Courts generally apply some form of a business judgment test in determining whether to approve a proposed

use, sale, or lease under section 363(b)(1). *See ASARCO, Inc. v. Elliott Mgmt. (In re ASARCO, L.L.C.)*, 650 F.3d 593, 601 (5th Cir. 2011); *In re Stearns Holdings, LLC*, 607 B.R. 781, 792 (Bankr. S.D.N.Y. 2019); In re *Friedman's, Inc.*, 336 B.R. 891, 895 (Bankr. S.D. Ga. 2005); *see generally* COLLIER ON BANKRUPTCY ¶ 363.02 (16th ed. 2019). Under this deferential standard, a bankruptcy court will generally approve a reasoned decision by a trustee or DIP to use, sell, or lease estate property outside the ordinary course of business. *See In re Alpha Nat. Res., Inc.*, 546 B.R. 348, 356 (Bankr. E.D. Va.), *aff'd*, 553 B.R. 556 (E.D. Va. 2016). However, when a transaction involves an "insider," courts apply heightened scrutiny to ensure that the transaction does not improperly benefit the insider at the expense of other stakeholders. *See In re Alaska Fishing Adventure, LLC*, 594 B.R. 883, 887 (Bankr. D. Alaska 2018); *In re Family Christian, LLC*, 533 B.R. 600, 622, 627 (Bankr. W.D. Mich. 2015).

SPECIAL RULES FOR USE OF CASH COLLATERAL

If a trustee or DIP proposes to use estate property in the form of "cash collateral," special rules apply. Section 363(a) of the Bankruptcy Code defines "cash collateral" as "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest." Cash collateral also includes "the proceeds, products, offspring, rents, or profits of property . . . subject to a security interest." Section 101(51) of the Bankruptcy Code defines "security interest" as a "lien created by an agreement."

Generally, cash collateral is thought of as an asset that can dissipate or be consumed quickly, easily, and undetectably. And once gone, cash collateral is difficult to trace and recover. Because of this transient characteristic, Congress has codified special provisions in the Bankruptcy Code to account for cash collateral and restrict the use of it, to protect the rights of the creditor that holds a security interest in the cash collateral.

Under section 363(c)(4) of the Bankruptcy Code, a trustee or DIP is required to segregate and account for any cash collateral in its possession, custody, or control. This requirement applies to both cash collateral the debtor has on hand before the commencement of the bankruptcy case and any cash collateral the trustee or DIP acquires thereafter. Because the trustee or DIP has a duty to protect and maintain the cash collateral for the benefit of the one or more secured creditors that have an interest in the collateral, it is especially important to identify each secured creditor that has an interest in it.

Under section 363(c)(2) of the Bankruptcy Code, a trustee or DIP may not use, sell, or lease cash collateral without either: (i) the consent of each secured creditor with an interest in the collateral; or (ii) the court's authorization. Often, a secured creditor will allow the DIP to use cash collateral for specific purposes to keep the business operational, under certain terms and conditions. This type of agreement benefits the secured creditor because it maintains the debtor's business as a going concern, thereby preserving the value of the secured creditor's interest in the collateral.

Pursuant to section 363(e), if the secured creditor and the trustee or DIP cannot agree on a proposed use of cash collateral, the court may grant such permission, provided that the secured creditor's interest in the collateral is adequately protected. Under section 363(p), the trustee or DIP bears the burden of proving that it can adequately protect the secured creditor's interest in the cash collateral. Even though section 363(c)(2) requires notice and a hearing before the court can grant permission to use cash collateral, the court may, and often does, hear motions to use cash collateral on an expedited basis—particularly at the inception of a bankruptcy case. The court may conduct a preliminary hearing on the first day of the bankruptcy case to authorize the use of cash collateral for certain urgent and vital uses on an interim basis to prevent immediate and irreparable harm to the debtor's estate. The court typically convenes a later final hearing on the use of cash collateral.

