YOUNG CONAWAY STARGATT & TAYLOR, LLP

YCST BANKRUPTCY LITIGATION GROUP TREND WATCH

Young Conaway is pleased to provide you with the first edition of the YCST Bankruptcy Litigation Group Trend Watch, a service from Young Conaway that is designed to identify emerging trends in litigation oriented bankruptcy court decisions that will impact your practice and the business of your clients. We hope that you will find the YCST Bankruptcy Litigation Group Trend Watch helpful and, as always, we are happy to field any comments or questions that you may have regarding the issues addressed in this YCST Bankruptcy Litigation Group Trend Watch or the bankruptcy litigation practice generally.

COURT HOLDS THAT *STERN V. MARSHALL* DOES NOT REMOVE A BANKRUPTCY COURT'S AUTHORITY TO ENTER FINAL JUDGMENTS ON MOST CORE MATTERS

Burtch v. Seaport Capital, LLC (In re Direct Response Media, Inc.), 466 B.R. 626 (Bankr. D. Del. Jan. 12, 2012) (Gross, J.)

Applying a very narrow interpretation of the Supreme Court's decision in *Stern v. Marshall*, Judge Gross held that "*Stern* only removed a non-Article III court's authority to finally adjudicate one type of core matter, a debtor's state law counterclaim asserted under § 157(b)(2)(C)", and that "*Stern* does not remove the bankruptcy courts' authority to enter final judgments on other core matters, including the authority to finally adjudicate preference or fraudulent conveyance actions."

STATE TAX AGENCIES HAVE NO SOVEREIGN IMMUNITY FROM STATE LAW FRAUDULENT TRANSFER CLAIMS

Zazzali v. Swenson (In re DBSI, Inc.), 463 B.R. 709 (Bankr. D. Del. Jan. 27, 2012) (Walsh, J.)

Defendant state tax agencies moved to dismiss the plaintiff's § 544(b)(1) fraudulent transfer claims contending that § 106 did not abrogate sovereign immunity with respect to fraudulent transfer claims brought under state law. Drawing on the Supreme Court's decision in *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006), the bankruptcy court denied the motion and held: (i) that Congress's power to enact bankruptcy legislation was understood to carry with it the power to subordinate state sovereignty; (ii) that avoiding fraudulent transfers and recovering the attendant property fell within the scope of what Congress could authorize bankruptcy courts to do; and (iii) that § 106(a)(1) abrogated sovereign immunity for certain sections of the Bankruptcy Code, including § 544(b)(1).

INSURER'S CONTINGENT CLAIM FAILS TO SERVE AS THE BASIS FOR SETOFF

In re WL Homes LLC, et al., 471 B.R. 349 (Bankr. D. Del. May 16, 2012) (Shannon, J.)

An insurance company's motion for stay relief to setoff a return premium under the debtor's prepetition insurance policy against the insurer's potential defense costs was denied for lack of "cause" because it failed to establish that applicable non-bankruptcy law

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About Young Conaway Stargatt & Taylor, LLP

Young Conaway Stargatt & Taylor, LLP, with offices in New York and Delaware, counsels and represents national, international and local clients, handling sophisticated advisory and litigation matters involving bankruptcy, corporate law and intellectual property. Nearing its sixth decade, Young Conaway also guides regional businesses and

"would permit this type of contingent claim to serve as the basis for setoff." The bankruptcy court further held that, even if applicable non-bankruptcy law permitted a setoff in that context, stay relief was not warranted because it was questionable whether the insurer's "claim" for potential defense costs had arisen prepetition and "[t]o setoff under § 553 there can be no question that 'liability has attached to the debt as of the petition date . . .'"

SECTION 548(a) TWO-YEAR LOOK-BACK PERIOD IS NOT A STATUTE OF LIMITATIONS AND THEREFORE CANNOT BE EQUITABLY TOLLED

Indus. Enters. of Am., Inc. v. Burtis, 2012 Bankr. LEXIS 325 (Bankr. D. Del. Jan. 24, 2012) (Shannon, J.)

The bankruptcy court held that § 548(a)'s two-year look-back period is not a statute of limitations, but rather is "a substantive element of a § 548 cause of action, and therefore cannot be equitably tolled."

COURT ALLOWS PLAINTIFF'S SECOND ATTEMPT TO AMEND COMPLAINT

Capmark Fin. Grp. Inc. v. Lin (In re Capmark Fin. Grp.), 479 B.R. 330 (Bankr. D. Del. Aug. 27, 2012) (Sontchi, J.)

Judge Sontchi denied a motion to dismiss for violation of Bankruptcy Rule 7015 holding that, although the plaintiffs' first amended complaint was void since it was filed after the applicable deadline without leave of the court or consent of defendant, the plaintiffs' second attempt to file and serve their amended complaint was timely as it was filed within 21 days after the service of defendant's motion to dismiss. Alternatively, the bankruptcy court held that, even if the plaintiffs' second attempt to file and serve their amended complaint was an "impermissible second bite at the apple and was void," the plaintiffs' motion for leave to file an amended complaint was granted.

POST-CONFIRMATION ACTION DISMISSED FOR LACK OF SUBJECT MATTER JURISDICTION

Triad Guaranty Ins. v. American Home Mortgage Investment Corp., et al., 477 B.R. 517 (Bankr. D. Del. Aug. 27, 2012) (Sontchi, J.)

