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NEW YORK BANKRUPTCY COURT RULES THAT GOOD FAITH IS NOT THE GATEKEEPER TO CHAPTER 15

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Despite the absence of any explicit directive in the Bankruptcy Code, it is well understood that a debtor must file a chapter 11 petition in good faith. The bankruptcy court can dismiss a bad faith filing "for cause," which has commonly been found to exist in cases where the debtor seeks chapter 11 protection as a tactic to gain an advantage in pending litigation. A ruling recently handed down by the U.S. Bankruptcy Court for the Southern District of New York suggests that no such good faith filing requirement applies to a petition seeking recognition under chapter 15 of the Bankruptcy Code of a foreign bankruptcy. In *In re Culligan Ltd.*, 2021 WL 2787926 (Bankr. S.D.N.Y. July 2, 2021), the court granted recognition under chapter 15 to the liquidation proceeding of a Bermuda company despite allegations that the company's court-appointed liquidators filed the chapter 15 petition solely to enjoin shareholder litigation pending in a New York State court. According to the bankruptcy court, although the Bankruptcy Code gives a U.S. court the discretion to deny any chapter 15 relief that is "manifestly contrary" to U.S. public policy, "this exception is not met by a simple finding that the Chapter 15 Petition has been filed as a litigation tactic."

PROCEDURES, RECOGNITION, AND RELIEF UNDER CHAPTER 15

Chapter 15 was enacted in 2005 to govern cross-border bankruptcy and insolvency proceedings. It is patterned on the 1997 UNCITRAL Model Law on Cross-Border Insolvency ("Model Law"), which has been enacted in some form by more than 50 countries.

Both chapter 15 and the Model Law are premised upon the principle of international comity, or "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws." *Hilton v. Guyot*, 159 U.S. 113, 164 (1895). Chapter 15's stated purpose is "to provide effective mechanisms for dealing with cases of cross-border insolvency" with the objective of, among other things, cooperation between U.S. and non-U.S. courts.

Under section 1515 of the Bankruptcy Code, the representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding." Section 101(24) of the Bankruptcy Code defines "foreign representative" as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign

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proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

Section 109(a) of the Bankruptcy Code provides that, "[n]otwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under [the Bankruptcy Code]." In *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013), the Second Circuit ruled that section 109(a) applies in cases under chapter 15 of the Bankruptcy Code. For purposes of section 109(a), "property in the United States" has been held to include an attorney retainer in a U.S. bank account, causes of action under U.S. law against parties in the United States, and contract rights governed by U.S. law, including U.S. dollar-denominated debt issued under an indenture governed by New York law with a New York choice-of-forum clause. *See In re Cell C Proprietary Ltd.*, 571 B.R. 542 (Bankr. S.D.N.Y. 2017); *In re Berau Capital Resources Pte Ltd*, 540 B.R. 80 (Bankr. S.D.N.Y. 2015); *In re Octaviar Administration Pty Ltd.*, 511 B.R. 361 (Bankr. S.D.N.Y. 2014).

"Foreign proceeding" is defined in section 101(23) of the Bankruptcy Code as:

> [A] collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

More than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries. Chapter 15 therefore contemplates recognition in the United States of both a foreign "main" proceeding—a case pending in the country where the debtor's center of main interests ("COMI") is located (*see* 11 U.S.C. § 1502(4))—and foreign "nonmain" proceedings, which may be pending in countries where the debtor merely has an "establishment" (*see* 11 U.S.C. § 1502(5)). A debtor's COMI is presumed to be the location of the debtor's registered office, or habitual residence in the case of an individual. *See* 11 U.S.C. § 1516(c). An "establishment" is defined by section 1502(2) as "any place of operations where the debtor carries out a nontransitory economic activity."

Upon recognition of a foreign "main" proceeding, section 1520(a) of the Bankruptcy Code provides that certain provisions of the Bankruptcy Code automatically come into force, including: (i) the automatic stay preventing creditor collection efforts with respect to the debtor or its U.S. assets (section 362, subject to certain enumerated exceptions); (ii) the right of any entity asserting an interest in the debtor's U.S. assets to "adequate protection" of that interest (section 361); and (iii) restrictions on use, sale, lease, transfer, or encumbrance of the debtor's U.S. assets (sections 363, 549, and 552).

Following recognition of a foreign main or nonmain proceeding, section 1521(a) provides that, to the extent not already in effect, and "where necessary to effectuate the purpose of [chapter 15] and to protect the assets of the debtor or the interests of the creditors," the bankruptcy court may grant "any appropriate relief," including a stay of any action against the debtor or its U.S. assets not covered by the automatic stay, an order suspending the debtor's right to transfer or encumber its U.S. assets, and "any additional relief that may be available to a trustee," with certain exceptions. Under section 1521(b), the court may entrust the distribution of the debtor's U.S. assets to the foreign representative or another person, provided the court is satisfied that the interests of U.S. creditors are "sufficiently protected."

Section 1507(a) of the Bankruptcy Code provides that, upon recognition of a main or nonmain proceeding, the bankruptcy court may provide "additional assistance" to a foreign representative "under [the Bankruptcy Code] or under other laws of the United States." However, the court must consider whether any such assistance, "consistent with principles of comity," will reasonably ensure that: (i) all stakeholders are treated fairly; (ii) U.S. creditors are not prejudiced or inconvenienced by asserting their claims in the foreign proceeding; (iii) the debtor's assets are not preferentially or fraudulently transferred; (iv) proceeds of the debtor's assets are distributed substantially in accordance with the order prescribed by the Bankruptcy Code; and (v) if appropriate, an individual foreign debtor is given the opportunity for a fresh start. *See* 11 U.S.C. § 1507(b).

Section 1522(a) provides that the bankruptcy court may exercise its discretion to order the relief authorized by sections 1519 and 1521 upon the commencement of a case or recognition of a foreign proceeding "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected."

Finally, section 1506 sets forth a public policy exception to the relief otherwise authorized in chapter 15, providing that "[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States." However, section 1506 requires a "narrow reading" and "does not create an exception for *any* action under Chapter 15 that may conflict with public policy, but only an action that is '*manifestly* contrary.'" *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 139 (2d Cir. 2013).

CULLIGAN

Culligan Ltd. ("debtor") was a Bermuda-incorporated holding company for direct and indirect subsidiaries that distributed water purification and filtration units through franchise dealers located exclusively in North America.

In a 2006 restructuring, the debtor borrowed $850 million to refinance existing debt, repay $200 million to an investor, and pay a $375 million dividend to shareholders. The debtor restructured again in early 2012.

In May 2012, certain of the debtor's minority shareholders, consisting of 71 of the 262 Culligan water dealers (collectively, "plaintiffs"), commenced a derivative action ("NY litigation") against the debtor's directors, its controlling shareholders, and certain other defendants in New York State court. The action alleged that the consolidated Culligan System entities, including the debtor, violated New York law in assuming debt and paying shareholders and investors as part of the 2006 restructuring because they had insufficient capital.

The state court dismissed the complaint in in March 2013, ruling that Bermuda law, rather than New York law, applied. The plaintiffs appealed.

On April 29, 2013, the debtor's majority shareholders authorized it to commence a members' voluntary liquidation ("MVL") under the Bermuda Companies Act of 1981. That same day, the Bermuda court appointed joint liquidators for the debtor for the purpose of winding up the company. The liquidators notified the plaintiffs of the filing and expressed their view that the NY litigation should not proceed because they had assumed control of the debtor.

The plaintiffs refused and in 2014 obtained a reversal on appeal of the state court's dismissal ruling. However, during the ensuing six years, the state court dismissed no fewer than four amended complaints on various grounds. Its decision on a motion to dismiss a fifth amended complaint was pending as of July 2021.

In June 2017, one of the debtor's affiliates paid it $11.67 million in connection with the winding-up proceeding, bringing the debtor's total cash holdings to $11.87 million. The liquidators accordingly determined that a distribution should be made to shareholders under the MVL in the amount of approximately $11.34 million. After reserving $500,000 to pay liquidation fees and expenses, as well as fees related to the NY litigation, they distributed $11.1 million to the debtor's shareholders, nearly $400,000 of which they disbursed to 56 of the 71 plaintiffs.

As of June 2019, the debtor had approximately $240,000 remaining in payment obligations to multiple shareholders, including nearly $38,000 to the 15 remaining plaintiffs, and had $288,000 in cash. However, due to expected liabilities arising from anticipated fees in the NY litigation, the liquidators determined that the debtor had become insolvent. In July 2019, they accordingly petitioned the Bermuda court to convert the MVL to a court-supervised liquidation. The court granted that relief and confirmed the liquidators in that role for purposes of the liquidation.

In June 2020, the liquidators sought an order from the Bermuda court restraining the plaintiffs from suing the debtor or commencing litigation in its name anywhere in the world. That proceeding was suspended, however, after the liquidators, as the debtor's foreign representatives, filed a chapter 15 petition in the U.S. Bankruptcy Court for the Southern District of New York on September 17, 2020, seeking recognition of the debtor's Bermuda liquidation as a "foreign main proceeding." They also sought an order confirming that the automatic stay precluded continuation of the NY litigation, due to the risk that the suit "may further deplete the dwindling assets of the Debtor and frustrate the Bermuda Liquidation."

