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COMMERCIAL RESTRUCTURING & BANKRUPTCY NEWS – MARCH 2012, ISSUE 1

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FORECLOSURES IN NEW JERSEY

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Nice to finally see some good news for lenders in New Jersey in the wake of the mortgage crisis. On February 27th, New Jersey's Supreme Court issued a unanimous ruling that even if a Notice of Intent to Foreclose does not contain all of the data elements required by the Fair Foreclosure Act, the foreclosure case does not have to be dismissed and instead, the trial court is empowered to remedy a cure for any defect in the Notice.

Mark Melodia, a partner in our Princeton, NJ office who argued the residential mortgage industry's case before the state's top court, said that, "We are pleased that this decision explicitly reverses the New Jersey Appellate Division's August 2011 decision in *Bank of New York v. Laks,* which had frozen foreclosure cases and new filings for the past six months."

Melodia continued that, "The decision restores order to New Jersey's real estate market and is expected to help put the state's economy on track to recovery."

Mark pointed out that the decision supports the lower courts' decision-making authority in mortgage foreclosure matters. "This is a reaffirmation that our Chancery Court judges are best positioned to determine in a given case whether a technical defect in foreclosure paperwork requires the extraordinary step of dismissing the case – which, like this one, may have been pending for years before the defect was identified – or whether a less drastic remedy, such as sending a new notice, is the fairer way to proceed."

The New Jersey Supreme Court also held that a homeowner's right to rescind the mortgage under the Truth in Lending Act requires that the homeowner pay back all monies received from the lender. Counsel in New Jersey for homeowners have attempted to obtain a "rescission" remedy without such payments by the homeowner.

Thanks Mark for the good news.

'SUBSTANTIVE RIGHTS' NOT ASSIGNABLE, INTERCREDITOR VOTING RIGHTS ASSIGNMENT NULLIFIED

In re SW Boston Hotel Venture, LLC, 460 B.R. 38 (Bankr. D. Mass. 2011)

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CASE SNAPSHOT

The intercreditor agreement expressly provided for the assignment of bankruptcy plan voting rights from the junior secured creditor to the senior secured lender. The proposed plan of reorganization placed the claims of these two creditors into two classes. The senior secured lender cast ballots against the plan, on its own behalf as well as on behalf of the junior lender. The junior lender also cast its own ballot, in favor of the plan. The court held that the assignment of the substantive right of plan voting rights was unenforceable under all circumstances, and held that the junior lender's vote therefore trumped the senior lender's vote on behalf of the junior lender.

FACTUAL BACKGROUND

Prudential Insurance Company was the senior secured lender to the debtor, SW Boston Hotel Venture, LLC, with regard to a hotel and condominium project. The City of Boston also loaned money to SW Boston, and Prudential and the City entered into a pre-petition intercreditor and subordination agreement, in which Prudential was established as the senior lender, and the City as the junior lender. Section 8(c) of the Agreement provided "in the event of … a bankruptcy … reorganization … whether or not pursuant to bankruptcy laws … Junior Lender will assign to Senior Lender the voting rights of Junior Lender in such proceeding…."

SW Boston eventually filed a chapter 11 petition, and proposed its plan of reorganization. Prudential cast ballots against the plan, on behalf of itself and on behalf of the City; the City cast its own ballot in favor of the plan. Prudential cast the only dissenting votes, and filed several objections against the plan at the confirmation hearing. The Bankruptcy Court held that the right of a claim holder to vote on a plan was a "substantive right" under the Bankruptcy Code and was not assignable, and, thus, the assignment was unenforceable.

COURT ANALYSIS

In support of its position, Prudential pointed to section 510(a) of the Bankruptcy Code, which provides that a subordination agreement is enforceable in a bankruptcy case, to the extent such agreement is enforceable under applicable non-bankruptcy law. The City and the debtor argued that the purported assignment of voting rights in the Agreement was unenforceable because parties cannot contractually annul provisions of the Bankruptcy Code. The City and the debtor pointed to section 1126(a), which provides that a holder of a claim "may accept or reject a plan."

The court adopted the reasoning of *Bank of Amer. v. N. LaSalle Street Ltd. P'ship (In re 203 N. LaSalle Street P'ship)* 246 B.R. 325 (Bankr. N.D. Ill. 2000), in which the court held that a voting rights assignment in a subordination agreement was contrary to section 1126(a), because Congress did not intend to permit creditors to alter substantive provisions of the Bankruptcy Code. The *SW Boston* court recognized that contrary authority existed, in which other courts had upheld plan voting rights assignments (identifying the Northern District of Georgia as an example), but this court found *203 N. LaSalle Street* and similar cases to be more persuasive. The court therefore upheld the City's vote on its own behalf, and rejected Prudential's vote on behalf of the City. The court overruled Prudential's other objections, and confirmed the plan.

PRACTICAL CONSIDERATIONS

The enforceability of plan voting rights provisions of intercreditor and subordination agreements is a frequent matter of dispute for bankruptcy courts. Some courts view voting as a substantive right that cannot be contractually altered (e.g., the

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OFFSHORE BANKRUPTCY-REMOTE ENTITY IS NOT BANKRUPTCY-PROOF; TRUST INDENTURE VOTING REQUIREMENT OVERRIDDEN IN INVOLUNTARY BANKRUPTCY CASE

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In re Zais Investment Grade Limited VII, 455 B.R. 839 (2011)

CASE SNAPSHOT

An involuntary chapter 11 case was commenced in the Bankruptcy Court by senior noteholders against a Cayman Islands corporation that had been established as a special purpose entity to hold securities. The senior noteholders commenced the case seeking to liquidate the debtor's assets, despite a provision in the trust indenture that required super-majority approval of all noteholders prior to such liquidation. The debtor did not contest the involuntary case, and the Bankruptcy Court entered an order for relief. Junior noteholders moved to dismiss the chapter 11 filing, asserting that: the debtor had no place of business in the United States and was thus not eligible to be a "debtor" under the Bankruptcy Code; the senior noteholders were not qualified petitioning creditors because their debt was non-recourse; and, the interests of creditors would be better served if the Bankruptcy Court would abstain from exercising its jurisdiction and dismiss the case. The court denied the junior noteholders' motion to dismiss the case.

FACTUAL BACKGROUND

Zais Investment Grade Limited VII was a corporation organized under Cayman Islands law, a special purpose entity created to hold securities. Zais issued several tranches of notes pursuant to a trust indenture; these notes were collateralized by a portfolio of collateralized debt obligations (Zais was what is known as a "CDO squared"). Zais retained a New York-based bank to serve as the Trustee under the trust indenture. The Trustee held the assets of Zais in the United States. The Collateral Manager for Zais was also based in the United States.

A default of a covenant of the indenture occurred in March 2009, triggering a provision that required the Trustee to hold the collateral securities intact. This in turn meant that the Collateral Manager was no longer managing the securities, but simply monitoring them as the Trustee collected and distributed the money the securities passively earned. Senior noteholders (A-1) accelerated their notes in June 2009, which required that all distributions be made to the A-1 noteholders until they were satisfied in full.