JEVIC AND DISTRIBUTIONS INCONSISTENT WITH THE BANKRUPTCY CODE'S PRIORITY SCHEME

Chapter 11 cases culminate by either confirmation of a plan of reorganization or liquidation that becomes effective; conversion to a chapter 7 case; or dismissal of the case. In the case of dismissal, section 349(b) of the Bankruptcy Code is designed to reinstate as nearly as possible the pre-bankruptcy status quo unless the court orders otherwise "for cause." Prior to *Jevic*, some courts relied on this provision to approve "structured dismissals" of chapter 11 cases that include some provisions, rights, and protections typically seen in chapter 11 plan confirmation orders, including provisions for distributions to creditors. In some instances, these distributions deviated from the Bankruptcy Code's priority scheme.

In *Jevic*, the Supreme Court held that bankruptcy courts may not deviate from the Bankruptcy Code's priority scheme when approving structured dismissals without the consent of creditors (without, however, offering any "view about the legality of structured dismissals in general").

The Court's 6-2 majority distinguished cases in which courts have approved interim settlements resulting in distributions of estate assets in violation of the priority rules, such as *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007). The majority found that *Iridium* "does not state or suggest that the Code authorizes nonconsensual departures from ordinary priority rules in the context of a dismissal—which is a final distribution of estate value—and in the absence of any further unresolved bankruptcy issues." In this sense, the majority explained, the situation in *Iridium* was similar to certain "first day" orders, where courts have allowed for, among other things, payments ahead of secured and priority creditors to employees for prepetition wages or to critical vendors on account of their prepetition invoices.

The majority further explained that "in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve." By contrast, the majority noted, the structured dismissal in *Jevic* served no such objectives (e.g., it did not benefit disfavored creditors by preserving the debtor as a going concern and enabling the debtor to confirm a plan of reorganization and emerge from bankruptcy). Rather, the majority emphasized, the distributions at issue "more closely resemble[d] proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards" (citing, among others, certain proposed section 363 asset sales).

CLAAR CELLARS

Claar Cellars LLC ("Claar") and RC Farms ("RC"), both of which are owned by the Whitelatch family ("Whitelatch"), operate 130 acres of vineyards in Washington. After RC harvests the grapes it produces, it sends the grapes to Claar, which processes them into wine and sells the wine. Under a 1997 purchase agreement, Claar is obligated to pay RC for the grapes Claar receives.

In January 2020, Claar and RC filed for chapter 11 protection in the Eastern District of Washington. RC asserted a secured claim against Claar in the amount of $330,000 on the basis of a state law creating a statutory lien for grape growers on the inventory and accounts receivable of wine producers to which the growers provide grapes.

As of the petition date, Claar and RC owed secured lender HomeStreet Bank ("HomeStreet") approximately $2 million. HomeStreet's prepetition collateral included personal property owned by both companies (including cash collateral) as well as real property owned by RC and a Whitelatch family trust.

After filing for bankruptcy, both debtors, whose cases were not consolidated, filed motions seeking court authority to use HomeStreet's cash collateral for the purpose of maintaining the real property (in the case of RC) and continuing operations. In the budget accompanying the motions, Claar proposed to make seven monthly payments to RC during 2020 in the aggregate amount of approximately $163,000 for grapes shipped to Claar prepetition. This amount represented roughly half of RC's prepetition secured claim. RC's representative testified that RC could not operate without the payments.

HomeStreet objected, arguing that: (i) the debtors were not adequately protecting HomeStreet's interest in its cash collateral; (ii) the proposed $163,000 in payments to RC would improperly satisfy a prepetition debt outside of a confirmed chapter 11 plan, thereby violating *Jevic*; and (iii) because the validity of RC's lien was questionable—an issue that needed to be adjudicated in an adversary proceeding—the court could not rely on the secured status of RC's claim to permit Claar's postpetition payments.