The plaintiffs opposed the recognition petition, arguing that: (i) the foreign representatives were forum shopping and commenced the case to enjoin the NY litigation and thereby circumvent the adverse rulings of the state court; and (ii) the foreign representatives filed the chapter 15 petition in bad faith and for the improper purpose of barring the plaintiffs from prosecuting the NY litigation by application of the automatic stay. According to the plaintiffs, the foreign representatives' bad faith was evidenced by the facts that the debtor was merely a nominal defendant in the NY litigation, it would not incur any liability, and its litigation costs were covered by insurance. They also asserted that the foreign representatives were not seeking a stay to provide breathing room to conduct good faith liquidation efforts but, rather, improperly seeking chapter 15 recognition and application of the stay to permanently enjoin—as distinguished from merely to pause—the NY litigation.

THE BANKRUPTCY COURT'S RULING

Eligibility for Chapter 15 Relief. First, U.S. Bankruptcy Judge James L. Garrity, Jr. found that the debtor was eligible for relief under chapter 15 even though it did not have a domicile or place of business in the United States because the debtor had an interest in funds deposited with its U.S. lawyers as a retainer in a client trust account in New York.

Next, Judge Garrity concluded that the liquidators qualified as foreign representatives of the debtor in accordance with section 101(24) of the Bankruptcy Code. He also determined that the debtor and the petition for recognition satisfied all of the remaining eligibility requirements for relief under chapter 15.

Judge Garrity then considered whether the debtor's COMI was located in Bermuda—a prerequisite for finding that the Bermuda liquidation could be recognized as a "foreign main proceeding." He concluded that the relevant date for determining the debtor's COMI was the date the liquidators were initially appointed by the Bermuda court—in 2013—and that the debtor's activities prior to that date had no bearing on the determination. Judge Garrity found that, both in 2013 and on the chapter 15 petition date in 2020, the debtor's COMI was in Bermuda, where it was incorporated and headquartered; most of its cash was on deposit; the debtor's shareholders voted to commence the MVL; and the liquidators resided and were overseeing all liquidation activities, which were governed by Bermuda law. According to Judge Garrity, the contingent and disputed litigation claims asserted in the NY litigation did not support a finding that the debtor's COMI was in New York, even though the state court had determined that New York law governed the dispute and much of the documentary evidence was located in New York.

Alleged Bad Faith Did Not Preclude Recognition. Judge Garrity also ruled that the narrow and rarely invoked public policy exception in section 1506 did not warrant denial of chapter 15 recognition. He wrote that "courts have generally found that section 1506 does not prohibit recognition in situations where the debtor has engaged in bad faith." *Culligan*, 2021 WL 2787926 , at *15 (citing *In re Manley Toys Ltd.*, 580 B.R. 632, 648 (Bankr. D.N.J. 2018), *aff'd*, 597 B.R. 578 (D.N.J. 2019); *In re Creative Fin. Ltd.*, 543 B.R. 498, 515 (Bankr. S.D.N.Y. 2016)). Instead, Judge Garrity explained, the question under section 1506 is not whether the debtor's actions violate public policy, but whether the foreign court's procedures and safeguards fail to comport with U.S. public policy.

Judge Garrity acknowledged that there was evidence to show that the foreign representatives filed the chapter 15 petition as part of their "litigation strategy" to bring an end to the NY litigation and that "the admitted, and apparently entire, purpose of the present chapter 15 filing" was to prevent the plaintiffs from continuing the lawsuit. *Id.* at *15. However, he faulted the plaintiffs' reliance on case law finding bad faith as "cause" for dismissing chapter 11 cases under section 1112(b) of the Bankruptcy Code. Unlike in chapter 11, Judge Garrity reiterated, recognition under chapter 15 is subject to the public policy exception of section 1506, which considers not whether the actions of the debtor violate public policy, but whether the foreign court's procedures and safeguards fail to comport with U.S. public policy. In the absence of any such allegations, Judge Garrity held that the alleged bad faith was not a basis to deny chapter 15 recognition.

Judge Garrity accordingly granted the petition for recognition of the Bermuda liquidation proceeding under chapter 15 as a foreign main proceeding. In so ruling, he declined to address whether the foreign representatives were entitled to supplementary injunctive relief under section 1521 (in addition to the automatic stay arising upon recognition under section 1520(a)) and stated that any request by the plaintiffs for relief from the automatic stay to continue the NY litigation was premature because it was not procedurally proper.

OUTLOOK

Culligan highlights important distinctions between cases under chapter 11 and chapter 15 of the Bankruptcy Code. Good faith acts as a gatekeeper to chapter 11 because access to chapter 11 is premised on the legitimacy of the debtor's need to reorganize or effect an orderly liquidation in response to genuine financial distress. Thus, the good faith inquiry focuses on the debtor's motives for seeking chapter 11 protection. And, as articulated in *In re National Rifle Association of America*, 628 B.R. 262 (Bankr. N.D. Tex. 2021), a chapter 11 case filed to gain an unfair advantage in litigation or avoid a regulatory scheme generally will be dismissed because the bankruptcy was not commenced in good faith.

By contrast, the public policy exception in chapter 15 focuses on the foreign country's insolvency process, rather than the debtor or its conduct. Chapter 15 was designed to provide a mechanism for U.S. bankruptcy courts to assist foreign tribunals and functionaries in the process of overseeing a foreign debtor's bankruptcy or insolvency. Provided the foreign bankruptcy or insolvency process roughly comports with U.S. public policy, the foreign debtor's (or foreign representative's) intent behind seeking recognition through chapter 15 is largely irrelevant.

SECOND CIRCUIT ADOPTS "CONTROL TEST" FOR IMPUTATION OF FRAUDULENT INTENT IN BANKRUPTCY AVOIDANCE LITIGATION

Dan Merrett • Mark G. Douglas

In yet another chapter in the tortured saga of the fallout from the failed 2007 leveraged buyout ("LBO") of media giant The Tribune Co. ("Tribune") in a transaction orchestrated by real-estate mogul Sam Zell, the U.S. Court of Appeals for the Second Circuit largely upheld lower court dismissals of claims asserted by Tribune's chapter 11 liquidation trustee against various shareholders, officers, directors, employees, and financial advisors for, among other things, avoidance and recovery of fraudulent and preferential transfers, breach of fiduciary duties, and professional malpractice. In *In re Trib. Co. Fraudulent Conv. Litig.*, 10 F.4th 147 (2d Cir. 2021), *reh'g en banc denied*, No. 19-3049 (2d Cir. Oct. 7, 2021), the Second Circuit affirmed four district court rulings dismissing the liquidating trustee's claims against all of the defendants except two financial advisors alleged to have received fraudulent transfers in the form of fees paid in connection with the LBO. In so ruling, the Second Circuit adopted the "control test" for determining whether the fraudulent intent of a company's officers can be imputed to its directors for the purpose of avoidance litigation.

TRIBUNE

In 2007, Tribune, owner of WGN America, *The Chicago Tribune*, and the *Los Angeles Times*, was the target of a two-stage LBO conceived by Zell that ultimately paid Tribune's shareholders more than $8 billion in exchange for their shares in the company. Prior to the LBO, Tribune's board of directors created a special committee to evaluate the LBO. The special committee included seven independent directors that served on the board.

Tribune had previously hired two financial advisors, Merrill, Lynch, Pierce, Fenner, and Smith, Inc. ("Merrill") and Citigroup Global Markets, Inc. ("Citigroup"), to conduct a strategic review and recommend possible courses of action. Both were also permitted to play a role in potential LBO financing, and each was contractually entitled to a $12.5 million "success fee" if a "strategic transaction" was completed. In addition, the special committee engaged Morgan Stanley & Co. LLC ("Morgan Stanley") to serve as its independent financial advisor.

There were two separate steps to the LBO. First, Tribune borrowed approximately $7 billion and purchased approximately 50% of its outstanding shares in a tender offer. Second, six months later, the company bought its remaining shares and borrowed an additional $3.7 billion in a go-private merger with a newly formed Tribune entity. The board engaged Duff & Phelps to provide a solvency opinion for both steps.

Duff & Phelps was also engaged to provide a solvency opinion by GreatBanc Trust Co. ("GreatBanc"), which served as the trustee for Tribune's employee stock ownership plan ("ESOP"). As part of the first step of the LBO, GreatBanc purchased $250 million in unregistered stock from Tribune on behalf of the ESOP. After the conclusion of the second step, the ESOP was the majority owner of Tribune.

Duff & Phelps never issued a solvency opinion to Tribune's board. Instead, for a fee of $750,000, Duff & Phelps delivered a "viability opinion" to GreatBanc in which it concluded that, considering potential tax savings, Tribune would be able to pay its debts as they became due after the LBO. The viability opinion took into account the tax savings expected to be realized from ESOP ownership and "expressly disclaimed" that it was a solvency opinion.

The same day, Morgan Stanley and Merrill issued "fairness opinions" that the price to be paid for Tribune's stock was fair. The special committee then unanimously voted to recommend the LBO, after which a majority of Tribune's board, including six of the independent directors, voted in favor of it. The board retained Valuation Research Company ("VRC") to render solvency opinions concerning both parts of the transaction, which it delivered shortly before the completion of each part of the LBO in exchange for a fee of $1.5 million.

