PROGRAM SUMMARY 8-26-23
By: Gary Wallace-Program Summary Committee Chair

CDCBAA Holds Seventh Meeting and MCLE Program of 2023: "SETTLEMENT AGREEMENTS and ADVERSARY PROCEEDINGS 101, Part II"

On August 26, 2023, the CDCBAA held its seventh members meeting and MCLE program of the year. The meeting and program were conducted as a live webinar via Zoom video. The program topics were: **"SETTLEMENT AGREEMENTS and ADVERSARY PROCEEDINGS 101, Part Two."** Our distinguished speakers were John Tedford, Esq. | Danning, Gill, Israel & Krasnoff, LLP, Robert S. Marticello | Smiley Wang-Ekvall, LLP and Hon. Wayne Johnson | Bankruptcy Judge, Central District of California, Riverside Division. CDCBAA president-elect and current board member Hale Andrew Antico moderated. What follows are some of the highlights of the seminar.

During the first hour, Messrs. Tedford and Marticello spoke regarding settlement agreements. Their discussion points addressed the following issues: when some settlements may be characterized as sales; the importance of choosing the date on which the settlement is effective; prevailing-party attorneys' fees clauses; the timing and scope of releases, and the distinction between liquidated damages provisions and enforceable penalty provisions.

Mr. Tedford began by discussing the legal authority for a trustee to settle or compromise claims. The most frequently cited authority is FRBP 9019 ("On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement."), even though the language of that rule does not explicitly give such authority. Section 27 of the former Bankruptcy Act also contains helpful language ("The . . . trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms and he may deem for the best interest of the estate."), and the broad language of 11 U.S.C. § 105(a) ("The court may issue any order . . . that is necessary or appropriate to carry out the provisions of this title.") has also been invoked on occasion.

Mr. Marticello pointed out that sometimes 11 U.S.C. section 363(b)(1) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.") comes into consideration when a question is raised as to whether the proposed settlement is, in reality, a sale. The case *In re Mickey Thompson Ent. Grp., Inc.*, 292 B.R. 415 (9th Cir. BAP 2003) was discussed as one example. There, the BAP determined that the estate would not receive anything else of value under the settlement because no party had identified any claims which the settling parties could assert against the estate. Thus, the settlement was held to be a *purchase* by the settling parties of a chose in action of the estate. The BAP held that the trustee had not shown that the proposed settlement was fair and

equitable under section 363, and that the interests of creditors would be better served by allowing interested parties to offer bids. Mr. Marticello pointed out that there is authority for taking a somewhat different view and mentioned *In re Open Med. Inst., Inc.*, 639 B.R. 169 (9th Cir. BAP 2022) (bankruptcy courts do not always need to examine a settlement as a sale)).

Mr. Tedford discussed what other provisions might come into play if a settlement is deemed a sale. He mentioned 11 U.S.C. § 363(i) (If the estate property is community property, a nondebtor spouse may purchase the property at the price at which such sale is to be consummated). Also, 11 U.S.C. § 363(m) may become an issue (the validity of a sale is not affected by the reversal or modification on appeal if the buyer purchased the property in good faith, unless the authorization of the sale and the sale is stayed pending appeal). This occurred in *In re Berkeley Delaware Court*, LLC, 834 F.3d 1036 (9th Cir. 2016).

Mr. Tedford then addressed the issue of when a settlement agreement should become effective. His preferred date is the date that the Court enters its order approving the settlement. A second, but less desirable, option is to have the agreement become effective when the time to appeal has expired (or when any appeals have concluded). However, this option gives opposing parties a 'free' stay pending appeal and could leave things in limbo for years. See, also, FRBP 8002(d)(1)(B) (up to 21 days after the 14-day period expires, the court may extend the time to appeal if the party requesting the extension shows excusable neglect.).