The adequate protection issue with respect to RC was resolved after RC agreed to grant HomeStreet a lien on another parcel of unencumbered real property and the court found that the value of the overall adequate protection package significantly exceeded the amount of HomeStreet's claim. HomeStreet, however, still objected to the proposed $163,000 in payments by Claar to RC.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court overruled HomeStreet's objections to the debtors' proposed uses of cash collateral.

At the outset of its opinion, the court stated that section 363(b)(1) is one of many provisions in the Bankruptcy Code "providing broad and flexible powers for courts to deploy to facilitate the rehabilitation of a given debtor based on the context of that debtor's case." Explaining its ruling, however, the court observed that "section 363(b)(1) is not a tool to obviate prohibitions found elsewhere in the Bankruptcy Code, no matter how inconvenient those prohibitions may be in a particular case." The court noted that the provision, while straightforward, is cabined, complicated, and throttled by other provisions of the Bankruptcy Code, applicable nonbankruptcy law, and judicially crafted limitations. This last group of limitations, for example, includes the prohibition against section 363(b) asset sales that amount to *sub rosa* chapter 11 plans evading the detailed confirmation requirements set forth in the Bankruptcy Code (citing *PBGC v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935, 940 (5th Cir. 1983)).

Against this backdrop, and applying heightened scrutiny to the transaction because of RC's status as an insider, the bankruptcy court approved the use of HomeStreet's cash collateral to make the payments to RC. According to the court, approval was warranted for five reasons:

(i) It was clear that RC possessed a secured claim against Claar in "some amount," and RC "articulated a colorable basis" under which it might be oversecured, which warranted periodic cash payments to RC as a form of adequate protection of its interest in Claar's property;
(ii) The payments to RC were essential to RC's continued viability, which in turn justified RC's pledge of additional collateral to adequately protect HomeStreet's interest and "avoid[ed] the inequity that would result if the Claar estate got a completely fair ride on RC's credit support";
(iii) Claar received other indirect benefits from the continued viability of RC, including greater enterprise value generated by any sale of the Whitelatch-owned businesses as a consolidated package;
(iv) The risk associated with the payments was minimal because of the relatively small "value leakage" and the ability for "recalibration" of the amount realized by RC on its remaining claim in the claims resolution process; and

(v) An adversary proceeding was not required before Claar could make any periodic payments to RC, given that courts frequently approve partial payments to secured creditors, "despite potentially viable challenges to the validity, priority, or extent of the underlying lien that could be finally determined only via adversary proceeding."

According to the bankruptcy court, authorizing the use of HomeStreet's cash collateral to pay part of RC's prepetition claims did not offend *Jevic* because the "payments are 'interim' distributions under any meaning of that word in *Jevic*" and because the distributions "advance significant bankruptcy objectives without causing material (or perhaps any) harm to any other creditor."

HomeStreet also argued that the proposed payments to RC could not be approved as a first-day "critical vendor" motion, which some courts have sanctioned under the "doctrine of necessity." However, because the debtors could not establish that RC was a critical vendor and disclaimed any reliance on this theory to justify the payments, the court declined to address the continued viability of the practice.

OUTLOOK

Claar Cellars is a primer on section 363(b) and the circumstances under which a DIP can use cash collateral over the objection of a secured creditor. However, the ruling is also notable for its commentary on the scope of *Jevic* in the context of a proposed non-ordinary course use, sale, or lease of estate property under section 363(b).

Claar Cellars is not the only recent court ruling concluding that *Jevic* has limited application to proposed transactions under section 363(b). For example, in *In re Old Cold LLC*, 879 F.3d 376 (1st Cir. 2018), the U.S. Court of Appeals for the First Circuit ruled that *Jevic* did not apply to an asset sale under section 363(b). The court rejected the argument that a winning bid in an auction sale that provided for the payment of certain unsecured claims before administrative claims impermissibly violated the priority rules in contravention of *Jevic*. Instead, the court applied section 363(m) of the Bankruptcy Code to render statutorily moot an appellate challenge to a sale to a good-faith purchaser because the sale order had not been stayed pending appeal. According to the First Circuit, "Section 363(m) sets forth only two requirements: that there is a good faith purchaser, and that the sale is unstayed." It concluded that "[n]othing in *Jevic* appears to add an exception to this statutory text."