In October 2009, investment funds managed by Anchorage Capital Group, L.L.C. acquired the A-1 notes. Anchorage attempted, without success, to convince Zais that the collateral could yield a better return if it were managed, or liquidated in an orderly fashion, rather than simply being left to runoff by collection of debt securities then held in trust. Under the trust indenture, the only way to effect an orderly disposition of assets was by obtaining the approval of two-thirds of all noteholders. Anchorage determined that obtaining this level of consent was virtually impossible. The trust indenture also prohibited the Trustee and the junior noteholders from commencing an involuntary bankruptcy case against Zais, but there was no such prohibition against A-1 noteholders. On April 1, 2011, Anchorage filed an involuntary petition under chapter 11. No other creditors joined the petition, and Zais did not answer or contest the petition. The Bankruptcy Court entered an order for relief by default April 26, 2011.

Anchorage filed a plan of reorganization and a disclosure statement. A junior noteholder, Hildene, submitted a declaration in which Hildene estimated that the collections from the collateral securities would be more than the amount needed to satisfy the A-1 noteholders. Hildene filed a motion to dismiss the case, alleging that: Zais, as a Cayman Islands company, was not eligible to be a "debtor" under the Bankruptcy Code; Anchorage could not commence the involuntary case because the notes were non-recourse (thus Anchorage was a secured creditor) and only unsecured creditors could commence an involuntary case; the Anchorage funds were the only creditors that would benefit from the bankruptcy, and the interests of all creditors would be better served outside of bankruptcy; and, Anchorage commenced the case in bad faith, seeking solely to circumvent the two-thirds' voting requirement of the trust indenture.

The court denied Hildene's motion.

COURT ANALYSIS

Eligible Debtor

The court rejected Hildene's contention that Zais was not eligible to be a debtor. Section 109(a) of the Bankruptcy Code provides that "only a person that resides or has a domicile, a place of business, or property in the United States … may be a debtor…." Hildene argued that Zais itself neither conducted business nor held property in the United States, and that those functions were carried out only by the Trustee and Collateral Manager. The court noted that the statute does not require that a person have its *principal* place of business in the United States – a person simply must have *a* place of business. Precedent established that a person does have a place of business in the United States if business is conducted in the United States on behalf of the person. Here, while labeling Zais as a "letterbox company," the court noted the "important functions of investing, collecting, disbursing, recordkeeping and communicating with noteholders" was done primarily in the United States. The court therefore did find that Zais had a place of business in the United States, through the activities of its Trustee and Collateral Manager. The court also found that the securities held in the United States by the Trustee were nominally property of Zais.

Non-Recourse Petitioner Eligibility

Section 303(b)(1) of the Bankruptcy Code requires creditors commencing an involuntary case to hold claims aggregating at least $14,425 in excess of the value of any collateral securing their claims. Hildene argued that, because the A-1 notes were non-recourse, the A-1 claims could never exceed the value of the collateral, so that the statutory threshold could not be met. Rather than addressing this claim on the merits, however, the court held that only the debtor could contest the

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DELAWARE SUPREME COURT HOLDS CREDITORS OF INSOLVENT LLCs DO NOT HAVE DERIVATIVE STANDING

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CML V, LLC v. Bax, et al., 2011 Del. LEXIS 480 (Del. Sept. 2, 2011)

CASE SNAPSHOT

Affirming the decision of the Court of Chancery for the State of Delaware, the Delaware Supreme Court held that, unlike corporate creditors, creditors of a Delaware Limited Liability Company do not have standing to sue the LLC's officers derivatively on behalf of an insolvent LLC.

FACTUAL BACKGROUND

JetDirect Aviation Holdings, LLC, a Delaware limited liability company, operated a private jet management and charter flight business. Beginning in 2005, JetDirect began acquiring small and mid-size competitors as part of a roll-up; however, these acquisitions left JetDirect with volatile cash flows and a highly leveraged balance sheet. In 2006, JetDirect's Board of Managers learned of serious deficiencies in the accounting system and internal controls. JetDirect's auditor later informed the Board that it would not complete its audit because JetDirect's internal controls lacked sufficient integrity. In 2007, the Board undertook efforts to improve the accounting functions, but these efforts only exacerbated the situation, and the internal accountants were unable to provide current, accurate financial information to the Board. Despite its knowledge of these severe accounting deficiencies, the Board approved four major acquisitions late in 2007.

Prior to the approval of the acquisitions, CML loaned JetDirect more than $25 million (later increasing the loan to $34 million) on a secured basis. In June 2007, JetDirect defaulted on its loan obligations to CML and by 2008, JetDirect was insolvent and its managers began liquidating assets to reduce its debt burden.

In May 2010, CML filed suit in the Delaware Chancery Court, asserting direct and derivative claims against the Board of Managers. CML's derivative claims alleged that some or all of the individual managers: (1) breached their duty of care by approving the four 2007 acquisitions without obtaining current, accurate financial information; (2) acted in bad faith by consciously failing to implement and maintain an adequate system of internal accounting controls; and (3) breached the duty of loyalty by personally benefiting from some of the asset sales.

The Chancery Court dismissed all of CML's claims, holding that a creditor of an LLC does not have standing to sue derivatively. CML appealed.

COURT ANALYSIS

The court addressed CML's derivative, and not direct, claims against JetDirect's board. CML asserted that the relevant provisions of Delaware's Limited Liability Company Act did provide creditors with standing to bring derivative actions on behalf of insolvent LLCs. Alternatively, CML argued that if the provisions of the Delaware code did deprive the Chancery Court of its equitable jurisdiction to extend derivative standing to such creditors, then those code provisions violated the Delaware Constitution.

The court first addressed the statutory argument and analyzed the plain language of Sections 18-1001 and 18-1002. Section 18-1001, entitled "Right to Bring Action," provides that "[a] member or assignee of a limited liability company interest may bring an action in the Court of Chancery in the right of a limited liability company…." Section 18-1002, entitled "Proper Plaintiff," states that, "[i]n a derivative action, the plaintiff must be a member or an assignee of a limited liability company interest…." CML argued that, despite the seemingly mandatory and exclusive language of 18-1002 ("must be a member or assignee"), the non-exclusive language of 18-1001 ("a member … may bring…") demonstrated that the state legislature intended a broad application of the law, and was merely rephrasing the language in the Delaware General Corporate Law. CML further argued that since Delaware courts have long held that creditors of insolvent Delaware corporations, under relevant statutory language, may bring derivative actions, the LLC law thus confers similar rights on creditors of LLCs.

The court rejected CML's statutory interpretation argument, holding that the LLC language was clear and unambiguous, plain on its face, and thus not subject to further interpretation. The court explained that the statutory language was unambiguous because (1) it was not susceptible of more than one reasonable interpretation, and (2) invoking the plain language did not cause an absurd or unintended result. The court highlighted language like "must" found in section 18-1002 as evidence of the legislature's intent to restrict derivative actions to LLC members and their assignees. Moreover, sections 18-1001 and 1002 serve different purposes: Section 18-1001 creates the right to file a derivative action on behalf of an LLC, and 18-1002 defines the specific parties that may exercise that right. The court also disagreed with CML's proposition that assigning plain meaning to sections 18-1001 and 1002 created an absurd result because creditors of an insolvent corporation received different treatment under Delaware's code than creditors of an insolvent LLC. According to the court, it is well within the legislature's authority to adopt a statutory scheme that treats creditors of insolvent LLCs and corporations differently. The court went on to note the legislature's intent to allow parties to define their respective relationships through the freedom of contract.

