This Year's Top 8th Circ. Bankruptcy Decisions

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With the COVID-19 pandemic depriving bankruptcy practitioners of our usual opportunities to meet in court and at conferences to discuss recent developments in the law, I spent time tracking developments in bankruptcy law within the U.S. Court of Appeals for the Eighth Circuit.

As 2020 draws to a close, this article looks back to examine this year's key holdings with an eye toward business bankruptcies and holdings where the Eighth Circuit has broken with other courts.

The goal is to provide local practitioners with an update and to flag for visiting practitioners those issues where practice here may be different from the circuits national practitioners may find more familiar.

I begin with two cases addressing post-confirmation liabilities and whether and when they are properly considered to be discharged. I then proceed to a case where the Eighth Circuit bankruptcy appellate panel rejected the widely held notion that equitable considerations may be taken into account when deciding whether an oversecured creditor may collect default interest at the contract rate.

Finally, I consider a case where the Eighth Circuit rejected holdings from the U.S. Court of Appeals for the Ninth Circuit and the U.S. Court of Appeals for the First Circuit bankruptcy appellate panels and found that federal law, not state law, governs the award of prejudgment interest following the avoidance and recovery of transfers under Sections 544(b) and 550 of the Bankruptcy Code.

Post-Confirmation Liabilities

I begin with two cases addressing post-confirmation liabilities: In re: Peabody Energy Corp.[1] and In re: Armstrong Energy Inc.[2] In both cases, the U.S. Bankruptcy Court for the Eastern District of Missouri was called upon to interpret its own orders to determine whether certain liabilities survived plan confirmation. The standard of review in both cases therefore was for abuse of discretion.

In Peabody, various California municipalities attempted post-confirmation to assert statutory and tort claims for Peabody's alleged contribution to the climate crisis.

Peabody sought entry of an order that the claims were discharged under its confirmed plan, which expressly excluded from discharge claims under "any applicable environmental law to which any reorganized debtor is subject," with "environmental law" defined to mean "all federal, state and local statutes, regulations and ordinances concerning pollution or protection of the environment, or environmental impacts on human health and safety, including [certain identified federal statutes] and any state or local equivalents of the foregoing."

The bankruptcy court found the claims were discharged and the Eighth Circuit affirmed. The Eighth Circuit held that the municipalities and Peabody advanced plausible interpretations of

the confirmation order and, therefore, the bankruptcy court did not err in adopting the interpretation advanced by Peabody.

Notably, the Eighth Circuit placed weight on the presumed intent of the plan drafters.

Practitioners should keep this canon of interpretation in mind for disputes about the meaning or scope of a confirmed plan, because it may yield a different outcome from the accepted notion that a confirmed plan should be interpreted using the principles of contract interpretation, which rests generally on giving effect to the intent not of the drafter but of the parties.[3]

Because the drafter of a plan most typically is the debtor, it stands to reason that a rule of interpretation that looks to the intent of the drafter is a thumb on the scale in favor of the debtor.

In Armstrong, certain prepetition lessors sought to enforce indemnification rights under their leases against the party that acquired the leases. Armstrong's plan called for a sale of substantially all its assets, including the leases, under Section 363. As part of a related transaction agreement, the acquirers agreed to assume and discharge when due most liabilities under the leases.

Notably, while the leases were amended in part prior to assumption, the indemnification provisions were not amended and instead were expressly ratified and confirmed.

Separately, though, the plan included a third-party release provision, but that provision carved out post-effective date obligations under the plan and the related transaction agreement.

The bankruptcy court held that enforcement of the indemnification rights was not enjoined by the plan. It observed that Section 1141 applies only to debtors and that Section 524(e) provides that discharge does not affect the liability of nondebtors for payment of a debt. The bankruptcy court also did not find that the pertinent documents evidenced that the parties intended for the indemnification rights to be released or enjoined.

On appeal, the Eighth Circuit boiled the question presented down to whether the indemnity provisions were pre-effective date obligations released under the plan or post-effective date obligations that were not. The court concluded there was no abuse of discretion in finding they were post-effective date obligations.

Importantly, the Eighth Circuit observed the bankruptcy court "correctly recognized that courts should treat third-party releases with caution" because they "are rare and are allowed only in extraordinary cases and only under exceptional circumstances."

The important points for practitioners to take away from these cases are:

- The standard of review when a bankruptcy court interprets its own order is not favorable for appellants, so it is key to ensure that any rights your client believes it has are expressly spelled

- A free and clear sale under Section 363(f) is not carte blanche to avoid obligations expressly
- In arguing the proper interpretation of a confirmed plan, it is appropriate to consider and argue the intention of the drafter — usually the debtor, sometimes with co- proponents — rather than the intention of the

Collection of Default Interest by Oversecured Creditors

In In re: Family Pharmacy Inc.,[4] the U.S. Bankruptcy Appellate Panel for the Eighth Circuit held that it was inappropriate to analyze whether a default rate of interest was an enforceable liquidated damages provision rather than an unenforceable penalty provision under Missouri law.

The court held, among other things, that "the liquidated damages analysis to a contractual interest rate brings into play 'reasonableness' factors that simply are not applicable to interest rates" under Section 506(b) as construed by the U.S. Supreme Court.