In *In re Daily Gazette Co.*, 584 B.R. 540 (Bankr. S.D.W. Va. 2018), the bankruptcy court ruled that *Jevic*'s prohibition against nonconsensual structured dismissal settlements that deviate from the Bankruptcy Code's priority scheme did not affect a chapter 11 debtor's ability to sell its assets with the intention of using the sales proceeds to pay administrative claims followed by a distribution to a secured creditor holding a blanket lien on the debtor's assets.

In *In re Nine W. Holdings, Inc.*, 588 B.R. 678 (Bankr. S.D.N.Y. 2018), the bankruptcy court approved a DIP's motion to retain and compensate a distressed management consultant under section 363(b) rather than the provisions of the Bankruptcy Code traditionally relied upon for professional retention and compensation requests in chapter 11 cases. According to the court, *Jevic* recognized that priority-skipping distributions are permissible when there are "significant Code-related objectives that the priority-violating distributions serve."

In *In re Veg Liquidation, Inc.*, 931 F.3d 730, 739 (8th Cir. 2019), the U.S. Court of Appeals for the Eighth Circuit noted that "even if the reasoning of *Jevic* on priority rules were extended to § 363 sales, it would not apply in the context of a consummated sale." According to the court, "Whatever force the Bankruptcy Code's priority rules might have at a sale approval hearing or on direct review of a § 363 sale, . . . a deviation from those rules does not render final judgments 'void.'"

Finally, although the court in *Claar Cellars* declined to address the continued viability of the "doctrine of necessity" in approving first-day critical vendor motions post-*Jevic*, other courts have held that the practice is sanctioned by the Supreme Court's ruling. For example, in *In re Murray Metallurgical Coal Holdings, LLC*, 2020 WL 1307378 (Bankr. S.D. Ohio Mar. 18, 2020), the court approved the payment of critical vendors at the inception of a bankruptcy case under section 363(b). Citing many other cases in which the practice has been sanctioned post-*Jevic*, the court wrote that "[t]he Supreme Court has recognized with apparent approval" the practice of authorizing payments to critical vendors where the payments would enable a successful reorganization, benefiting even disfavored creditors.

FROM THE TOP IN BRIEF

Brad B. Erens ▪ Mark G. Douglas

The U.S. Supreme Court recently handed down three rulings potentially impacting bankruptcy cases.

NUNC PRO TUNC *RELIEF*

In *Roman Catholic Archdiocese of San Juan v. Acevedo Feliciano*, No. 18-921, 2020 WL 871715 (U.S. Feb. 24, 2020), the Court circumscribed the use of *nunc pro tunc* ("now for then") orders that make relief ordered by a court apply retroactively to an earlier point in time.

The Catholic Church in Puerto Rico terminated a pension plan for employees of its school. A commonwealth trial court entered a judgment directing the church to pay $4.7 million and ordered seizure of its assets to satisfy the judgment. The Puerto Rico Supreme Court affirmed the trial court, and the Catholic Church appealed that decision to the U.S. Supreme Court. The problem was that, before the trial court entered its orders, the church had removed the litigation to federal district court, arguing that the case was related to a bankruptcy case that had been filed by the schools' pension trust. And a state court loses jurisdiction once a notice of removal is filed. The bankruptcy court did dismiss the bankruptcy case shortly before the trial court issued its orders in March 2018. However, the federal district court did not remand the removed litigation to the trial court until nearly five months later. It sought to address this lag with a *nunc pro tunc* judgment stating that the order "shall be effective" as of the date that the bankruptcy court dismissed the trust's bankruptcy case.