Shortly after the second stage of the LBO was completed in December 2007, Tribune experienced financial difficulties due to declining advertising revenues and failed to meet projections. The company filed for chapter 11 protection in December 2008 in the District of Delaware.

A flurry of litigation ensued, with suits filed in 21 states as well as the Delaware bankruptcy court alleging, among other things, fraudulent payments to Tribune shareholders, breaches of fiduciary duties, Delaware corporate law violations, and professional malpractice.

In *Neil v. Zell*, 753 F. Supp. 2d 724 (N.D. Ill. 2010), the U.S. District Court for the Northern District of Illinois ruled that GreatBanc breached its fiduciary duties to Tribune's employees by allowing the ESOP to purchase unregistered stock during the LBO that did not qualify for an exemption under federal law, instead of buying common stock on the open market. The court later certified a class action in the litigation, which was settled in 2012 for an amount exceeding $17 million.

In December 2011, the U.S. Judicial Panel on Multidistrict Litigation consolidated the Tribune lawsuits in the U.S. District Court for the Southern District of New York.

The U.S. Bankruptcy Court for the District of Delaware confirmed Tribune's chapter 11 plan in July 2012. The plan assigned the estate's causes of action to a litigation trust. The litigation trustee ("trustee") then became the successor plaintiff in the multidistrict litigation.

PRIOR *TRIBUNE* COURT RULINGS ON TRUSTEE'S CLAIMS

In *In re Trib. Co. Fraudulent Conv. Litig.*, 2017 WL 82391 (S.D.N.Y. Jan. 6, 2017) ("*Tribune 1*"), the district court dismissed claims that the payments to Tribune's former shareholders as part of the LBO could be avoided and recovered under sections 548 and 550 of the Bankruptcy Code as actual fraudulent transfers.

When considering whether a debtor had the actual intent to hinder, delay, or defraud its creditors within the meaning of section 548(a)(1)(A), the court explained, "courts focus on the intent of the transferor, not the intent of the transferee." *Id.* at *5. However, if the transferor is a corporation, courts assessing intent in this context look to the intent of the corporate agents who effectuated the transaction on behalf of the corporation. Under certain circumstances, the court noted, the intent of such corporate actors to defraud can be imputed to the corporation.

The district court acknowledged that the Second Circuit had at that time not yet articulated a test for determining when an officer's intent should be imputed to a corporation in actual fraudulent transfer litigation. However, the district court agreed with decisions from other courts that the intent of a debtor's officers may be imputed to the debtor if the officers were in a position to control the disposition of the transferor's property and, exercising that control, effectuated the fraudulent transfer. *Id.* at *6.

The court rejected the argument that only the directors' intent is relevant in assessing the corporation's intent because "it is too restrictive and 'effectively disregards any influence on the Board that [officers] may have exercised.'" *Id.* at *7 (citation omitted). At the same time, the court also rejected the argument that an officer's intent is *always* attributable to the corporation in actual fraud cases.

Instead, the court held that, for the purpose of imputing fraud in this context, if a party that does not own a majority of a corporation's shares is alleged to control the corporation, the plaintiff must show "'such formidable voting and managerial power that [he], as a practical matter, [is] no differently situated than if [he] had majority voting control' of the corporation's shares." *Id.* (quoting *In re Morton's Rest. Grp., Inc. Shareholders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013)).

The district court concluded, however, that Tribune's officers had neither voting power nor managerial control of Tribune.

The *Tribune 1* court rejected the trustee's argument that the officers had misled VRC into issuing a flawed solvency opinion, thereby indirectly deceiving the board and the special committee. According to the court, "[A]llowing the Trustee's expansive conception of the imputation doctrine sweeps the corporate landscape too broadly." *Id.* at *10. The district court concluded that the trustee's "multi-layered imputation theory" would undermine Congress's policy of protecting securities markets by introducing substantial uncertainty to the law governing actual fraudulent transfer claims. *Id.* at *11. "[G]iven the ease with which one could allege that the misrepresentation of a material fact—originating from any source—manipulated the board's decision making," the court wrote, "it is important to confine the imputation doctrine to those actors who deliberately and directly exert control inside the boardroom." *Id.*

Thus, the *Tribune 1* court ruled that, because the officers did not exercise voting or managerial control, "the Trustee's attempt to impute the Officer Defendants' intent to the corporation is unjustified." *Id.*

The district court also concluded that, because the trustee alleged that the independent directors were "clearly" in a position to control the outcome of the board's vote, any intent to defraud on their part could be imputed to Tribune for purposes of the trustee's fraudulent transfer claim. However, the court ruled that the trustee failed to allege actual fraudulent intent on the part of the independent directors under either: (i) the "purposeful harm test," whereby the plaintiff must provide either direct proof of actual intent or, because fraudulent intent is rarely susceptible to direct proof, a strong inference of fraudulent intent by relying on certain "badges of fraud"; or (ii) the "securities law test," which requires either evidence that the directors had both the motive and the opportunity to hinder, delay, or defraud the debtor's creditors or strong circumstantial evidence of conscious misbehavior or recklessness.

The district court explained that, because proving intent to hinder, delay, or defraud creditors is very difficult, some courts consider the following "badges of fraud" when determining whether an inference can be made to support such a finding:

> (1) the lack or inadequacy of consideration; (2) the family, friendship or close associate relationship between the parties; (3) the retention of possession, benefit or use of the property in question; (4) the financial condition of the party sought to be charged both before and after the transaction in question; (5) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency

or threat of suits by creditors; and (6) the general chronology of the events and transactions under inquiry.

Id. at *13 (quoting *In re Kaiser*, 722 F.2d 1574, 1582 (2d Cir. 1983)).

Among other things, the *Tribune 1* court rejected the argument that the independent directors acted with fraudulent intent because Tribune received less than reasonably equivalent value in connection with the LBO and because the LBO rendered Tribune insolvent. Allowing such allegations to raise a strong inference of fraudulent intent, the court wrote, would "turn every constructive fraudulent conveyance claim into an actual fraudulent conveyance claim and thereby undermine the distinction between the two claims." *Id*. at *14.

The court acknowledged that the claim that an allegedly fraudulent transfer was made to an insider or "close associate" can support an inference of fraudulent intent. However, it found that the only payments the independent directors received as part of the shareholder transfers were proceeds of the sale of their shares in Tribune and that "any inference of scienter that could be drawn from the Independent Directors' receipt of a miniscule fraction of the Shareholder Transfers is weak at best." *Id.* at *13.

The district court also rejected the argument that the fifth badge of fraud had been satisfied. It explained that LBOs, by their nature, are transactions outside the ordinary course of business that require the incurrence of new debt. Accepting the trustee's argument, the court wrote, "would mean that every LBO that ends in a bankruptcy within two years of its effectuation would subject transferring shareholders to an actual fraudulent conveyance claim." *Id.* at *15.

Addressing the securities law test, the *Tribune 1* court acknowledged that the independent directors had the motive and opportunity to hinder, delay, or defraud Tribune's creditors because the independent directors would receive consideration in exchange for their shares only if the LBO was consummated. However, the court concluded, "the mere fact that the Independent Directors received Shareholder Transfers in connection with the LBO fails to support a strong inference of scienter, since a corporate director's desire to realize personal benefits in connection with a merger is a motive shared by every corporate director in America." *Id.* at *16 (citation and internal quotation marks omitted).

The district court rejected the trustee's argument that the independent directors had acted recklessly when they approved the LBO. Because the special committee hired its own advisor and worked with the board's advisors, the court explained, the special committee did not "blindly" accept the projections of Tribune's management. *Id.* at *17. Moreover, the court noted, failure to conduct more rigorous downside testing of the LBO would support a finding of negligence, not conscious misbehavior or recklessness.

The court also determined that, although the independent directors considered negative trends in the newspaper industry and concluded that the trends weighed in favor of the LBO, the trustee's argument amounted to "little more than a meatless assertion that the Independent Directors should have known better," which was not enough to establish fraudulent intent. *Id.* at *19.

On the basis of these findings, the court ruled that the trustee had also failed to plead facts sufficient to allege that the independent directors possessed actual intent to hinder, delay, or defraud Tribune's creditors through the LBO.

In *In re Trib. Co. Fraudulent Conv. Litig.*, 2018 WL 6329139 (S.D.N.Y. Nov. 30, 2018) ("*Tribune 2*"), the district court granted motions to dismiss the trustee's claims against certain officers, directors, and shareholder defendants for breach of fiduciary duties to Tribune or its subsidiaries, aiding and abetting such fiduciary duty infractions, unjust enrichment, and violations of Delaware corporate law in connection with the LBO. According to the court, the trustee failed to allege that the defendants owed fiduciary duties to Tribune following closure of the first step of the LBO, that the defendants ever owed fiduciary duties to Tribune's creditors, that they took actions that rendered Tribune insolvent as part of the first step, or that Tribune mistakenly transferred assets to any of the defendants.