The court turned to CML's constitutional challenge to the Chancery Court's ruling, and found that the legislative curtailment of the Chancery Court's equitable jurisdiction was not unconstitutional.

The court began its analysis by noting that the Delaware Constitution prohibits the state legislature from limiting the equity jurisdiction to less than the general equity jurisdiction of the High Court of Chancery of Great Britain that existed at the time the colonies separated from Britain. The court explained that at common law, courts of equity granted equitable derivative standing to corporate stockholders to sue on behalf of the corporation in order to prevent a failure of justice. The corporate form and corporate derivative standing both pre-date the Delaware General Corporate Law, and thus, the General Corporate Law, rather than *creating* the right to sue derivatively, actually restricts that right, by defining the parties that may exercise that right. Delaware precedent holds that a judicially created equitable doctrine may be extended to address new circumstances, so long as the extension is consistent with the principles of equity. In that

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Delaware Supreme Court Holds Creditors of Insolvent LLCs Do Not Have Derivative Standing—continued from page 4

context, Delaware courts extended derivative standing to creditors of insolvent corporations. Moreover, precedent established that the common law right to extend derivative standing may be exercised only to prevent a failure of justice, and is limited only to the corporate context.

The corporate entity existed in 1792, when Delaware ratified its first constitution, but a limited liability company did not exist – at common law or otherwise – at that time. An LLC is strictly a statutorily created entity (in 1992, in Delaware), and, therefore, the state legislature is free to create, or not create, whatever rights in whichever parties it chooses. In the case of LLCs, the Delaware legislature defined, very specifically, the parties that may exercise derivative standing. Because LLCs did not exist at common law in 1792, the state legislature did not unconstitutionally limit the jurisdiction of the Court of Chancery.

The court held that the LLC statute, by its plain language, limits derivative standing to members or assignees, and is constitutional.

PRACTICAL CONSIDERATIONS

The Delaware Supreme Court suggested that creditors in CML's position had remedies other than derivative standing, such as negotiating contractual or personal guaranty remedies. Whether such alternative remedies are realistic or palatable to creditors of Delaware LLCs is another question. One thing is sure – creditors of LLCs need to be aware that they do not have the same derivative rights as corporate creditors in Delaware, and creditors in other jurisdictions should work with counsel to examine their state LLC laws to determine if a similar conundrum exists.

Offshore Bankruptcy-Remote Entity is Not Bankruptcy-Proof; Trust Indenture Voting Requirement Overridden in Involuntary Bankruptcy Case—continued from page 3

involuntary petition, and since the debtor had not contested the petition, or the petitioning creditors' qualifications, the issue could not now be raised.

Abstention

Hildene argued that the court should abstain and dismiss the bankruptcy case because the interests of the debtor and all creditors could be better served outside of bankruptcy. Hildene listed seven factors the court should consider: the efficiency of administration; whether another forum is available; whether federal proceedings are necessary; whether there is an alternate means of obtaining equitable distribution of assets; whether an out-of-court workout can be accomplished; whether a non-federal insolvency proceeding is far advanced; and, the purpose for which bankruptcy jurisdiction has been sought.

The court found most of the factors either not possible or inapplicable. Hildene's essential contention was that Anchorage was trying to use bankruptcy to circumvent the limitations of the trust indenture. The court saw no reason to dismiss the case prior to conducting confirmation hearings. The court viewed "this matter as an inter-creditor dispute to be resolved in an appropriate forum. Movants have failed to prove that it is in the best interests of creditors to abstain…. The court will determine at confirmation whether the plan treats creditors fairly and equitably without discrimination."

Bad Faith

Hildene disparaged the motives of Anchorage, alleging Anchorage was attempting to gain unfair advantage at the expense of other creditors. The court pointed out that if Anchorage's calculations that no creditors beyond A-1 would ever receive a payment were correct, then no other noteholder would be disadvantaged. If Anchorage was incorrect, however, the time and place for remedying that was the confirmation hearing, rather than a dismissal action. The court found that Hildene had not made a *prima facie* case of bad faith, and even if Hildene had made its case, the court concluded that Anchorage had exercised good faith in the involuntary petition filing.

The court explicitly made "no finding regarding confirmation of the plan proposed by the petitioning creditors," and denied the motion to dismiss or abstain.

PRACTICAL CONSIDERATIONS

CDOs and CDO-squared entities are often organized offshore, and are designed to be bankruptcy-remote vehicles. This holding makes it clear that bankruptcy-remote is not the same as bankruptcy-proof. The court also overrode the super-majority provisions of the indenture, reasoning that the executory contract provisions of the Bankruptcy Code, as well as the cram-down provisions, allow a junior creditor's expectations to be wiped out. The court determined that addressing these issues at the confirmation hearing would be a more suitable course. This case is on appeal, and we will keep you updated.

SUCCESSOR LIABILITY – DOES IT SURVIVE A SECTION 363(f) SALE?

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(This article originally appeared in *The Bankruptcy Strategist,* Vol. 29, No. 2, Dec. 2011)

An asset sale under section 363(f) of the Bankruptcy Code is becoming an increasingly popular mechanism to improve a company's financial condition as an alternative to a traditional plan of reorganization. There are substantial advantages to a 363(f) sale, the most important being that purchasers may take property of the estate "free and clear of any interest in such property." This language unquestionably permits purchasers to take property of the estate free and clear of any liens, but whether 363(f) contemplates other types of *interests*, such as successor liability *claims*, is more complicated. While the trend of recent case law supports an expansive reading of "interests in property," prospective buyers at 363(f) sales should be aware of, and protect against, the risk of potential successor liability claims.

Four Exceptions to the Rule

As a general rule, no successor liability is imposed on a purchaser of corporate assets. There are, however, four generally recognized exceptions to this general rule of non-liability, namely if: (1) there is an express agreement to assume the obligations of the transferor; (2) the transaction amounts to a de facto merger or consolidation of two companies; (3) the transaction is a fraudulent attempt to escape liability; or (4) the transferee is a mere continuation of the transferor – with growing approval for additional exceptions, including the "continuity of enterprise" exception and the "product line" exception. Although the details of each exception vary from state to state, no successor liability will be imposed absent one of these exceptions regardless of whether the asset sale is conducted pursuant to section 363(f) of the Bankruptcy Code. If, on the other hand, the buyer at a section 363(f) sale is aware that one of these exceptions may apply, it should consider the risk that potential successor liability claims may survive the sale.