The U.S. Supreme Court ruled in its *per curiam* opinion that the trial court had no jurisdiction until the litigation was remanded and that its orders were therefore void. The *nunc pro tunc* order was not effective to cure the jurisdictional defect of the trial court's orders. The Court acknowledged that a federal court may issue a *nunc pro tunc* order to "reflect the reality of what has already occurred," but emphasized that such an order "presupposes a decree allowed, or ordered, but not entered, through inadvertence or error." This was not the case here. The Court accordingly vacated the Puerto Rico Supreme Court's judgment without considering the merits of the appeal and remanded for further proceedings. Justice Alito, joined by Justice Thomas, filed a concurring opinion in which he agreed with the Court's jurisdictional ruling but highlighted certain of the important issues that might arise on remand regarding the liabilities of affiliated church entities.

Bankruptcy courts often grant certain relief *nunc pro tunc*, such as an order approving the retention of a professional retroactive to the date the retention application was filed or granting retroactive relief from the automatic stay. At least one bankruptcy court has already held that, under *Archdiocese of San Juan*, "utilizing *nunc pro tunc* orders to approve the retention of estate professionals retroactive to some date prior to the actual date of court approval is inappropriate." *See In re Benitez*, 2020 WL 1244109 (Bankr. E.D.N.Y. Mar. 13, 2020). According to the court, the "retroactive approval of the retention of an estate professional, whether it

be *nunc pro tunc*, post-facto or any similar nomenclature, is not mandated under the Code or Rules." Nevertheless, the court concluded that "neither the Code nor the Rules preclude an award of 'reasonable compensation' or reimbursement for 'actual, necessary expenses' pursuant to section 330 for services rendered prior to an order approving retention of the professional." The court wrote, "Simply stated, a professional must be retained as required by the statute, but once having been retained, the bankruptcy court is free to compensate him for services rendered to the estate at any time, pre and post-court approval, in accordance with section 330 of the Code." In addition, in *In re Telles*, No. 8-20-70325-reg (Bankr. E.D.N.Y. Apr. 30, 2020), the court cited *Archdiocese of San Juan* in denying a motion for a *nunc pro tunc* order vacating the automatic stay prior to a state court-authorized foreclosure sale because "there was never a determination by this Court vacating the stay prior to the foreclosure sale." In so ruling, the court wrote that "a *nunc pro tunc* order cannot bless a state court authorized foreclosure sale where the automatic stay has deprived the state court of such jurisdiction."

PROPERTY OF THE BANKRUPTCY ESTATE

In *Rodriguez v. FDIC*, No. 18-1269, 2020 WL 889191 (U.S. Feb. 25, 2020), the Court held that state law (together with any applicable federal rules), rather than federal common law, determines which member of a corporate group is entitled to a tax refund, in the absence of an unambiguous tax allocation agreement.

Writing for the Court, Justice Gorsuch concluded that the U.S. Court of Appeals for the Tenth Circuit should not have applied the "*Bob Richards* rule," a federal common-law rule based on the Ninth Circuit's decision in *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262 (9th Cir. 1973). As initially articulated, that rule provided that, in the absence of a tax allocation agreement between the members of a corporate group, "a refund belongs to the group member responsible for the losses that led to it" (citing *Bob Richards*, 473 F.2d at 265). However, Justice Gorsuch explained, the rule has evolved in some jurisdictions beyond a "stopgap rule" applying to cases without a tax allocation agreement to become "a general rule always to be followed unless the parties' tax allocation agreement unambiguously specifies a different result."

According to Justice Gorsuch, "[T]here is no federal general common law," and "only limited areas exist in which federal judges may appropriately craft the rule of decision," such as admiralty disputes and certain disputes between states. A new area for federal common lawmaking, Justice Gorsuch explained, may be claimed only if strict conditions are satisfied, including the requirement that such common lawmaking is necessary to protect uniquely federal interests. "Nothing like that exists here," he wrote, noting that the federal government does not have a unique interest in determining how a consolidated corporate tax refund, once paid to a designated agent, is distributed among group members.