The court also dismissed claims to avoid severance payments made to certain employees after the LBO as actual and constructively fraudulent and preferential transfers based on: (i) its previous determination in *Tribune 1* that the LBO could not be avoided as an actual fraudulent transfer; (ii) its finding that the severance payments could not be avoided as constructive fraudulent transfers because Tribune received value in exchange for the payments; and (iii) its finding that the payments were made more than 90 days prior to Tribune's bankruptcy filing to non-insider creditors.

In *In re Trib. Co. Fraudulent Conv. Litig.*, 2019 WL 294807 (S.D.N.Y. Jan. 23, 2019) ("*Tribune 3*"), the district court denied in part and granted in part motions to dismiss claims against the independent directors for breach of fiduciary duty, violations of Delaware corporate law, unjust enrichment, equitable subordination, and avoidance of indemnification obligations. Among other things, the court found that: (i) the trustee adequately alleged violations of the duty of loyalty, rendering exculpatory provisions immaterial; (ii) because the second step of the LBO was structured as a merger, rather than a purchase or redemption of stock, the Delaware corporate law claim was barred by the doctrine of "independent legal significance"; (iii) to support his equitable subordination claim, the trustee plausibly alleged that the independent directors violated their fiduciary duties to Tribune; and (iv) Tribune's indemnification obligations to the independent directors could not be avoided as fraudulent transfers because Tribune incurred those obligations more than two years before filing for bankruptcy.

In *Tribune 3*, the district court also dismissed in part and granted in part motions to dismiss the trustee's claims against an independent director (who did not join Tribune's board until after step one of the LBO) and certain related entities for breach of fiduciary duty, avoidance of fraudulent and preferential transfers and obligations, alter ego liability, unjust enrichment, and equitable subordination.

Finally, the district court dismissed claims asserted by the trustee against Citigroup, Merrill, Morgan Stanley, VRC, and Duff & Phelps for aiding and abetting breaches of fiduciary duty, professional malpractice, unjust enrichment, and avoidance of fee payments made in connection with the LBO. Among other things, the court determined that: (i) the trustee did not allege that Duff & Phelps provided inaccurate or incomplete information in connection with the LBO to Tribune or GreatBanc; (ii) the trustee's claims for aiding and abetting breaches of fiduciary duties and professional malpractice were barred by the doctrine of *in pari delicto*; and (iii) Tribune received reasonably equivalent value in exchange for the financial advisors' fees, and the trustee made no allegations that Tribune paid the fees with the intent to defraud creditors.

In *In re Trib. Co. Fraudulent Conv. Litig.*, 2019 WL 1771786 (S.D.N.Y. Apr. 23, 2019) ("*Tribune 4*"), the district court denied the trustee's motion for leave to amend his complaint to add claims for constructive fraudulent transfers under section 548(a)(1)(B) of the Bankruptcy Code against Tribune's former shareholders. According to the court, notwithstanding the U.S. Supreme Court's ruling in *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018), the trustee's constructive fraudulent transfer claims were preempted by the safe harbor for certain securities, commodity, or forward contract payments contained in section 546(e) of the Bankruptcy Code, and amendment of the complaint accordingly would be futile.

All four of the district court rulings on the motions described above were appealed to the Second Circuit, which addressed the appeals in a single opinion.

THE SECOND CIRCUIT'S RULING ON APPEAL

A two-judge panel of the Second Circuit (the third judge on the panel passed away during the pendency of the appeal) affirmed in part, vacated in part and remanded the cases below for additional determinations.

Writing for the panel, U.S. Circuit Judge Denny Chin initially noted that "the issue of whether a company's officers' intent to defraud creditors can be imputed to an independent special committee for purposes of a fraudulent conveyance claim under the Bankruptcy Code is a question of first impression in this Circuit." *Tribune*, 10 F.4th at 160.

Judge Chin found that the district court properly applied the "control test" in making that determination. He wrote that, "for an intentional fraudulent transfer claim, which requires 'actual intent,' a company's intent may be established only through the 'actual intent' of the individuals 'in a position to control the disposition of [the transferor's] property.'" *Id.* (citing *In re Roco Corp.*, 701 F.2d 978, 984 (1st Cir. 1983); *In re Lehman Bros. Holdings, Inc.*, 541 B.R. 551, 576 (S.D.N.Y. 2015)).

In this case, Judge Chin explained, Tribune's board, as permitted under Delaware law, delegated its authority to approve the LBO to the special committee. Therefore, the trustee was required to plead allegations that gave rise to a strong inference that the special committee had the actual intent to hinder, delay, or defraud Tribune's creditors, as required by section 548(a)(1)(A) of the Bankruptcy Code.

However, Judge Chin concluded that the trustee failed to plausibly allege that the intent of Tribune's senior management should be imputed to the special committee because he did not

allege, among other things, that: (i) Tribune's senior management controlled the transfer of Tribune's property as part of the LBO; (ii) senior management inappropriately pressured the independent directors to approve the LBO or dominated the special committee; or (iii) any financial or personal ties existed between senior management and the independent directors that could have affected the impartiality of the special committee.

According to Judge Chin, "to impute the officers' intent onto the Special Committee, which was working independently with an outside financial advisor and independently reviewed opinions provided by Duff & Phelps and VRC, would stretch the 'actual intent' requirement as set forth in § 548(a)(1)(A) to include the merely possible or conceivable or hypothetical as opposed to existing in fact and reality." *Id.* at 161.

Judge Chin also found that the district court correctly held that the trustee failed to plead "badges of fraud" sufficient to raise a strong inference of actual fraudulent intent on the part of the special committee. He agreed with the district court that the independent directors' profit motive in approving the LBO did not give rise to a strong inference of actual fraudulent intent. Judge Chin found similarly unpersuasive the trustee's argument that the independent directors were aware of the risky nature of the LBO and the strong likelihood that Tribune would be unable to service debt incurred as part of the transaction.

The Second Circuit accordingly ruled that, in *Tribune 1*, the district court did not err in dismissing with prejudice the trustee's fraudulent transfer claims against Tribune's former shareholders.

The court also found no error in the district court's dismissal in *Tribune 2* of the trustee's claims against certain officer, director, employee, and shareholder defendants for substantially the same reasons stated in *Tribune 2*.

Next, the Second Circuit held that, in *Tribune 3*, the district court did not err in dismissing the trustee's aiding and abetting breach of fiduciary duty and professional malpractice claims against financial advisors Citigroup, Merrill, and Morgan Stanley. It also ruled that the district court properly dismissed the trustee's actual fraudulent transfer claims against those defendants because the complaint did not sufficiently allege that the transfers to them were made with the intent to hinder, delay, or defraud Tribune's creditors.

However, Judge Chin explained, the complaint did adequately plead such actual intent with respect to VRC and, therefore, the district court's dismissal of that claim must be vacated. He noted that the complaint alleged, among other things, that the fee was the highest VRC had ever charged for a solvency opinion and that the firm agreed to use a nonstandard definition of "fair value." *Id.* at 171.

Next, Judge Chin concluded that the constructive fraudulent transfer claims against Citigroup and Merrill should not have been dismissed, but that the constructive fraudulent transfer claims against Morgan Stanley and VRC were properly dismissed. He explained that, whereas Morgan Stanley and VRC, unlike Citigroup and Merrill, had no financial stake in the LBO's consummation because they earned their respective fees upon delivery of their contracted-for opinions, "the factual question of whether Citigroup and Merrill provided reasonably equivalent value for their success fees cannot be decided without first assessing whether the banks satisfactorily performed their duties." *Id.* at 174. In addition, Judge Chin noted, the payments to Morgan Stanley and VRC were in large part due before the first step of the LBO was completed, and there was no allegation in the trustee's complaint that Tribune was insolvent before the first step.

Finally, the Second Circuit affirmed the district court's ruling in *Tribune 4* denying the trustee leave to amend his complaint to add actual and constructive fraudulent transfer claims.

OUTLOOK

Relatively little remains of the twisted and tortured litigation spanning more than a decade concerning the 2007 Tribune LBO. The Second Circuit affirmed the dismissal of all claims except the actual fraudulent transfer claims asserted against VRC for avoidance of its $1.5 million fee and the constructive fraudulent transfer against Citigroup and Merrill Lynch for avoidance of their collective $25 million in success fees. The U.S. Supreme Court is unlikely to agree to hear any appeal by the trustee of the Second Circuit's ruling. Additional appeals, however, may ensue from the remanded litigation against the financial advisors.

Perhaps the most notable aspect of the Second Circuit's ruling is its adoption as a matter of first impression of the control test, rather than a "scope-of-employment agency" standard or a "proximate cause" standard, for imputing intentional fraud in avoidance litigation.

The trustee filed a petition for rehearing *en banc* of the Second Circuit's decision in which he argued that the panel applied the wrong standard for imputing fraudulent intent to corporate actors. The Second Circuit denied the petition on October 7, 2021.

Jones Day represents certain of the defendants in the Tribune *fraudulent transfer litigation.*

ANOTHER BANKRUPTCY COURT RULES THE "SOLVENT DEBTOR EXCEPTION" SURVIVED ENACTMENT OF THE BANKRUPTCY CODE

Paul M. Green • Mark G. Douglas

Whether the pre-Bankruptcy Code "solvent debtor exception" requiring the payment of postpetition interest to dissenting unsecured creditors under a chapter 11 plan survived the enactment of the Bankruptcy Code in 1978 has been the subject of a handful of recent court rulings. This is, perhaps, most notably true of the chapter 11 case of Ultra Petroleum Corp. in connection with a protracted battle over the debtor's obligation to pay make-whole premiums to unsecured noteholders.