An insurer initiated a post-confirmation action against certain debtors and non-debtor owners of plaintiff's insured mortgage loans seeking to rescind its insurance obligations to the owners. Judge Sontchi granted the non-debtor defendants' motion to dismiss for lack of subject matter jurisdiction on the grounds that: (i) the insurer failed to meet its burden to demonstrate a "close nexus" between the rescission action and the debtors' plan or bankruptcy cases; and (ii) the rescission action arose solely under state law and did not "arise in" the debtors' bankruptcy cases or "arise under" the Bankruptcy Code.

COURT ANALYZES ORDINARY COURSE OF BUSINESS AND NEW VALUE DEFENSES AND REDUCES DEFENDANTS' PREFERENCE EXPOSURE

Burtch v. Revchem Composites, Inc., f/n/a Revchem Plastics, Inc., 463 B.R. 302 (Bankr. D. Del. Jan. 4, 2012) (Sontchi, J.)

Defendants filed a motion for summary judgment contending that certain payments were not preferential under the "ordinary course of business" defense of § 547(c)(2) or the "subsequent new value" defense of § 547(c)(4). Judge Sontchi denied the motion as to the ordinary course of business defense finding that the parties' relationship prior to the 90-day preference period was insufficient evidence for the defendants to meet their burden to establish the applicability of the ordinary course of business defense. The bankruptcy court, however, granted the motion in part with respect to the subsequent new value defense and calculated the defendants' preference exposure after applying that defense.

PLAINTIFF ENJOINED FROM ASSERTING CAUSE OF ACTION AGAINST TRUSTEE OF A LIQUIDATING TRUST UNDER THE *BARTON* DOCTRINE

In re DBSI, Inc. et al., 2012 Bankr. LEXIS 3558 (Bankr. D. Del. Aug. 2, 2012) (Walsh, J.)

Movants sought permission to add the trustee of the liquidating trust (in his capacity as trustee) as a defendant in a pending state court action. The trustee had already been named as a defendant in his individual capacity. Applying the Barton doctrine as set forth in the plan confirmation order, Judge Walsh denied the motion because one of the movants, as a holder of a claim against a debtor, was subject to the plan injunction and therefore was specifically enjoined from asserting any cause of action against the trustee. The bankruptcy court denied the motion for the additional reason that the plan injunction covered the assets of the liquidating trust.

COURT GRANTS MOTION FOR PROTECTIVE ORDER FINDING THAT CERTAIN AFFIDAVITS WERE PROTECTED ATTORNEY WORK PRODUCT

Burtch v. Luminescent Sys., Inc, (In re AE Liquidation, Inc.), 2012 Bankr. LEXIS 5710 (Bankr. D. Del. Dec. 11, 2012) (Walrath, J.)

Judge Walrath granted defendants' motion for a protective order concerning two affidavits of former employees and related documents finding that those documents were protected attorney work product under Fed. R. Civ. P. 26(b)(3) and that plaintiff could not demonstrate the requisite "substantial need" for the documents to overcome the attorney work product protection.

WARN ACT CLASS ACTION COMPLAINT DISMISSED AS DEFICIENT

Sanchez v. AFA Foods (In re AFA Inv., Inc.), 2012 Bankr. LEXIS 5764 (Bankr. D. Del. Dec. 14, 2012) (Walrath, J.)

Judge Walrath dismissed a class action complaint based on alleged WARN Act violations finding that the complaint was deficient because it pleaded almost no facts in support of the claims and the putative class representative failed to plead there were sufficient job losses under 29 U.S.C. § 2101(a) at any of the applicable sites. The bankruptcy court, however, granted plaintiff 30 days to amend the complaint.

FEE SERVICES AGREEMENT NOT AMBIGUOUS AND CLAIMANT ENTITLED ONLY TO A MONTHLY ADVISORY FEE RATHER THAN A PERCENTAGE TRANSACTION FEE

In re Abitibibowater Inc., et al., 2012 Bankr. LEXIS 5729 (Bankr. D. Del. Dec. 12, 2012) (Carey, J.)

A creditor filed a proof of claim contending that it was entitled it to a 2% fee for certain transaction-related services that it provided to the debtors. The debtors (and later, the post-confirmation agent with authority to object to claims), objected to the claim asserting that the claimant was only entitled to a $100,000 per month advisory fee in accordance with the terms of the parties' contract. The claimant filed a motion seeking to have the bankruptcy court interpret the meaning of the parties' agreement. The bankruptcy court denied the motion and sustained the claim objection. Applying applicable state law, the bankruptcy court concluded that the contract was not ambiguous, and the claimant was entitled only to a monthly advisory fee and not a percentage transaction fee.

COMMITTEE'S CLAIMS DISMISSED FOR FAILURE TO ESTABLISH THAT DEFENDANT'S BREACH CAUSED ANY DAMAGES TO DEBTORS OR OTHER CREDITORS

Official Comm. of Unsecured Creditors of Champion Enters., Inc., v. Credit Suisse et al., 2012 Bankr. LEXIS 4009 (Bankr. D. Del. Aug. 30, 2012) (Gross, J.)

The committee initiated an action seeking an award of damages against and disallowing claims by defendant based on alleged breaches of a credit agreement. The bankruptcy court dismissed the claims against the defendant finding that, although defendant breached the credit agreement, the committee failed to establish that defendant's breach caused any damages to the debtors or other creditors.

If you have any questions or would like to discuss the decision further, please contact any of the Bankruptcy Litigation Group members at Young Conaway. The Firm is also available for complimentary Delaware Update CLE programs to address any aspects of Delaware law that are of interest to our friends and colleagues around the country.