The fact that the case involved corporate property rights in the context of a federal bankruptcy case and a tax dispute did not alter this conclusion. Justice Gorsuch noted that state law generally determines property rights in bankruptcy cases and that the Internal Revenue Code generally creates no property rights.

The Court vacated a $4.1 million tax refund given to the Federal Deposit Insurance Corporation (the "FDIC"), as receiver for a failed bank, rather than to the chapter 7 trustee for the bank's corporate parent, and remanded to the Tenth Circuit for further proceedings. On remand, the Tenth Circuit, applying Colorado law, held that the FDIC, as receiver for the failed bank, owned the federal tax refund. *See In re United W. Bancorp, Inc.*, 2020 WL 2702425 (10th Cir. May 26, 2020). It accordingly affirmed the judgment of the district court and remanded the case to the bankruptcy court for further proceedings.

STATE SOVEREIGN IMMUNITY

In *Allen v. Cooper*, No. 18-877, 2020 WL 1325815 (U.S. Mar. 23, 2020), the Court held that state sovereign immunity applies to copyrights as it does to patents. In reaching that conclusion, the Court explained its reasoning in *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006), which held that the U.S. Constitution's Bankruptcy Clause (Art. 1, § 8, cl. 4) abrogated states' sovereign immunity, and limited the case to that clause.

In a seminal decision that preceded *Katz*—*Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996)—a 5-4 majority of the Court held that congressional abrogation of a state's sovereign immunity requires "unequivocal statutory language" and a provision in the U.S. Constitution permitting Congress to encroach on a state's sovereign immunity. The ruling led to concerns that sovereign immunity would prevent a bankruptcy court from disallowing a claim filed by a state or permit a state to disregard the discharge of a debt in bankruptcy. In *Katz*, the Court ameliorated these concerns by holding that an action to avoid a preferential transfer is not barred by sovereign immunity because, in ratifying the Bankruptcy Clause, the states acquiesced in the subordination of whatever sovereign immunity they might otherwise have asserted in proceedings, such as preference avoidance litigation, brought to enforce a bankruptcy court's *in rem* jurisdiction (jurisdiction over property rights rather than individuals).

In *Allen*, a videographer copyrighted videos and photographs of a shipwreck that belonged to the state of North Carolina. The videographer sued for copyright infringement after the state later published some of the videos and photographs. A federal district court ruled that the videographer's cause of action was not barred by state sovereign immunity because Congress abrogated such immunity for copyright infringement in the Copyright Remedy Clarification Act of 1990 (the "CRCA"). The U.S. Court of Appeals for the Fourth Circuit reversed, ruling that the CRCA was invalid with respect to copyrights.

The Supreme Court upheld the Fourth Circuit's ruling. Writing for the Court, Justice Kagan initially noted that in *Florida Prepaid Postsecondary Ed. Expense Bd. v. College Savings Bank*, 527 U.S. 627 (1999), the Court ruled that a statute with the same language as the CRCA did not validly extinguish sovereign immunity with regard to patents because Congress could not use its power over patents in Article I of the Constitution to abrogate sovereign immunity. She wrote that "[w]e find that our decision in *Florida Prepaid* compels the same conclusion" with respect to copyrights.

Justice Kagan rejected the argument that *Katz* compelled a different result because *Katz* does not apply to copyrights. She explained that, in *Katz*, the Court ruled that "Article I's Bankruptcy Clause enables Congress to subject nonconsenting States to bankruptcy proceedings (there, to recover a preferential transfer). We thus exempted the Bankruptcy Clause from *Seminole Tribe*'s general rule that Article I cannot justify haling a State into federal court." Justice Kagan also wrote that "[i]n bankruptcy, we decided, sovereign immunity has no place" and everything in *Katz* "is about and limited to the Bankruptcy Clause; the opinion reflects what might be called bankruptcy exceptionalism." The Bankruptcy Clause, she explained, "was *sui generis* . . . among Article I's grants of authority," and the states waived sovereign immunity in bankruptcy cases by having adopted the Constitution.