The U.S. Bankruptcy Court for the District of Massachusetts weighed in on this issue in *In re Mullins*, 2021 WL 2948685 (Bankr. D. Mass. July 13, 2021). After delivering a treatise on the history and application of the exception, the court held that certain provisions of the Bankruptcy Code—namely, the "absolute priority rule" and the "best interests test"—"incorporate and implement the 'solvent debtor exception' established over the course of hundreds of years of insolvency jurisprudence." The court also held that the appropriate rate of postpetition "pendency" interest is the federal judgment rate.

IMPAIRMENT UNDER A CHAPTER 11 PLAN

Classes of claims or interests may be either "impaired" or "unimpaired" by a chapter 11 plan. The distinction is important because only impaired classes have the ability to vote to accept or reject a plan. Under section 1126(f) of the Bankruptcy Code, unimpaired classes of creditors and shareholders are conclusively presumed to have accepted a plan.

Section 1124 provides that a class of creditors is "impaired" under a plan unless, among other things, the plan: (i) "leaves unaltered the legal, equitable, and contractual rights" to which each creditor in the class is entitled; or (ii) cures any defaults (with limited exceptions), reinstates the maturity and other terms of the obligation, and compensates each creditor in the class for resulting losses.

Section 1124 originally included a third option, then section 1124(3), for rendering a claim unimpaired—by providing the claimant with cash equal to the allowed amount of its claim. In *In re New Valley Corp.*, 168 B.R. 73 (Bankr. D.N.J. 1994), the court ruled that, in light of this third option, a solvent debtor's chapter 11 plan that paid unsecured claims in full in cash, without postpetition interest, did not impair the claims.

Because of the perceived unfairness of *New Valley*, Congress removed this option from section 1124 of the Bankruptcy Code in 1994. Since then, most courts considering the issue have held that, if an unsecured claim is paid in full in cash with postpetition interest at an appropriate rate, the claim is unimpaired under section 1124. *See, e.g., In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197, 205–07 (3d Cir. 2003).

THE BANKRUPTCY CODE'S PRIORITY SCHEME

The Bankruptcy Code sets forth certain priority rules governing distributions to creditors in both chapter 7 and chapter 11 cases. Secured claims enjoy the highest priority under the Bankruptcy Code. *See generally* 11 U.S.C. § 506. The Bankruptcy Code then recognizes certain priority unsecured claims, including claims for administrative expenses, wages, and certain taxes. *See id.* § 507(a). General unsecured claims come next in the priority scheme, followed by any subordinated claims and the interests of equity holders.

In a chapter 7 case, the order of priority for the distribution of unencumbered assets is determined by section 726 of the Bankruptcy Code. The order of distribution ranges from payments on claims in the order of priority specified in section 507(a), which have the highest priority, to payment of any residual assets after satisfaction of all claims to the debtor, which has the lowest priority. Distributions are to be made pro rata to parties of equal priority within each of the six categories specified in section 726. If claimants in a higher category of distribution do not receive full payment of their claims, no distributions can be made to parties in lower categories.

In a chapter 11 case, the chapter 11 plan determines the treatment of secured and unsecured claims (as well as equity interests), subject to the requirements of the Bankruptcy Code. If a creditor does not agree to impairment of its claim under the plan—such as by agreeing to receive less than payment in full—and votes to reject the plan, the plan can be confirmed only under certain specified conditions. Among these conditions are the following: (i) the creditor must receive at least as much under the plan as it would receive in a chapter 7 liquidation (11 U.S.C. § 1129(a)(7)) (commonly referred to as the "best interests" test); and (ii) the plan must be "fair and equitable" (*Id.* § 1129(b)(1)).

Section 1129(b)(2)(B) of the Bankruptcy Code provides that a plan is "fair and equitable" with respect to a dissenting impaired class of unsecured claims if the creditors in the class receive or retain property of a value equal to the allowed amount of their claims or, failing that, if no creditor or equity holder of lesser priority receives any distribution under the plan. This is known as the "absolute priority rule."

DISALLOWANCE OF CLAIMS FOR UNMATURED INTEREST AND THE SOLVENT DEBTOR EXCEPTION

Section 502(b)(2) of the Bankruptcy Code provides that a claim for interest that is "unmatured" as of the petition date shall be disallowed. *See generally* COLLIER ON BANKRUPTCY ¶ 502.03 (16th ed. 2021) ("fixing the cutoff point for the accrual of interest as of the date of the filing of the petition is a rule of convenience providing for equity in distribution"). Charges that have been deemed to fall into this category include not only ordinary interest on a debt but also items that have been deemed the equivalent of interest, such as original issue discount and make-whole premiums (although the latter is the subject of vigorous dispute). *Id.* This means that, unless there is an exception stated elsewhere in the Bankruptcy Code (see below), any claim for postpetition interest will be disallowed.

The bar on recovery by creditors of interest accruing after a bankruptcy filing predates the enactment of the Bankruptcy Code and is derived from English law. *Nicholas v. U.S.*, 384 U.S. 678, 682 (1966) (explaining that "[i]t is a well-settled principle of American bankruptcy law that in cases of ordinary bankruptcy, the accumulation of interest on claims against a bankruptcy estate is suspended as of the date the petition in bankruptcy is filed [which rule is] grounded in historical considerations of equity and administrative convenience"); *Sexton v. Dreyfus*, 219 U.S. 339, 344 (1911) (recognizing the rule that interest ceases to accrue on unsecured debt upon commencement of bankruptcy proceedings is a fundamental principle of English bankruptcy law, which is the basis of the U.S. system). Section 63 of the Bankruptcy Act of 1898, as amended by the Chandler Act of 1938, expressly disallowed unmatured interest as part of a claim. Bankruptcy Act of 1938, ch. 575, § 63, 52 Stat. 840 (repealed 1978).

English law contained notable exceptions to the rule. These exceptions included the "solvent debtor" exception, which provided that interest would continue to accrue on a debt after a bankruptcy filing if the creditor's contract expressly provided for it, and would be payable if the bankruptcy estate contained sufficient assets to do so after satisfying other debts. *See In re Ultra Petroleum Corp.*, 913 F.3d 533, 543-44 (5th Cir.) (citing treatises and cases), *opinion withdrawn and superseded on reh'g*, 943 F.3d 758 (5th Cir. 2019). In such cases, the post-bankruptcy interest was part of the underlying debt obligation, as distinguished from interest "on" a creditor's claim. *Id.*

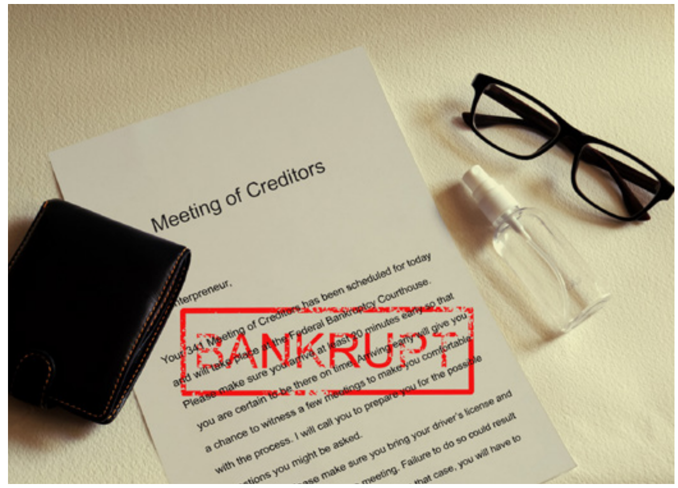
The fundamental principle barring creditors from recovering postpetition interest on their claims was incorporated into U.S. bankruptcy law—as were the exceptions, but only in part.

In pre-Bankruptcy Code cases where the debtor possessed adequate assets to pay all claims in full with interest—meaning that the payment of interest to one creditor did not impact the recovery of other creditors—principles of equity dictated that creditors be paid interest to which they were otherwise entitled, most commonly at the rate determined by their contracts with the debtor. *See Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.*, 233 U.S. 261, 266–67 (1914) (concluding "in the rare instances where the assets ultimately proved sufficient for the purpose, that creditors were entitled to interest accruing after adjudication"); *Debentureholders Protective Comm. of Cont'l Inv. Corp. v. Cont'l Inv. Corp.*, 679 F.2d 264, 269 (1st Cir. 1982) (in refusing to confirm a plan under chapter X of the Bankruptcy Act because it did not pay postpetition interest on unsecured claims, noting that "[w]here the debtor is solvent, the bankruptcy rule is that where there is a contractual provision, valid under state law, providing for interest on unpaid [installments] of interest, the bankruptcy court will enforce the contractual provision with respect to both [installments] due before and [installments] due after the petition was filed"); *Ruskin v. Griffiths*, 269 F.2d 827, 832 (2d Cir. 1959) ("[W]here there is no showing that the creditor entitled to the increased interest caused any unjust delay in the proceedings, it seems to us the opposite of equity to allow the debtor to escape the expressly bargained-for" contractual interest provision); *Sword Line, Inc. v. Indus. Comm'r of N.Y.*, 212 F.2d 865, 870 (2d Cir. 1954) (explaining that "interest ceases upon bankruptcy in the general and usual instances noted . . . unless the bankruptcy bar proves eventually nonexistent by reason of the actual solvency of the debtor"); *Johnson v. Norris*, 190 F. 459, 466 (5th Cir. 1911) (determining that debtors "should pay their debts in full, principal and interest to the time of payment whenever the assets of their estates are sufficient").