Four Categories of Claimants

Courts have addressed the survival of successor liability in the context of four categories of claimants: (1) known creditors, whose claims exist at the time of the sale or plan confirmation; (2) unknown creditors who had pre-petition physical contact with or exposure to the debtor's product, but are not aware of their exposure to the product and have not yet manifested symptoms or discovered their injury; (3) unknown creditors who had, and were aware of, pre-petition physical contact with or exposure to the debtor's product, but have not yet manifested symptoms or discovered their injury; and (4) future claimants who had no pre-petition physical contact with or exposure to the debtor's product, but who, nevertheless, are injured after consummation of an asset sale, or confirmation of a plan as a result of a defective product manufactured and sold by the debtor prior to bankruptcy. The application of section 363(f) to each category of claimants depends, in large part, on whether the notice given by the debtor of the bankruptcy proceeding and the sale is sufficient to protect the claimant's rights under the Due Process Clause of the 14th Amendment.

Known Creditors

With respect to known creditors, the trend in recent case law is toward an expansive reading of section 363(f) that permits the transfer of estate property free and clear of obligations that flow from the ownership of such property, including successor liability claims arising from the debtor's defective products. As an example, in *In re Trans World Airlines,* 322 F.3d 283 (3d Cir. 2003), the Third Circuit concluded that successor liability claims constitute "interests in property" within the meaning of section 363(f) because "they arise from the property being sold" and, therefore, the property transfers free and clear of those claims. Relying on *Trans World Airlines*, the Southern District of New York came to a similar conclusion with respect to known creditors in *In re Chrysler, LLC,* 405 B.R. 84 (Bankr. S.D.N.Y. 2009) (appeal vacated as moot), and *In re General Motors Corp.,* 407 B.R. 463 (Bankr. S.D.N.Y. 2009). The due process rights of known creditors are protected through actual written notice of the bankruptcy proceeding. Although courts appear to be trending toward precluding known creditors from bringing successor liability claims after a 363(f) sale, previous decisions hold otherwise. See, e.g., *In re Wolverine Radio Co.,* 930 F.2d 1132, 1147-48 (6th Cir. 1991). Consequently, buyers should not assume that assets of the estate will automatically be transferred free and clear of successor liability claims, and their sale orders should always include provisions expressly providing that they are released from successor liability.

Unknown Creditors with Pre-Petition Contact

The second category of claimants includes unknown creditors who had pre-petition physical contact with or exposure to the debtor's product, but have not yet manifested symptoms or discovered their injury. By their nature, these claimants likely will not be identifiable by the debtor during the bankruptcy case, and their due process rights must be protected before their claims are discharged. Courts have developed a special mechanism to deal with the due process concerns of this category of unknown creditors (most commonly, asbestos claimants). Their successor liability claims may be extinguished, provided that a future claims representative is appointed to protect their interests and a trust is created to pay their claims. For asbestos claimants, this mechanism is codified in section 524(g) of the Bankruptcy Code.

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Successor Liability – Does it Survive a Section 363(f) Sale?—continued from page 6

Unknown Creditors Without Manifested Symptoms

The third category of claimants includes creditors who had, and were aware of, pre-petition physical contact with or exposure to the debtor's product, but have not yet manifested symptoms or discovered their injury. The Western District of Pennsylvania recently dealt with this category of claimant in *Wright v. Owens Corning,* 450 B.R. 541 (W.D. Pa. 2011). In the late 1990s, the claimant installed shingles on her roof that were manufactured and sold by Owens Corning. In 2000, Owens Corning filed for bankruptcy relief under chapter 11 of the Bankruptcy Code, and the bankruptcy court confirmed the debtor's plan of reorganization in 2006. The plan discharged the debtor and reorganized debtor from all claims and liabilities that arose before the confirmation date. In 2009, the claimant discovered that her shingles were cracked and water was leaking into her home. Using the test enunciated by the Third Circuit in *Jeld-Wen, Inc. v. Van Brunt (In re Grossman's, Inc.),* 607 F.3d 114 (3d Cir. 2010), the court determined that the claimant held a pre-petition claim because she was "exposed pre-petition to a product or other conduct giving rise to an injury, which underlies a 'right to payment' under the Bankruptcy Code." Because the claim arose pre-petition, it was discharged pursuant to the confirmation order. Further, the claimant's due process rights were not violated because the debtor published notice of the bankruptcy proceedings in several national, regional, and local newspapers and trade publications. According to *Wright*, the successor liability claims of this category of claimants may be discharged, provided that their due process rights are satisfied through constructive notice by publication.

Injured as a Result of a Defective Product

The fourth category of claimants includes those persons who had no pre-petition contact or relationship with the debtor or its products, but who, nevertheless, are injured after consummation of an asset sale or confirmation of a plan as a result of a defective product manufactured and sold by the debtor prior to bankruptcy. Because these future claimants do not hold claims against the estate at the time of the sale or confirmation and, therefore, cannot receive effective notice, a 363(f) sale cannot affect their right to sue a successor in interest. In *In re Grumman Olson Indus., Inc.,* 455 B.R. 243 (Bankr. S.D.N.Y. 2011), the debtor filed a petition under chapter 11 of the Bankruptcy Code in 2002, and sold its assets pursuant to section 363(f) in 2003. Pursuant to the sale order, the assets were purportedly transferred free and clear of successor liability claims. In 2008, a truck manufactured and sold by Grumman prior to its bankruptcy was involved in an accident and caused personal injury. Initially, the court noted that these facts represent "the extreme case of pre-petition conduct that [did] not … result[] in any tortious consequence to the victim" until after the sale was completed. Using the two-part "*Piper*" test, the court determined that the claimants did not have a "claim" (as that term is defined in section 101(5) of the Bankruptcy Code) against Grumman at the time of the sale because the claimants did not have any contact with Grumman or its products prior to the sale. As a result, the claimants did not receive proper notice of the bankruptcy case or the sale. Even if the claimants had constructive notice of the case, they could not file a claim or object to the sale because they did not have any contact or relationship with Grumman prior to the accident. In sum, *Grumman* stands for the proposition that "a person injured after the sale (or confirmation) by a defective product manufactured and sold prior to the bankruptcy does not hold a 'claim' in the bankruptcy case and is not affected by either the section 363(f) sale order or the discharge under 11 U.S.C. section 1141(d)." This conclusion was implicitly recognized in *General Motors Corp.* as the buyer agreed to assume all product liability claims arising from operation of GM vehicles occurring subsequent to the 363 sale, regardless of when the product was purchased.

Conclusion

Although asset sales under section 363(f) cannot automatically absolve purchasers of all potential successor liability, there are steps that a purchaser can take to insulate itself to a certain extent. Based upon the case law discussed above, the necessary ingredients to a free and clear sale appear to be effective notice and procedural fairness. To that end, purchasers should require that debtors provide constructive notice of the asset sale to unknown claimants by publication, as was done in *Owens Corning*. The debtors should also reserve an appropriate amount of the sale proceeds to address potential unknown claims, similar to the trusts in asbestos cases. Taking these steps will, at a minimum, weigh in favor of the purchaser if an unknown or future claimant subsequently brings a successor liability action that is not barred by the 363(f) sale.