Finding no meaningful distinction between patents and copyrights, Justice Kagan concluded that the Court could reach no other result in light of *Florida Prepaid* and the principle of *stare decisis*, under which there must be "'special justification,' over and above the belief 'that the precedent was wrongly decided'" to reverse one of the Court's own precedents.

In his concurring opinion, Justice Thomas agreed that *Florida Prepaid* is binding precedent, but he disagreed with Justice Kagan's discussion of *stare decisis*. He also wrote that he continues to believe *Katz* was "wrongly decided." In his own concurring opinion, Justice Breyer, joined by Justice Ginsburg, reiterated his "longstanding view" that *Seminole Tribe* was wrongly decided.

LEGISLATIVE UPDATE

Mark G. Douglas

CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY (CARES) ACT

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136 (the "CARES Act"). The legislation, which earlier that day had quickly passed the House of Representatives, having passed 96-0 in the Senate on March 25, provides $2 trillion in economic stimulus to U.S. industries and citizens confronting the challenges of the COVID-19 pandemic.

Section 1113 of the CARES Act includes several important bankruptcy provisions designed to assist financially distressed consumers and small businesses. Key provisions include:

- Changes to the Small Business Reorganization Act of 2019 that increase the eligibility threshold for businesses filing under new subchapter V of chapter 11 of the Bankruptcy Code from $2,725,625 in debt to $7,500,000. The debt threshold will revert to $2,725,625 after one year.
- A clarification that the calculation of "disposable income" in section 1325(b)(2) of the Bankruptcy Code for purposes of confirming a chapter 13 plan does not include coronavirus-related payments.
- An amendment to the definition of "current monthly income" in section 101(10A) of the Bankruptcy Code to exclude coronavirus-related payments from the federal government for purposes of determining whether a debtor is eligible for relief under chapters 7 and 13.
- A change to section 1329 of the Bankruptcy Code to permit the modification of a chapter 13 wage earner plan after confirmation "if the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic" and to permit a post-modification creditor repayment plan of up to seven years after the initial plan payment was due.

These bankruptcy provisions sunset within one year.

Section 1102 of the CARES Act provides that any business that employs not more than 500 employees shall be eligible

to receive a forgivable loan under the Small Business Act of as much as $10 million to be used for employee payroll and related benefits, mortgage payments, rent, utilities, and certain other expenses. Although the CARES Act says nothing about excluding companies in bankruptcy from receiving Paycheck Protection Program loans, on April 15, 2020, the Small Business Administration released an interim rule stating that companies in bankruptcy are not eligible for loans under the program and that any company that files for bankruptcy before receiving funds under the program must withdraw its application. The rule almost immediately led to litigation seeking to preclude or enjoin its enforcement. *See, e.g., Hidalgo County Emergency Serv. Foundation v. Carranza (In re Hidalgo County Emergency Serv. Foundation)*, No. 20-02006 (Bankr. S.D. Tex. Apr. 25, 2020); *Calais Regional Hospital v. Carranza (In re Calais Regional Hospital)*, No. 20-1006 (Bankr. D. Maine May 1, 2020); *Roman Catholic Church of the Archdiocese of Santa Fe v. U.S. (In re Roman Catholic Church of the Archdiocese of Santa Fe)*, No. 20-1026 (Bankr. D.N.M. May 1, 2020); *Springfield Hospital, Inc. v. Carranza (In re Springfield Hospital, Inc.)*, No. 19-10283 (Bankr. D. Vt. May 4, 2020).

Section 4003(D) of the CARES Act authorizes the Secretary of the Treasury to provide financing to banks that make direct, low-interest loans to eligible businesses with between 500 and 10,000 employees, provided that the borrower certifies, among other things, that: (i) the funds it receives will be used to retain at least 90 percent of the recipient's workforce, at full compensation and benefits, until September 30, 2020; (ii) the recipient will not pay common stock dividends or repurchase its stock while the loan is outstanding, except as contractually obligated to do so as of the enactment date; (iii) the recipient will not outsource or offshore jobs or abrogate collective bargaining during the term of the loan and for two years afterward; and (iv) "the recipient is not a debtor in a bankruptcy proceeding."