Messrs. Tedford and Marticello then turned to the issue of the advisability of including a provision awarding attorneys' fees to the prevailing party in the event of a breach of the settlement agreement. Factors to consider in deciding whether to have one include: 1) who seems most likely to breach; and 2) the likelihood of collectability in the event of a breach. Several noteworthy cases addressing the "prevailing party" issue were mentioned, including *In re Penrod*, 802 F.3d 1084 (9th Cir. 2015).

Messrs. Tedford and Marticello then discussed the timing and scope of released parties in a bankruptcy settlement. On the timing question, it was suggested that, even if the release is going to be effective on the effective date of the agreement, counsel should still consider starting the relevant paragraph(s) with "As of the Effective Date . . .." Also, if one party is required to pay money to the other, consider starting the paragraph providing for the release of the payee with "As of the date on which Party A receives the Settlement Payment . . .." Alternatively, make the release effective 60-90 days after receipt of payment.

Regarding the scope of releases, it was noted that, in general, trustees will not agree to give broad releases of unknown claims because they can't properly assess and value what they don't know. A cautionary tale was discussed using *Fuls v. Shastina Props., Inc.*, 448 F.Supp. 983 (N.D. Cal. 1978) (release of corporate debtor's liability would have, unintendedly, released the officer's alleged alter ego liability).

Finally, Messrs. Tedford and Marticello touched on the distinction between liquidated damages and penalties in settlements. Here, California Civil Code § 1671(b) may apply: "[A] provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." It was noted that courts normally look beyond the language of the contract to determine whether a term is a valid liquidated

damages clause. See *Graylee v. Castro*, 52 Cal.App.5th 1107 (2020); see also *Ridgley v. Topa Thrift & Loan Assn*., 17 Cal.4th 970 (1998) (a liquidated damages clause will generally be considered unreasonable, and therefore unenforceable, if it "bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach.").

During the next hour and a half, Judge Johnson spoke regarding adversary proceedings. This was the second part of his multi-part presentation on this topic. He covered motions to dismiss, amending pleadings, the jurisdictional issues that arise between state court actions and adversary proceedings, initial status conferences, and (very briefly) discovery. What follows is a summary of the highlights of his presentation.

Regarding motions to dismiss, Judge Johnson discussed Rule 7012, which incorporates FRCP 12(b)-(i) by reference in adversary proceedings. He presented several theoretical scenarios in which motions to dismiss raise several different types of arguments, and he then explained how they might be processed. Several cases were mentioned which identify the standard of review: e.g., *Farina v. Hoskins (In re Farina)*, 2023 Bankr. LEXIS 2029, *7 (9th Cir. BAP August 18, 2023): "In assessing the adequacy of the complaint, the court must accept all pleaded facts as true and construe them in the light most favorable to the plaintiff. See *Cousins v. Lockyer*, 568 F.3d 1063, 1067 (9th Cir. 2009)." Judge Johnson stated that, in most cases, leave to amend (where it appears possible to do so) will be granted even if the motion to dismiss is meritorious. Judge Johnson also cautioned against bringing motions to dismiss that might have unintended consequences, such as possibly creating a lingering thought in the judge's mind that there may be some truth to the allegations. Sometimes it is better to simply answer the complaint (with the proper affirmative defenses) and move directly to the discovery phase to obtain the necessary evidence to hopefully defeat the complaint. Judge Johnson also pointed out FRCP Rule 9(b) & FRBP Rule 7009(b): "Fraud or Mistake; Conditions of Mind. In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally."

Next, Judge Johnson discussed amending complaints. He addressed Rule 7015, which incorporates by reference Rule 15 F.R.Civ.P. in adversary proceedings. Rule 15 of the Federal Rules of Civil Procedure states, in part that a party "…may amend its pleading once as a matter of course within: (A) 21 days after serving it, or (B) if the pleading is one to which a responsive pleading is required, 21 days after service of a responsive pleading or 21 days after service of a motion under Rule 12(b), (e), or (f), whichever is earlier." Judge Johnson also pointed out that a plaintiff has only one opportunity to unilaterally file an amended complaint within twenty-one days of the filing of the first motion to dismiss, but not thereafter or for a subsequent motion to dismiss absent a stipulation or court approval. Also, a properly filed amended complaint moots a pending motion to dismiss. See *Ramirez v. County of San Bernardino*, 806 F.3d 1002, 1007 (9th Cir. 2015).