'Substantive Rights' Not Assignable, Intercreditor Voting Rights Assignment Nullified—continued from page 2

Bankruptcy Courts of the Northern District of Illinois, the District of Minnesota and the District of Massachusetts), while other courts do not (e.g., the District Courts of Arizona and the Northern District of Georgia). For a related discussion, please see our discussion (in the September 2011 Commercial Restructuring & Bankruptcy Alert) of *In re Avondale Gateway Center Entitlement,* LLC, 2011 WL 1376997 (D. Ariz. Apr. 12, 2011), in which the court upheld an arguably less clear assignment of voting rights in a subrogation agreement that subrogated the "claims" of one lender to another. The *Avondale* court held that plan voting rights were implicitly part of a "claim," and, thus, the plan voting rights were subrogated (or assigned) as part of the agreement. Creditors should be aware that the enforceability of plan voting rights assignments in their agreements is an open question depending on the jurisdiction in which their borrower files for bankruptcy protections.

FREE-AND-CLEAR ASSET SALES PRICE MUST EXCEED OUTSTANDING DEBT TO SATISFY SECTION 363(f)(3)

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In re Nance Properties, Inc., Case No. 11-06197-8-JRL (Bankr. E.D.N.C. Nov. 8, 2011)

CASE SNAPSHOT

The chapter 11 debtor sought to sell its assets free and clear of all liens pursuant to section 363(f) of the Bankruptcy Code. The secured creditor objected because the proposed sales price was less than the total indebtedness secured by the property. Pursuant to section 363(f)(3) of the Code, a debtor cannot sell property free and clear if the sales price for the property is "not greater than the aggregate value of all liens on such property." The court analyzed two lines of cases to determine the meaning of "value," and held that "value" means the "face value," rather than the "economic value" of the liens. Although the sales price was greater than the economic value (i.e., present value) of the liens, the court denied the debtor's motion because the sales price was less than the face value (i.e., outstanding debt owed) of the liens.

FACTUAL BACKGROUND

The debtor, Nance Properties, Inc., was a North Carolina corporation that operated Valvoline stations. After filing a chapter 11 petition, it continued operating as a debtor-in-possession. First Citizens Bank & Trust Company held pre-petition liens against substantially all of the debtor's real property, as well as inventory, equipment and fixtures. The total balance of debt owed to First Citizens on the petition date exceeded $1.5 million. The debtor's schedules indicated the value of the subject properties was approximately $875,000. The debtor negotiated a sales price for the property of $1.2 million with an independent buyer.

Nance moved to sell the assets free and clear of all liens under section 363(f). First Citizens objected, arguing that the sales price did not exceed the aggregate value of all liens on the property in contravention of section 363(f)(3).

COURT ANALYSIS

Section 363(f) allows a debtor to sell assets free and clear of all liens in five distinct situations. At issue in this case was section 363(f)(3), which requires that "the price at which such property is to be sold is greater than the aggregate value of all liens on such property." The issue before this court was whether section 363(f)(3) permitted the sale of assets at a price that exceeds the economic value of the liens, but that is less than the aggregate amount of the indebtedness secured by the property.

The court discussed two distinct lines of cases interpreting the phrase "the aggregate *value* of all liens" (emphasis in opinion). The first line of cases holds that the sales price must exceed the aggregate "face value" of the liens, i.e., the amount of the outstanding indebtedness the liens secure. The second line of cases holds that the sales price must exceed the "economic value" of the liens, i.e., the present value of the property. The debtor argued that the court should follow the second line of cases and grant its motion because the sales price of $1.2 million exceeded the economic value of the property. The secured creditor argued that the court should follow the first line of cases and deny the debtor's motion because the sales price did not exceed the face value of the liens.

The court declined the debtor's invitation to follow the "economic value" cases. The court acknowledged that both interpretations of 363(f)(3) had valid justifications, as well as criticisms. The court adhered to long-standing precedent in its district, holding that the sales price must exceed the face value of the liens. The court therefore denied the debtor's motion to sell the assets free and clear of all liens.

PRACTICAL CONSIDERATIONS

Despite a recognition of the harsh realities of the current economy and the practical effect its decision would have on the increasing prevalence of underwater mortgages, the court felt bound by the precedent in its district. The case highlights the importance of existing case law in particular jurisdictions, especially with respect to unsettled questions of law.

COURT FINDS INDIRECT UPSTREAM OWNER EXERCISED *DE FACTO* CONTROL, WARRANTS LIABILITY FOR WARN ACT NOTICE VIOLATION

Jared Roach
Associate, Pittsburgh

D'Amico, et al. v. Tweeter Opco, LLC and Schultze Asset Management, LLC (In re Tweeter Opco, LLC), 453 B.R. 534 (Bankr. D. Del. 2011)

CASE SNAPSHOT

A group of ex-employees initiated an adversary proceeding against the debtor and its indirect upstream owner seeking to hold the companies liable as a "single employer" for failure to comply with the notice provisions required by the Worker Adjustment and Retraining Notice Act. The Bankruptcy Court found the two companies constituted a single employer and were therefore liable for violations of the WARN Act. The court reviewed a five-part test set forth by the Third Circuit. The test factors are: (1) common ownership; (2) common directors and/or officers; (3) the *de facto* exercise of control; (4) unity of personnel policies emanating from a common source; and (5) the dependence of operations between the entities. The court evaluated the five factors, and granted the plaintiffs' motion for summary judgment.

FACTUAL BACKGROUND

Tweeter Opco, LLC filed a chapter 11 petition November 5, 2008. The case was later converted to a chapter 7 proceeding. The plaintiffs sued the debtor, as well as Schultze Asset Management, an indirect upstream owner of the debtor, alleging the debtor failed to comply with the WARN Act and provide the required 60-day written notice in advance of mass layoffs. Because of the debtor's bankruptcy, the adversary proceeding was stayed as to the debtor, and the plaintiffs and SAM filed cross-motions for summary judgment.

The issues raised in the cross-motions were: (1) whether SAM and the debtor were a "single employer" under the WARN Act; (2) if they were a "single employer," was SAM entitled to the "faltering company" exception under the WARN Act; and (3) whether the debtor acted in good faith, thereby precluding damages under the WARN Act.

COURT ANALYSIS

Under the WARN Act, a covered employer cannot close a plant or conduct mass layoffs of at least 50 employees without providing at least 60 days written notice to the employees. To state a *prima facie* case of a violation, the plaintiffs here were required to show (1) the debtor was a covered "employer" under the WARN Act, (2) the debtor's corporate headquarters and the adjacent building constituted a "single site of employment" under the WARN Act, (3) the permanent shutdowns of the plants in Pennsylvania and Massachusetts caused at least 50 employees from each site to suffer an "employment loss," and (4) the WARN Act's mandatory 60-day written notice was not provided to each affected employee.

As a threshold issue, the Bankruptcy Court found that the debtor was a covered "employer" under the WARN Act. Furthermore, the court held that two adjacent buildings operated by the debtor and SAM were a single site of employment because the buildings shared a parking lot, a receptionist, and equipment. The court also found that at least 50 employees suffered an "employment loss," and that the requisite 60-day notice had not been provided.