A more detailed summary of the CARES Act is available here.

PROPOSED AMENDMENTS TO COMMODITY FUTURES TRADING COMMISSION BANKRUPTCY RULES

On April 14, 2020, the Commodity Futures Trading Commission approved proposed amendments to Part 190 of its rules governing bankruptcy proceedings of commodity brokers, including futures commission merchants and derivatives clearing organizations. The proposed amendments, intended to update Part 190 comprehensively to reflect current market practices, include provisions: (i) establishing a policy preference for transferring (rather than liquidating) positions of public customers and their proportionate share of associated collateral; (ii) establishing a new subpart C to Part 190 to govern the bankruptcy of derivatives clearing organizations; and (iii) augmenting the discretion given to bankruptcy trustees to adapt to the unique characteristics of a particular commodity broker bankruptcy.

The comment period on the proposed amendments expires July 13, 2020.

NEWSWORTHY

Jones Day ranks No. 1 in the *Acritas US Law Firm Brand Index 2020*, a report ranking the top law-firm brands in the United States. This is the ninth year of the *Index* and the fourth consecutive year the Firm earned the top spot. Jones Day is the only law firm to retain its position in the *Index* from last year.

Lucas Wilk (Perth), ***Roger Dobson (Sydney)***, ***Katie Higgins (Sydney)***, and ***Tim L'Estrange (Melbourne and Sydney)*** were recognized in the 2021 edition of *The Best Lawyers™ in Australia* in the field of Insolvency & Reorganization Law.

Heather Lennox (Cleveland and New York), ***Kevyn D. Orr (Washington)***, ***Carl E. Black (Cleveland)***, ***Robert W. Hamilton (Columbus)***, ***Thomas M. Wearsch (Cleveland)***, ***James O. Johnston (Los Angeles)***, ***Brad B. Erens (Chicago)***, ***Jeffrey B. Ellman (Atlanta)***, ***Corinne Ball (New York)***, ***Bruce Bennett (Los Angeles and New York)***, ***Charles M. Oellermann (Columbus)***, and ***Gregory M. Gordon (Dallas)*** were recognized in the area of Bankruptcy/Restructuring in *Chambers USA* 2020.

Heather Lennox (Cleveland and New York) was named a "Star Individual" in the area of Bankruptcy/Restructuring in *Chambers USA* 2020.

Fabienne Beuzit (Paris), ***Elodie Fabre (Paris)***, ***Dr. Olaf Benning (Frankfurt)***, ***Jasper Berkenbosch (Amsterdam)***, ***Erik Schuurs (Amsterdam)***, and ***Juan Ferré (Madrid)*** were recognized in the field of Insolvency and Restructuring in *The Legal 500 EMEA* 2020.

Corinne Ball (New York) was among the "Senior Statespeople" recognized by *Chambers USA* 2020 in the field of Bankruptcy/Restructuring.

An article written by ***Carl E. Black (Cleveland)***, ***Mark J. Andreini (Cleveland; Insurance Recovery; Business & Tort Litigation)***, and ***Jonathan Noble Edel (Cleveland)*** entitled "Creditors at the Gate: How Good Are Your Indemnities and D&O Insurance?" will be published in the June 2020 edition of *Pratt's Journal of Bankruptcy Law*.

An article written by ***Corinne Ball (New York)*** entitled "Empire Generating: Majority Lender Is Poised To Control Outcome Using Credit Bid" appeared in the April 22, 2020, issue of the *New York Law Journal*.

BUSINESS RESTRUCTURING REVIEW

The *Business Restructuring Review* is a publication of the Business Restructuring & Reorganization Practice of Jones Day.

Executive Editor: Charles M. Oellermann
Managing Editor: Mark G. Douglas

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