Even though section 502(b)(2) of the Bankruptcy Code provides that a claim for unmatured interest shall be disallowed, there are specific exceptions to the rule included elsewhere in the Bankruptcy Code. For example, section 506(b) of the Bankruptcy Code provides that an oversecured creditor is entitled to interest as part of its allowed secured claim.

In addition, in a chapter 7 case, the distribution scheme set forth in section 726 of the Bankruptcy Code designates as fifth in priority of payment "interest [on an unsecured claim] at the legal rate from the date of the filing of the petition." Thus, if the bankruptcy estate in chapter 7 case is sufficient to pay claims of higher priority, creditors are entitled to postpetition interest before the debtor can recover any surplus.

In a chapter 11 case, the chapter 7 priority scheme governs whether section 1129(a)(7) of the Bankruptcy Code is satisfied. Referred to as the "best interests" test, section 1129(a)(7) mandates that, unless each creditor in an impaired class accepts a chapter 11 plan, the creditor must receive at least as much under the plan as it would receive in a chapter 7 liquidation of the debtor. However, section 1129(a)(7)—and, by extension,



section 726—apply only if a class of claims is impaired by a chapter 11 plan.

In cases where interest on a claim is permitted, the rate of interest payable is unclear. Section 726(a)(5) refers to interest at "the legal rate," which could mean the contract rate, the post-judgment rate, the federal statutory rate specified in 28 U.S.C. § 1961, or some other rate.

Whether the solvent debtor exception survived enactment of the Bankruptcy Code in 1978 is a matter of dispute. A handful of rulings from the federal circuit courts have suggested that the exception survived. *See, e.g., In re Ultra Petroleum Corp.*, 943 F.3d 758, 765–66 (5th Cir. 2019) ("Our review of the record reveals no reason why the solvent debtor exception could not apply. As other circuits have recognized, 'absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights.' . . . That might be the case here. . . . But 'mindful that we are a court of review, not of first view,' we will not make the choice ourselves or weigh the equities on our own.") (citations omitted); *Gencarelli v. UPS Capital Bus. Credit*, 501 F.3d 1, 7 (1st Cir. 2007) (holding that a prepayment penalty in a solvent debtor chapter 11 case should not be disallowed under section 502(b) as unreasonable, and noting that "[t]his is a solvent debtor case and, as such, the equities strongly favor holding the debtor to his contractual obligations as long as those obligations are legally enforceable under applicable non-bankruptcy law"); *Official Comm. of Unsecured Creditors v. Dow Corning Corp. (In re Dow Corning Corp.)*, 456 F.3d 668, 678 (6th Cir. 2006) (noting that "[t]he legislative history of the Bankruptcy Code makes clear that equitable considerations operate differently when the debtor is solvent: '[C]ourts have held that where an estate is solvent, in order for a plan to be fair and equitable, unsecured and undersecured creditors' claims must be paid in full, including postpetition interest, before equity holders may participate in any recovery'" (quoting 140 Cong. Rec. H10,752–01, H10,768 (1994) (statement of Rep. Brooks, Chairman of the House Committee on the Judiciary and coauthor of the Bankruptcy Reform Act of 1994)).

RECENT COURT RULINGS

In *In re Ultra Petroleum Corp.*, 624 B.R. 178 (Bankr. S.D. Tex. 2020) ("*UPC*"), *leave to appeal granted*, No. 21-20008 (5th Cir. Jan. 5, 2020), the bankruptcy court, on remand from the Fifth Circuit, considered whether a solvent debtor was obligated to pay a make-whole premium to unsecured noteholders under its confirmed chapter 11 plan and whether the noteholders were entitled to postpetition interest on their claims pursuant to the solvent debtor exception. Among other things, the court ruled that the solvent debtor exception survived the enactment of the Bankruptcy Code. Based on the legislative history, the court wrote, "Congress gave no indication that it intended to erode the solvent debtor exception" when it enacted the Bankruptcy Code. *Id.* at 198. Moreover, it noted, "[e]quitable considerations" continue to support it, including the policy against allowing a windfall at the expense of creditors to any debtor that can afford to pay all of its debts. *Id.*

According to the court, this conclusion is also supported by post-Bankruptcy Code court rulings involving solvent debtors as well as the removal from the Bankruptcy Code in 1994 of section 1124(3). In short, the court wrote, there is a "monolithic mountain of authority, developed over nearly three hundred years in both English and American courts, holding that a solvent debtor must make its creditors whole." *Id.* at 200 (citations omitted).

The court explained that, standing alone, neither section 105(a) of the Bankruptcy Code (giving the bankruptcy court broad equitable power), section 1129(a)(7) (the best interests test), nor section 1129(b)(1) (requiring a cram-down chapter 11 plan to be fair and equitable with respect to dissenting impaired classes of creditors) is a statutory source for the solvent debtor exception. Instead, the court wrote, "piecing these Bankruptcy Code provisions together," the solvent debtor exception flows through section 1124(1), which provides that, to render a class of claims unimpaired, a plan must leave unaltered the claimants' "legal, equitable, and contractual rights." *Id.* at 202. According to the court, "[b]ecause an unimpaired creditor has equitable rights to be treated no less favorably than an impaired creditor and to be paid in full before the debtor realizes a recovery, a plan denying post-petition interest in a solvent debtor case alters the equitable rights of an unimpaired creditor under § 1124(1)." *Id.* at 203.

Finally, the bankruptcy court held that the default contract rate is the appropriate rate of interest rather than the federal judgment rate. The court explained that the noteholders' right to postpetition interest was based on "two key equitable rights"—the right to receive no less favorable treatment than impaired creditors and the right to have their contractual rights fully enforced. *Id.* at 204. According to the court, if the noteholder class were paid interest at the federal judgment rate, it would be worse off than if it were impaired under UPC's plan because "even though the [noteholders] would receive identical interest as a hypothetical impaired class, as an unimpaired class the Claimants were deprived of the right to vote for or against the plan." *Id.* In addition, the court noted, limiting the noteholder class to interest at the federal judgment rate would contravene the purpose of the solvent debtor exception, which dictates that when a debtor is solvent, "a bankruptcy court's role is merely to enforce the contractual rights of the parties." *Id.*

In *In re Cuker Interactive, LLC*, 622 B.R. 67 (Bankr. S.D. Cal. 2020), a class of unsecured creditors consisting of two law firms opposed confirmation of a chapter 11 plan for a solvent debtor under which they were to be paid in full with interest, arguing that their claims were impaired because the plan proposed to pay interest at the federal judgment rate rather than the contract rate. Initially, the court noted that, in accordance with Ninth Circuit precedent, a solvent debtor must pay postpetition interest to general unsecured creditors "at the legal rate." *Id.* at 69 (citing *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002) (applying the federal judgment rate in cases where creditors were impaired); *In re PG&E, Corp.*, 610 B.R. 308 (Bankr. N.D. Cal. 2019) (postpetition interest must be paid at the federal judgment rate to render unsecured claims unimpaired), *aff'd sub nom. Official Committee of Unsecured Creditors v. PG&E Corp.*, No. 20-cv-04570-HSG (N.D. Cal. May 21, 2021), *appeal filed*, No. 21-16043 (9th Cir. June 17, 2021); *In re Beguelin*, 220 B.R. 94 (B.A.P. 9th Cir. 1998) (same)).

On the basis of that precedent, the court ruled that, in accordance with the solvent debtor exception, the bankruptcy court's role in a case involving a solvent debtor was "'merely to enforce the contractual rights of the parties.'" *Cuker*, 622 B.R. at 71 (quoting *UPC*, 624 B.R. at 195). Moreover, the *Cuker* court explained, construing the solvent debtor exception to require the payment of contract-rate interest might be problematic in some cases:

While the "solvent-debtor exception" would work in cases with only a few creditors, the Court agrees that application of this exception poses a significant threat to the bankruptcy court's administrative efficiency in larger cases. *See In re Cardelucci*, 285 F.3d at 1236 (recognizing that even on occasions when a debtor may receive a windfall, the uniform approach of applying the Federal Judgment Rate to calculate postpetition interest to unsecured creditors is a more efficient and fair and equitable outcome than applying each creditors' contractual rate or the applicable state law judgment rate, which varies state-by-state). If the "solvent-debtor exception" were applied to a debtor with hundreds or thousands of creditors, the estate might be compelled to carry on indefinitely, at a huge administrative expense, determining the individual contractual rights of each individual unsecured creditor; and perhaps, resulting in different treatment to creditors of the same class. The Court agrees with the Ninth Circuit in *Cardelucci* that there is no reason Congress would have intended to create such a costly administrative inefficiency in the bankruptcy courts.

Id. The court accordingly held that interest must be paid at the federal judgment rate.