Judge Johnson then turned to the distinction between exclusive jurisdiction versus concurrent jurisdiction in the context of bankruptcy court adversary proceedings. He noted that bankruptcy courts have exclusive jurisdiction over *some* section 523 causes of action and concurrent jurisdiction over others. See *In re Bowen*, 102 B.R. 752 (9th Cir. BAP 1988). He further noted the following language from 4 Collier on Bankruptcy ¶ 523.03, which succinctly

states that "… the bankruptcy court has exclusive jurisdiction of most dischargeability determinations under subsections 523(a)(2), (4) and (6). For all the other exceptions to discharge enumerated in section 523(a), jurisdiction may be exercised by either the bankruptcy court or the state or other nonbankruptcy court. *In re Crawford*, 33 C.B.C.2d 1427, 183 B.R. 103 (Bankr. W.D. Va. 1995); see *Cummings v. Cummings*, 244 F.3d 1263 (11th Cir. 2001) (concurrent jurisdiction for proceedings under section 523(a)(5)); *In re Siragusa*, 27 F.3d 406 (9th Cir. 1994) (same)."

The question of whether a bankruptcy *should* exercise jurisdiction to decide a nondischargeability action when that jurisdiction is concurrent often depends on how far along the state court action has progressed and whether there are third parties involved. For section 523(a)(3) or (5) or (15) or any subsections other than (2), (4) or (6), the state courts and bankruptcy courts share concurrent jurisdiction. Either one can enter both findings and a judgment on any section 523(a) claim other than (2), (4) or (6). For section 523(a)(2), (4) or (6) claims, the bankruptcy court has exclusive jurisdiction to enter the final judgment declaring a debt non-dischargeable. Only the bankruptcy court, not the state court, can enter the judgment there. However, under certain circumstances, the state court can enter findings that form the basis for the bankruptcy court judgment. But the bankruptcy court will still have to determine first that the principles of issue preclusion and collateral estoppel apply. The four essential elements to decide if issue preclusion applies are: 1) the former judgment must be valid and final; 2) the same issue is being brought; 3) the issue is essential to the judgement; 4) the issue was actually litigated." See *Grogan v. Garner*, 111 S.Ct. 654, 658, n.11 (1991) ("Our prior cases have suggested, but have not formally held, that the principles of collateral estoppel apply in bankruptcy proceedings under the current Bankruptcy Act…").

Finally, Judge Johnson spent time discussing initial status conferences. LBR 7016-1 was discussed at length. Several discovery issues were briefly mentioned as well.

The entire seminar was interactive, and attendees were permitted to ask questions. Pop-up poll questions were presented to attendees at various points as well. As usual, a lengthy handout containing many useful statutory and case law citations was provided to all attendees.

The next CDCBAA members meeting and Zoom MCLE program will be held on September 23, 2023. It will be the **"8th ANNUAL JAMES T. KING BANKRUPTCY SYMPOSIUM - COMMUNICATING WITH JUDGES: JUDGES ARE PEOPLE TOO."** Our speakers will be Hon. John Owens | Judge, Ninth Circuit Court of Appeals; Hon. Robert Faris | Chief Judge, Ninth Circuit Bankruptcy Appellate Panel; Prof. Daniel Bussel | UCLA School of Law; and M. Jonathan Hayes | Law Clerk to Hon. William Lafferty-Judge, Ninth Circuit Bankruptcy Appellate Panel. CDCBAA president-elect Hale Andrew Antico, Esq. will moderate.

We hope you will join us.

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