The primary issue, and the issue that would determine liability, was whether the debtor and its indirect owner, SAM, constituted a "single employer." The court applied the five-factor test adopted by the Third Circuit (derived from Department of Labor regulations) to determine if SAM and the debtor constituted a "single employer." These factors are: (1) common ownership; (2) common directors and/or officers; (3) the *de facto* exercise of control; (4) unity of personnel policies emanating from a common source; and (5) the dependence of operations between the two entities. The court addressed these factors in turn.

Common Ownership

The plaintiffs asserted that SAM indirectly owned and controlled the debtor and that SAM was indirectly a substantial lender to the debtor. SAM argued that it was too far removed from direct ownership of the debtor. Moreover, SAM relied on a Southern District of New York decision in which the court held that grandparent companies are not common owners of the subsidiaries of their subsidiaries. Accordingly, SAM could not be found to be a common owner of the debtor. The court rejected the holding of the New York case and *per se* rule that grandparents cannot share common ownership with an indirect subsidiary.

Most important to the court's holding was the fact that SAM exercised financial control over the debtor. Specifically, the court held that SAM had financial control over the debtor through its lender relationship and influence, enabling Mr. Schultze to make critical decisions for the debtor.

Common Directors and Officers

The court found that Mr. Schultze was part of the formal management teams of both the debtor and SAM, which constituted common directors and officers. Accordingly, the plaintiffs proved the second prong of the test.

De Facto *Exercise of Control*

The core inquiry into the *de facto* exercise of control factor is "whether the parent has specifically directed the illegal employment practice that forms the basis for the litigation." (Citation omitted). The court examined undisputed evidence that Mr. Schultze consistently sought reductions in payroll to increase profits, and his belief that the easiest way to reduce payroll was to terminate large portions of the workforce. The court also analyzed the supervisory and direct roles of SAM's general counsel and other senior employees in terminating employees as a direct consequence of Mr. Schultze's desire to cut payroll costs. The court concluded that, not only did SAM exercise *de facto* control of the debtor, but that its control was also "particularly egregious." A finding of "particularly egregious" control warrants assessment of liability.

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CREATION OF ARTIFICIALLY IMPAIRED CLASS TO APPROVE CRAM-DOWN PLAN IS NOT *PER SE* IMPERMISSIBLE

Ann Pille
Associate, Chicago

In re Village at Camp Bowie I, L.P., 454 B.R. 702 (Bankr. N.D. Texas, 2011)

CASE SNAPSHOT

The debtor's only secured creditor objected to the chapter 11 cram-down plan, arguing that the debtor had created an artificially impaired unsecured class in order to obtain approval of the plan over the secured creditor's objection. While the court found that the debtor had, in fact, created an artificially impaired class, the court held that this was not *per se* improper. Instead, it examined whether the debtor lacked good faith in proposing the plan, and found that the debtor's conduct was an attempt to preserve equity, which was permissible under the Bankruptcy Code so long as the secured creditor received payment in full of the present value of its claim. As such, the court denied the secured creditor's objection to the plan confirmation on this basis.

FACTUAL BACKGROUND

The debtor, Village at Camp Bowie I, L.P., owned commercial property in Texas. This property secured first and second notes in favor of secured lenders, the combined outstanding balances of which were approximately $32 million as of the petition date. After the debtor defaulted on the loans, but prior to filing the bankruptcy petition, the institutional lender auctioned off the notes. Western Real Estate Equities, LLC purchased the notes at a discount and posted the property for foreclosure in August 2010. The debtor intentionally withheld payments to its unsecured creditors, and then filed its bankruptcy petition August 2, 2010.

The debtor's proposed reorganization plan designated two voting-impaired creditor classes – Western, the only secured creditor, and the unsecured creditors. The third class was comprised of equity holders. The plan proposed to pay the $60,000 owed to unsecured creditors in three monthly installments beginning on the effective date of the plan. The plan proposed to pay Western interest-only payments for three years (at a rate of 5.83 percent), followed by two years of principal and interest payments amortized over a 30-year term. At the end of five years, the Western debt would be paid in full. As drafted by the debtor, the plan contained no unimpaired classes. Western voted against the plan, and the unsecured creditors voted in favor of the plan. The debtor sought confirmation of its plan, and Western objected.

Western argued that the debtor had artificially impaired the unsecured creditors in order to satisfy the cram-down requirement that at least one impaired class approve the plan. Western also argued that the proposed interest rate failed to provide Western with the present value of its interest.

COURT ANALYSIS

Section 1129(b)(1) of the Bankruptcy Code allows for the confirmation of cram-down plans, and requires satisfaction of all the tests set forth in section 1129(a) (except 1129(a)(8)). Section 1129(a)(10) requires that at least one impaired class accept the plan.

In analyzing the debtor's plan, the court first addressed the issue of artificial impairment, which it described as the technique of minimally impairing a class of creditors solely to satisfy the statutory requirement that at least one impaired class approve a cram-down plan in order to obtain plan confirmation. Noting that there was no materiality standard in the statute, the court stated that any degree of impairment was sufficient to categorize a class as impaired. As such, a class of creditors could be impaired if they receive payment in full on the effective date of a plan – so long as they are not also paid post-petition interest. The court stated that nothing in section 1129(a) requires denial of a plan that uses artificial impairment to satisfy section 1129(a)(10), and instead found that the analysis turned on whether the debtor had proposed the plan in good faith.

The court discussed "good faith" tests and their application at length. First, the court examined whether the debtor's plan was proposed "with the legitimate and honest purpose to reorganize," and whether it had a reasonable hope of success. The court found that, "without a doubt," the debtor proposed the plan with the sincere hope of reorganizing, and the plan was feasible, so it had a reasonable hope of success.

Second, the court applied a broader test of good faith – the totality of the circumstances surrounding the establishment of the plan. Generally, artificial impairment does not, *per se*, constitute bad faith. It is, however, a factor to consider in making a determination of good faith. The court expressed concern about a debtor's ability to negotiate with a creditor intent on taking over the debtor's business, stating that the only leverage a debtor might have is to create an artificially impaired class in order to satisfy section 1129(a)(10). The Bankruptcy Court found it noteworthy that Western was not a lender in the traditional sense, and that its intent in acquiring this debt was solely to obtain ownership of the subject property.

Western argued that the debtor's improper motive was to preserve equity. The court agreed as to the motive, but found that this, too, was not improper. It identified several provisions of the Bankruptcy Code that evidenced Congress' intent to preserve the interests of equity holders, so long as the rights of creditors were also preserved.

The court concluded that the debtor, seeking its best chance to reorganize, preserve equity, and keep Western from acquiring the property, had no option but to create a class of artificially impaired creditors in order to cram-down the plan. "In another case, artificial impairment might be evidence of a lack of good faith. In this case, facing a creditor that will not be satisfied other than by cash payment in full or the demise of the Debtor, the court cannot make such a finding."