MULLINS

Joseph R. Mullins ("debtor") filed for chapter 11 protection on May 8, 2019, in the District of Massachusetts. He proposed a chapter 11 plan that would pay general unsecured claims in full with prepetition and post-effective date interest, but would not pay unsecured creditors interest that accrued between the petition date and the effective date ("pendency interest"). As of the date of the plan confirmation hearing, the debtor was solvent to the tune of approximately $50 million.

The unsecured creditor class objected to confirmation, arguing that the proposed plan impaired their claims and that it violated the best interests test (section 1129(a)(7)) and the absolute priority rule (section 1129(b)(2)(B)) by not granting creditors pendency interest at the rate prescribed by state law. According to them, section 1129(b)(2)(B) is ambiguous and uses broad language that must be interpreted through the lens of the solvent debtor exception.

The debtor countered that section 1129(b)(2)(B) is clear and requires merely that interest be paid from the plan effective date to ensure that general unsecured creditors receive payments having a present value equal to their allowed claims. According to the debtor, because the provision refers to "the allowed amount of such claim," the court need only look to section 502(b)(2), which provides that an allowed claim excludes unmatured interest as of the petition date. Therefore, the debtor argued, section 502(b)(2) established that the "allowed" amount of each general unsecured claim did not include pendency interest, and the absolute priority rule and the fair and equitable standard were satisfied because the plan proposed to pay the unsecured claims in full with post-effective date interest at 3.25%—an adjusted market rate equaling or exceeding the requirements of the absolute priority rule.

The debtor also argued that pendency interest should be paid only if required to satisfy the best interests test of section 1129(a)(7) and, if so required, at the federal judgment rate. The debtor urged the court not to adopt a "free-floating solvent debtor exception and a balancing of the equities test." *Mullins*, 2021 WL 2948685, at *8.

THE BANKRUPTCY COURT'S RULING

U.S. Bankruptcy Judge Christopher J. Panos concluded that the solvent debtor exception survived enactment of the Bankruptcy Code by means of the absolute priority rule and the best interests test.

He reasoned that the lawmakers' use of the phrase "fair and equitable" in sections 1129(b)(1) and 1129(b)(2) "was intended to codify at least a century of bankruptcy jurisprudence . . . and grounded the solvent debtor exception as it related to impaired creditors in that provision." *Id.* Judge Panos also noted that, by using the term "includes" in the opening clause of section 1129(b)(2), Congress did not intend the minimum requirements expressly set forth regarding secured claims, unsecured claims, and interests to limit the meaning of "fair and equitable." Moreover, he explained, the legislative history of the provision does not suggest that "Congress intended to abrogate the solvent debtor exception." *Id.* at *9.

According to Judge Panos, this conclusion is bolstered by the legislative history of the 1994 amendments to the Bankruptcy Code, when Congress repealed section 1124(3) in response to the *New Valley* decision:

The words "fair and equitable" are terms of art that have a well-established meaning under the case law of the Bankruptcy Act as well as under the Bankruptcy Code. Specifically, courts have held that where an estate is solvent, in order for a plan to be fair and equitable, unsecured and undersecured creditors'

claims must be paid in full, including postpetition interest, before equity holders may participate in any recovery.

Id. at *10 (quoting H.R. Rep. No. 103–835 at 47–48 (1994)). Judge Panos acknowledged that divining lawmakers' intent regarding a specific provision of a statute is "an imprecise and unsatisfying exercise." However, on the basis of this legislative history and relevant court rulings, he was "persuaded that Congress must have been cognizant of the long-established solvent debtor exception and there is no evidence of any intent to abrogate centuries of law that had developed by enacting the Bankruptcy Code." *Id.* at *11.

Construing section 1129(b) as not abrogating the solvent debtor exception, Judge Panos noted, does not conflict with section 502(b)(2). He explained that, although section 502(b)(2) unambiguously provides that postpetition interest cannot be included as part of an allowed claim, "there is a significant distinction between whether postpetition interest can be *part* of an allowed claim and whether there are circumstances under which the debtor may be required to pay postpetition interest *on* an allowed claim." *Id.* at *12.

Judge Panos emphasized that he was not adopting a "free-floating solvent debtor exception and a balancing of the equities test." *Id.* at *8 n.8. Rather, he wrote, "well-developed jurisprudence and the evidentiary record in this and in future cases will dictate the course of the 'solvent debtor exception' in these rare cases—unless a future statutory amendment or other controlling appellate authority mandates a different approach." *Id.* Moreover, because he concluded that the statutory provisions codifying the absolute priority rule and the best interests test required the payment of pendency interest in this case, Judge Panos also declined to decide "whether the solvent debtor exception is founded more generally in an 'equitable right' inherent in insolvency proceedings under the Code rather than in § 1129(b) or any other specific provisions of the Code.» *Id.* at *13 n.12.

Judge Panos concluded that the payment of pendency interest to unsecured creditors was warranted in the case before him. Among other things, Judge Panos emphasized that the debtor unquestionably had more than enough cash to fund distributions under his chapter 11 plan, including the payment of pendency interest to the unsecured creditors class.

Judge Panos then addressed the appropriate rate of pendency interest. He noted that setting the rate was within his discretion, but acknowledged that the weight of authority, "absent strong equitable considerations," supported a finding that pendency interest at the state law contract rate should be paid by a solvent debtor to a dissenting class of unsecured creditors for a chapter 11 plan to be fair and equitable. *Id.* at *15. Even so, Judge Panos explained, the claims of unsecured creditors in this case were based on a state court judgment rather than a contract. He therefore concluded that, to satisfy the "fair and equitable standard," the debtor had to propose an amended plan that paid pendency interest to unsecured creditors at the state judgment rate (here, 12% per annum), which significantly exceeded any risk-based market rate.

However, Judge Panos agreed with the majority of other courts, finding that, to satisfy the "best interests" test, which incorporates section 726(a)(5)'s dictate that interest be paid at "the legal rate" in a case involving sufficient assets, pendency interest must be paid at the federal judgment rate (approximately 0.74% per annum).

The unsecured creditors argued that, in a solvent debtor case, the court had the discretion to interpret "the legal rate" as the state judgment rate applicable to their claims as an extension of the solvent debtor exception. However, based on his holdings regarding the fair and equitable standard requirements and the relationship of those requirements to the best interests test, Judge Panos declined "to explicitly decide in this case whether, when a debtor is liquidation solvent, a rate of interest higher than the federal judgment rate might constitute 'the legal rate' for purposes of § 726(a)(5) as applied by § 1129(a)(7)(A)(ii) or whether a more general ‹solvent debtor exception' might dictate that result." *Id.* at *19 (footnote omitted).

He accordingly denied confirmation of the debtor's chapter 11 plan without prejudice to the debtor's right to propose an amended plan.

OUTLOOK

The dispute regarding the continued vitality of the solvent debtor exception has been examined in several recent court rulings. The significance of these decisions, however, is limited because solvent debtor chapter 11 cases are rare. Even so, they reinforce the well-established statutory and equitable principle that debtors with the means to pay all of their creditors in full should be obligated to do so.

Although the courts in *Mullins* and *UPC* agreed that the solvent debtor exception survived the enactment of the Bankruptcy Code, they notably disagreed over the statutory basis for its continued application. In *Mullins*, the court concluded that sections 1129(a)(7) and 1129(b)(2) provide the necessary authority, whereas the *UPC* court specifically rejected reliance on these sections (as well as the court's broad equitable authority under section 105(a)) *as a basis for applying the exception. Instead, the court in UPC determined that the solvent debtor exception flows through section 1124(1), which conditions nonimpairment of a class of claims on leaving unaltered the claimants' "legal, equitable, and* contractual rights."

Court rulings regarding the rate of interest—whether the federal judgment rate, a state judgment rate or the contractual default rate—that must be paid to unsecured creditors in a solvent debtor case have been a mixed bag, with a possible circuit split in the offing due to pending circuit court appeals in the *UPC* and *PG&E* cases. The issue has also arisen in the chapter 11 cases of The Hertz Corporation and its affiliates (collectively, "Hertz"). The U.S. Bankruptcy Court for the District of Delaware confirmed a chapter 11 plan for Hertz on June 10, 2021. The plan provided for the payment of postpetition interest to unsecured creditors at the federal judgment rate, but preserved for future litigation the dispute over both the requirement to pay postpetition interest to render the claims unimpaired and the appropriate rate of interest.

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AN EQUITABLE TIGHTROPE: *BLACKJEWEL*'S BALANCING ACT ON AFTER-ACQUIRED PROPERTY IN BANKRUPTCY

Taylre C. Janak • Mark G. Douglas

It is well recognized that, in keeping with the "fresh start" or "rehabilitative" policy, the Bankruptcy Code invalidates after-acquired property clauses in prepetition security agreements, but also includes an exception to the general rule for prepetition liens on the proceeds, products, offspring, or profits of prepetition collateral. Less well understood is that there is an "exception to the exception" if a bankruptcy court determines that the "equities of the case" suggest that property acquired by the estate should be free of such liens.