Instead, a contractual default interest rate should be enforced "so long as those rates are allowed under state law." Note that this "allowed under state law" provision, taken literally, could be read to permit precisely the liquidated damages/penalty analysis the court rejected; presumably the court intended it to preclude only the enforcement of usurious interest rates.

Perhaps, more notably, the court rejected that the equities of the case warranted the disallowance of default interest. The court acknowledged that, when the bankruptcy court did so, it followed "what is likely the majority position."

But, it rejected that majority position, holding that the Eighth Circuit had not ruled on the issue and that the weight of Supreme Court authority prohibits bankruptcy courts from "weighing equitable concerns" when "the statute itself provides the answer in a more straightforward and less time-consuming matter."

Put more bluntly: "No section of the Bankruptcy Code gives the bankruptcy court authority, equitable or otherwise, to modify a contractual interest rate prior to plan confirmation."

The key takeaway from this case is that in the Eighth Circuit, unlike in most jurisdictions, an oversecured creditor is entitled to payment of interest at the default rate provided same is not usurious under applicable state law, and that there is no room for equitable considerations to overturn that result.

Prejudgment Interest on Awards Under Sections 544(b) and 550

In a consolidated decision resolving two appeals from adversary proceedings in the In re: Petters Company Inc. cases, the Eighth Circuit held that federal law, not state law, controls the award of prejudgment interest on judgments for the value of transfers avoided under Section 544(b) of the Bankruptcy Code.[5] In so doing, the court split with the Ninth Circuit and the First Circuit bankruptcy appellate panels.

Most of the opinion turned on application of the Minnesota Uniform Fraudulent Transfer Act as interpreted by the Minnesota Supreme Court. Those who practice regularly in Minnesota should consult it.

Many practitioners will be more interested, however, in the court's holding that federal law, not state law, controls the award of prejudgment interest when the value of a transfer avoided under Section 544(b) is recovered. The court's primary reasoning is that while entitlement to avoidance under Section 544(b) is (usually) governed by state law, Section 544(b) does not authorizer recovery of avoided transfers.

Rather, recovery of avoided transfers is governed by Section 550 which, in turn, is "the source for the award of prejudgment interest."

In so holding, the court split with the Ninth Circuit, which held with no analysis in In re: Agricultural Research and Technology Group Inc.[6] that state law "regarding prejudgment interest is applicable via" Section 544(b).

It also split with the First Circuit bankruptcy appellate panel's holding in In re: Keefe[7] that prejudgment interest is to be determined by reference to state law because while Section 544(b) authorizes a trustee to assert a fraudulent conveyance claim based on state law, and Section 550 "identifies the entities from whom recovery may be made," it is the applicable state fraudulent conveyance statute that provides the "substantive basis for the judgment."

The Eighth Circuit also went a step further to charge the U.S. District Court for the District of Minnesota with improperly expanding the U.S. Supreme Court's 1938 holding in Erie Railroad Co. v. Tompkins[8] that in cases where a federal court sits in diversity, the court is to apply the substantive law of the forum state.

Here, the court observed, "the district court's jurisdiction was based on a federal question, not on diversity of supplemental jurisdiction, leaving no basis for applying state law other than" Section 544(b), because an avoidance claim under Section 544(b) is a federal cause of action.

The question of what law governs the award of prejudgment interest is not trivial, as evidenced by what happened in this case.

The district court concluded that Minnesota law mandated the award of prejudgment interest at 10%, which increased the judgment against one defendant by 80% and against another two defendants by 47%. Conversely, under federal law, the award of prejudgment interest is discretionary — both as to whether it should be awarded and the rate at which it accrues.

The key takeaway from this case is that the controlling law on prejudgment interest on judgments for the value of transfers avoided under Section 544(b) is an open question.

While the First and Ninth Circuits would hold it is controlled by state law, the Eighth Circuit holds it is controlled by federal law. Those practicing in other courts should be aware of this circuit split to argue their clients should or should not — depending on whether their clients are plaintiffs or defendants — be entitled to receive mandatory prejudgment interest at state rates.

This blog post was drafted by Ryan Hardy, an attorney in the Spencer Fane LLP St. Louis, MO office. For more information, visit www.spencerfane.com.

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[1]In re Peabody Energy Corp., 958 F.3d 717, (8th Cir. 2020).

[2]In re Armstrong Energy Inc., 613 B.R. 529 (8th Cir. B.A.P. 2020).

[3]See, e.g., In re Shenango Group, Inc., 501 F.3d 338, 344 (3d Cir. 2007); In re Stratford of Texas, Inc., 635 F.2d 365, 368 (5th Cir. 1981); In re Dow Corning Corp., 456 F.3d 668,

676 (6th Cir. 2006).

[4]In re Family Pharmacy, Inc. , 614 B.R. 58 (8th Cir. B.A.P. 2020).

[5]Kelley v. Boosalis, 974 F.3d 884 (8th Cir. 2020).

[6]In re Agricultural Research and Technology Group, Inc. , 916 F.2d 528, 541 (9th 1990).

[7] In re Keefe , 401 B.R. 520, 527 (1st Cir. B.A.P. 2009).

[8] Erie R. Co. v. Tompkins , 304 U.S. 64 (1938).