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TENTH CIRCUIT HOLDS AUTOMATIC STAY APPLIES TO DEBTOR'S APPEAL OF PRE-PETITION ACTION AGAINST IT, JOINING MOST OTHER CIRCUITS

Christopher O. Rivas
Associate, Los Angeles

TW Telecom Holdings Inc. v. Carolina Internet Ltd., Case No. 11-1068 (10th Cir. Nov. 15, 2011)

CASE SNAPSHOT

The Tenth Circuit Court of Appeals reversed its longstanding position, and held that section 362(a) of the Bankruptcy Code does automatically stay the debtor's appeal of an action commenced against the debtor prior to the bankruptcy filing, regardless of whether the debtor is the appellant or the appellee. This decision aligns the Tenth Circuit with at least nine other circuits.

FACTUAL BACKGROUND

TW Telecom Holdings obtained a default judgment against Carolina Internet in the amount of $3 million. Carolina Internet appealed from that judgment, and during the pendency of that appeal, Carolina Internet filed a voluntary petition for chapter 11 bankruptcy. The question before the court was whether section 362(a)(1) of the Bankruptcy Code stayed Carolina Internet's appeal of the pre-petition judgment against it.

COURT ANALYSIS

In cases going back some 20 years, the Tenth Circuit had held that section 362(a)(1) does *not* stay a debtor's appeal from a pre-petition judgment, even where the judgment is the result of a creditor's action against the debtor. Earlier decisions relied on Federal Bankruptcy Rule of Procedure 6009, as well as *Collier on Bankruptcy,* a well-known and oft-used (even by courts) bankruptcy treatise.

At least nine other circuits disagreed with the Tenth Circuit's interpretation, holding that the plain language of section 362(a)(1) does stay appellate proceedings where the debtor appellant was a defendant in the trial court. Interestingly, although the Tenth Circuit's view was based in large part on a prior edition of *Collier*, the treatise itself had explicitly rejected the Tenth Circuit's view and reliance on the treatise.

The court held that it was rejecting its prior interpretation of section 362(a)(1), and stated that, "[f]rom this date forward, this Circuit will read 'section 362… to stay appeals in proceedings that were *originally brought* against the debtor, regardless of whether the debtor is the appellant or the appellee. Thus, whether a case is subject to the automatic stay must be determined at its inception.'" (Emphasis in original, internal citations omitted.) The court therefore ordered the debtor's appeal stayed.

PRACTICAL CONSIDERATIONS

The Tenth Circuit has joined the large majority of circuits – an appeal from any action originally brought against the debtor will be stayed – whether the debtor is the appellant or appellee.

Creation of Artificially Impaired Class to Approve Cram-Down Plan is Not *Per Se* Impermissible—continued from page 10

The court, while emphasizing that artificial impairment should not be encouraged, concluded that its use is not *per se* prohibited, and that, in this case, it was both permissible and an exercise of the debtor's good faith. The court denied Western's objection.

PRACTICAL CONSIDERATIONS

The Bankruptcy Court stated that it was applying the plain meaning of the relevant statutory provisions in concluding that artificial impairment was neither *per se* illegal nor a *per se* exercise of bad faith. This court seemed to bend over backwards to find that the debtor acted in good faith. After all, the debtor owed more than $30 million to Western, and the debtor, which could have paid the unsecured creditors the comparatively negligible sum of $60,000 on the effective date, merely stretched that over three months to create an impaired class. This seems to tread pretty close to gamesmanship, and it is unclear whether this decision would be upheld on appeal, or utilized in other jurisdictions.

Court Finds Indirect Upstream Owner Exercised *De Facto* Control, Warrants Liability for WARN Act Notice Violation —continued from page 9

Unity of Personnel Policies

A unity of personnel policies is present when the two companies engage in centralized hiring and firing, payment of wages, and personnel and benefits record keeping. After reviewing the evidence offered by SAM (the plaintiffs did not offer any evidence), the court concluded that it lacked sufficient evidence to find that SAM and the debtor functioned as a single entity.

Dependency of Operations

The court did not find that the debtor and SAM had a dependency of operations because there was no evidence offered that suggested the two companies were dependent upon one another to continue operations.

Ultimately, the Bankruptcy Court held that the plaintiffs proved common ownership, common directors, and the *de facto* exercise of control by SAM over the debtor. The latter factor was particularly egregious because SAM exercised control over hiring and firing decisions relevant to the litigation.

The court then turned to the defenses that SAM raised – the "faltering company" defense, and the good faith defense.

The "faltering company" defense is statutory and excuses an employer's compliance with the 60-day notice requirement. Specifically, the WARN Act allows an employer to use this defense when the employer provides as much advance notice as is practicable, and sets forth specific facts in the notice that explain the reason for shortening the notice period. The debtor's notice, provided on the first day it terminated employees, simply stated that advance notice could not be given "due to adverse business conditions beyond our control." The court found that the notice failed to provide specific facts supporting the short notice, and so, held that the debtor was not entitled to the "faltering company" defense.

The WARN Act also allows an employer to raise a good faith defense, which SAM did. Procedurally, however, SAM did not raise the affirmative defense in its answer, so therefore SAM waived its right to assert the defense.

The Bankruptcy Court denied SAM's motion for summary judgment, and granted the plaintiffs' motion for summary judgment.

PRACTICAL CONSIDERATIONS

Based on this decision, it is not sufficient to escape liability for the acts of a grandchild company when the grandparent company exercises "particularly egregious" control. Indeed, the opinion suggests that the more involved the grandparent company is in the grandchild's daily operation, the more likely the grandparent company will be held liable. It is not absolute protection to establish a company tree with many separate entities if the entities are overly involved and centrally managed. Companies should be aware of, and follow, the five-part test adopted by the Bankruptcy Court.

CORPORATE SYNERGY AMONG RELATED DEBTORS KEY TO FINDING CONFERRAL OF ECONOMIC BENEFIT IN FRAUDULENT TRANSFER ACTION

Joseph Filloy
Associate, Pittsburgh

Spicer v. Konjoyan (In re Renaissance Hospital, et al.), Adv. No. 10-04190-DML (Bankr. N.D. Texas, Nov. 1, 2011)

CASE SNAPSHOT

Related hospital entities filed for bankruptcy. The chapter 7 trustee sought to avoid and recover allegedly fraudulent transfers made by one of the bankrupt entities to the defendant, arguing that the defendant never performed services for that specific entity. The defendant argued that debtors were related entities, and that the services the defendant performed conveyed reasonably equivalent value to the entity in the form of direct or indirect economic benefit. The court held that there was a corporate synergy among the related debtors, so that the defendant had provided reasonably equivalent value. Thus, the transfers were not fraudulent and could not be recovered by the trustee.

FACTUAL BACKGROUND

Several hospitals, including the Houston Community Hospital and the Renaissance Hospital - Groves, were managed by Renaissance Healthcare Systems, Inc. All of the Renaissance Healthcare entities filed chapter 11 petitions. The court ordered that the estates be jointly administered. The filings were converted to chapter 7 proceedings, and a trustee was appointed. Konjoyan was the medical director at Groves, and performed services as an independent contractor at Groves. The payments at issue, in excess of $75,000, had been made pre-petition to Konjoyan by HCH for the services Konjoyan had provided to Groves. There was no contract between HCH and Konjoyan.

The trustee filed an adversary action against Konjoyan, alleging that Konjoyan had not provided any services to HCH, and that HCH had therefore not received reasonably equivalent value in exchange for the $75,000 HCH paid to Konjoyan.

Konjoyan argued that funds and other benefits were transferred back and forth among HCH and the other Renaissance debtors; that there was a corporate synergy between HCH and the other debtors; and that HCH did, as a result of Konjoyan's services provided to Groves, receive direct and/or indirect benefits and reasonably equivalent value.

COURT ANALYSIS

Section 548(c) of the Bankruptcy Code allows a transferee to retain any interest transferred "to the extent such transferee or obligee gave value to the debtor in exchange for such transfer or obligation." Thus, if the debtor receives reasonably equivalent value in exchange for the transfer, the transfer is not fraudulent. The court stated that dollar-for-dollar exchange is not required to constitute reasonably equivalent value.

Citing precedent, the court stated that the test for indirect value is "whether the payments or transfers conferred an economic benefit on the debtor," and that indirect value "includes the synergy realized from the joining of two enterprises."

Defining "synergy" as "combined action or operation," the court found that sharing management, funds and other economic benefits among HCH and the other Renaissance entities resulted in a corporate synergy that "constituted a single economic unit managed by HCH." Konjoyan's services enabled Groves to keep its emergency room open, making Groves a more valuable asset and conferring a benefit on the economic unit as a whole – including HCH. Therefore, the court held HCH did receive reasonably equivalent value in exchange for the $75,000 it paid to Konjoyan. The transfers were not fraudulent, and were not recoverable. The trustee's claims were denied, and the court assessed court costs against the trustee.

PRACTICAL CONSIDERATIONS

The Bankruptcy Court examined the financial operations of the debtors to collapse the related companies into a single, synergistic economic unit. Trustees of related debtors must take care to engage in similar analysis before undertaking recovery actions, or they will run the risk of being assessed for court costs, as this trustee was.

FEDERAL COURTS JURISDICTION AND VENUE CLARIFICATION ACT OF 2011

Amy Tonti
Partner, Pittsburgh

The Federal Courts Jurisdiction and Venue Clarification Act of 2011, H.R. 394, went into effect January 6, 2012, and applies to all cases filed thereafter. Some of the highlights of the new Act include:

- **Removal.** In a multi-defendant case, the new statute allows any defendant to file a notice of removal within 30 days of actual service, allowing each defendant a full 30 days following service on that defendant to file a removal notice. The "rule of unanimity," applied by a number of courts, is now codified, and all defendants still must join in the removal, but the later-served defendant's deadline to remove is not tied to service on other defendants.

- **Amount in Controversy.** Under the Act, the amount in controversy is established by the amount demanded in the complaint, unless the defendant can prove by a "preponderance of evidence" that the plaintiff seeks (a) non-monetary relief, or (b) a money judgment that state practice either does not permit demand for a specific sum or permits recovery of damages in excess of the amount demanded.

- **Venue Restrictions**

  - Under the Act, venue for any civil action, whether based on diversity or federal question jurisdiction, is proper in "(1) a judicial district in which any defendant resides, if all defendants are residents of the State in which the district is located; (2) a judicial district in which a substantial part of the events or omissions giving rise to the claim occurred, or a substantial part of property that is the subject of the action is situated; or (3) if there is no district in which an action may otherwise be brought as provided, any judicial district in which a defendant is subject to the court's personal jurisdiction with respect to such action."

  - The Act codifies that "residency" is a natural person's state of domicile, the same standard used in the determination of citizenship for diversity jurisdiction.

  - The Act re-defines the residency of a corporation: corporations are now defined as residents *only* of those judicial districts where they would be subject to personal jurisdiction if that district were a separate state. Corporations and insurance companies with significant foreign operations are to be considered citizens of both the state by which they are incorporated and any other state, including any foreign state, where they maintain their principal place of business.

- Litigants may stipulate to the transfer of venue to a district where the lawsuit may otherwise have not originally been brought "for the convenience of the parties and witnesses and in the interest of justice."

- Under the Act, while federal courts retain jurisdiction over state-law claims between a citizen of a state and citizens of a foreign state, federal courts cannot exercise jurisdiction over such claims if they are asserted between a citizen of a state and "citizens or subjects of a foreign state who are lawfully admitted for permanent resident in the United States and are domiciled in the same State."

COUNSEL'S CORNER: NEWS FROM REED SMITH

Presentations

Kurt Gwynne was on a panel for the Association of Commercial Finance Attorneys in New York, on January 12. The panel topic was "Credit Bidding – Recent Updates Inside and Outside the Bankruptcy Code and Gifting in Bankruptcy Proceedings."

On February 9, **Bob Simons** was a panelist at the 2012 Aircraft Registration Conference in Delray Beach, Fla., for the National Business Aviation Association. His topic was "Aircraft Repossessions and Remedies."

Amy Tonti will be serving as Pennsylvania Bar Institute faculty for a "Hot Topics in Bankruptcy" seminar March 7 in Pittsburgh.

Amy Tonti, Bob Simons and **Jared Roach** will present a half-day seminar March 28 to the Pennsylvania Association of Credit Management entitled, "Hot Topics in Creditors' Rights and Bankruptcy." It will take place at the Doubletree by Hilton in Moon Township, Pa.

On April 20, **Bob Simons** will be a panelist on the "Bankruptcy Forum: What a Judge, Trustees and Other Experts Want You to Know," for the National Business Institute. The Forum will address a wide range of issues, including bankruptcy litigation and ethics and professionalism.

Articles

Bob Simons was quoted extensively by author Brian Shappell in an article entitled, "Bringing Down the Gavel: The 2012 Court Cases Credit Professionals Need to Monitor." The article was published in the February 2012 issue of Business Credit.

Awards

Kimberly E.C. Lawson received a pro bono award from the Delaware State Bar Association. The following is an excerpt from a piece that was written about the presentation:

> Kimberly E.C. Lawson, an attorney in the Wilmington office of Reed Smith LLP, won the Delaware State Bar Association's *2011 Achievement Award* for her pro bono work which is one of the DSBA's annual *Christopher W. White Distinguished Access to Justice* awards.
>
> Ms. Lawson, of counsel in the firm's Financial Industry Group, has been committed to pro bono causes throughout her career. Ms. Lawson focuses on representing children as an attorney guardian ad litem through the Office of the Child Advocate in Delaware. Ms. Lawson has represented children through the Office of the Child Advocate for over ten years. For the past two years, she has also been representing a prisoner in a civil rights action.
>
> *The Achievement Award* is presented to a member of the Bar who has shown an exemplary contribution to pro bono services and stands as a role model to other attorneys. The criteria for selection include the number of pro bono hours worked, number of cases the attorney has taken on, consistency, flexibility and accessibility in accepting cases, and overall commitment and service on pro bono committees promoting legal services to those in need.

The Delaware State Bar Association presented the award to Ms. Lawson on October 25 at a ceremony held in Wilmington.

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