This exception was recently addressed by the U.S. District Court for the Southern District of West Virginia. In *United Bank v. Blackjewel, L.L.C. (In re Blackjewel, L.L.C.)*, 2021 WL 2667511 (S.D. W. Va. June 29, 2021), *appeal filed*, No. 21-1831 (4th Cir. July 30, 2021), the court affirmed a bankruptcy court order denying an undersecured lender's motion seeking as a form of "adequate protection" the payment of asset sale proceeds allegedly subject to its prepetition security interest in receivables. According to the district court, the bankruptcy court did not abuse its discretion in finding that it would be inequitable for the lender's liens to attach to the proceeds of a postpetition sale because "allowing [the lender] to receive the proceeds of unencumbered estate assets would be inequitable to the unsecured creditors."

INVALIDATION OF CERTAIN AFTER-ACQUIRED PROPERTY CLAUSES IN BANKRUPTCY

Section 552(a) of the Bankruptcy Code states that "[e]xcept as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." This provision reflects the principle that "the debtor's fresh start should entitle the debtor to use after-acquired property, so long as it is not property of the estate under section 541(a)(6) [defining as "estate property" the proceeds, product, offspring, rents, or profits of or from estate property], free and clear of a prebankruptcy lien." COLLIER ON BANKRUPTCY ("COLLIER") ¶ 552.01 (16th ed. 2021).

Section 552(b)(1), however, includes a limited "savings clause" for certain security interests. That section provides, with limited exceptions not relevant here:

> [I]f the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products,

offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

11 U.S.C. § 522(b)(1). A separate savings clause for pledged real property rents and related fees is covered by section 552(b)(2).

Thus, the savings clause for liens on postpetition proceeds, products, or profits of (or rents from) property pledged prepetition is itself subject to an exception "to the extent that the court, after notice and a hearing and based [on] the equities of the case, orders otherwise." *In re Las Vegas Monorail, Co.*, 429 B.R. 317, 344 (Bankr. D. Nev. 2010). This "exception to the exception" authorizes a bankruptcy court to utilize its discretion when deciding whether to allow a prepetition lien to survive postpetition. *See United Va. Bank v. Slab Fork Coal Co.*, 784 F.2d 1188, 1191 (4th Cir. 1986); *Gray v. Bank of Early*, 2018 WL 9415069, *6 (M.D. Ga. Sept. 20, 2018).

Courts have typically applied the "equities of the case" exception in cases where a secured creditor would receive a windfall because, for example, the value of the creditor's collateral is increased by an expenditure of estate funds that would otherwise be distributed to unsecured creditors in the case. *Id.* (citing cases and noting that five courts of appeals have embraced this interpretation of section 552(b)(1)'s purpose and application); *accord In re Transcare Corp.*, 2020 WL 8021060, *41 (Bankr. S.D.N.Y. July 6, 2020) ("The 'equities of the case' exception is a means of allocating the value of post-petition collateral proceeds between the secured creditor and the estate."); *see generally* COLLIER at ¶ 552.02[4].

The legislative history of section 552(b) indicates that the exception is intended to cover situations such as when raw materials are converted into inventory, or inventory into accounts at the expense of the bankruptcy estate, therefore depleting available funds for general unsecured creditors. *See* H. Rep. No. 95–595, at 376–77 (1977). In enacting it, lawmakers strove to strike an appropriate balance between the rights of secured creditors and the rehabilitative purposes of the Bankruptcy Code. *See Slab Fork*, 784 F.2d at 1191.

Guided by the legislative history, some courts have examined three factors when determining whether the equities of the case exception should apply: "the amount of time and estate funds expended on the collateral, the position of the secured party, and the rehabilitative nature of the bankruptcy case." *In re Laurel Hill Paper Co.*, 393 B.R. 89, 93 (Bankr. M.D.N.C. 2008). Other courts have "conducted a balancing of equities to determine whether a security interest in post-petition proceeds should be reduced." *Gray*, 2018 WL 9415069, at *9 (citing and discussing cases).

BLACKJEWEL

In July 2017, coal mining company Blackjewel L.L.C. ("Blackjewel") became a co-obligor on a loan made to a Blackjewel affiliate by United Bank ("lender") under a 2012 loan and security agreement. The lender's collateral originally included the affiliate's "accounts, receivables and inventory," but was amended in 2013 to grant the lender a security interest in the affiliate's property, "whether now owned or hereafter acquired," including, among other things, all accounts and receivables, all "rights, agreements, and property securing or relating to payment of the [r]eceivables," all "[p]roceeds and products of all of the foregoing in any form, . . . and all increases and profits received from all of the foregoing." The lender renewed its financing statements covering this collateral (owned by both the affiliate and Blackjewel) after Blackjewel became a co-obligor on the loan.

Also in July 2017, Riverstone Credit Partners ("Riverstone") agreed to loan Blackjewel $34 million in exchange for a security interest in substantially all of Blackjewel's assets, including coal mined from Wyoming.

In 2018, Blackjewel entered into a coal supply agreement ("BJMS coal agreement") with Blackjewel Marketing and Sales LP ("BJMS"), whereby Blackjewel agreed to sell all coal produced from its Wyoming mines to BJMS.

As of June 2019, there were no outstanding amounts owed by BJMS to Blackjewel under the BJMS coal agreement (or a previous agreement with BJMS's predecessor-in-interest), meaning that Blackjewel had no corresponding accounts receivable.

Blackjewel and certain affiliates (collectively, "debtors") filed for chapter 11 protection in July 2019 in the Southern District of West Virginia.

In August 2019, the federal government halted the transport of certain coal shipments from the debtors' properties in Kentucky and Virginia, alleging that the debtors failed to pay prepetition employee wages and that the coal shipments were therefore "hot goods" under applicable federal law.

The lender filed claims in the chapter 11 cases asserting that it was owed approximately $7 million.

In October 2019, the debtors moved for authorization to sell substantially all of their Wyoming mining assets. In connection with the proposed sale, the debtors sought court approval of several settlement agreements, including: (i) an agreement with BJMS providing that BJMS would pay the debtors for coal mined postpetition and the parties would exchange mutual releases; (ii) an agreement with the federal government settling the hot goods dispute under which the debtors would use a portion of the BJMS settlement proceeds to pay the outstanding wage claims of employees; and (iii) an agreement with Riverstone under which the debtors would pay Riverstone $32 million in exchange for a release of its liens.

The bankruptcy court approved the sale and the related settlement agreements on October 4, 2019.

In accordance with the BJMS settlement, BJMS then paid the debtors $8,513,496, consisting of: (i) $3,038,496 for postpetition accounts receivable generated between September 27, 2019, and the effective date of the sale; and (ii) $5,475,000 for accounts receivable generated between the bankruptcy petition date and September 26, 2019. Thereafter, the debtors used approximately $6.3 million of the settlement proceeds to pay employee wages, leaving approximately $2.1 million in "residual proceeds" from the BJMS settlement.

After the sale, the lender, asserting that its claim was undersecured and that its security interest attached to both prepetition and postpetition accounts receivable, filed a motion seeking payment of the residual proceeds as a form of "adequate protection." The debtors objected. They argued that the lender's lien did not encumber the residual proceeds for the following reasons: (i) the BJMS settlement proceeds could not be proceeds of the debtors' prepetition accounts receivable because, as of the petition date, there were no amounts owed by BJMS to the debtors; (ii) even if the BJMS settlement proceeds were proceeds of the debtors' postpetition accounts receivable, the lender did not have a lien on such proceeds because section 552(a) severed the lien on the debtors' accounts receivable as of the petition date; (iii) section 552(b)(1) did not apply because postpetition accounts receivable are not proceeds of prepetition accounts receivable; and (iv) even if the lender's lien technically extended to the BJMS settlement proceeds, the court, in its discretion and pursuant to section 552(b)(1), should determine that the equities of the case precluded the lender's lien from attaching to the residual proceeds.

The bankruptcy court denied the lender's adequate protection motion, finding that the lender failed to perfect its alleged security interest under applicable law in the BJMS coal agreement. It also found that, unlike Riverstone, the lender never had a lien (perfected or otherwise) on coal (mined or unmined) from Blackjewel's Wyoming mines.

Finally, the court concluded that the equities of the case did not favor the lender. First, it explained, the coal sold by the debtors to BJMS postpetition was not encumbered by the lender's liens, and, even if the coal was later converted to create encumbered "proceeds" of the BJMS coal agreement, allowing any prepetition security interest to attach to such postpetition proceeds would constitute a windfall to the lender at the expense of the estate and unsecured creditors.

Second, the court wrote, even if the lender had perfected its interest, "it would be inequitable for any liens to attach to the postpetition proceeds . . . because those proceeds arose out of the unencumbered inventory of the estate, [and] allowing [the lender] to receive the proceeds of unencumbered estate assets would be inequitable to the unsecured creditors."

The lender appealed to the district court.

THE DISTRICT COURT'S RULING

On appeal, the district court framed the issue before it as "whether the bankruptcy court abused its discretion by relying on a clearly erroneous factual finding to rule that even if [the lender] had perfected its valid security interest, the equities of the case nonetheless prevent that interest from attaching." *Blackjewel*, 2021 WL 2667511, at *4.

The lender argued on appeal that the bankruptcy court's equities of the case holding was an abuse of discretion because the decision was based on the "erroneous factual finding" that the Wyoming coal was unencumbered, albeit not by the lender's security interest, but by Riverstone's lien. According to the lender, because the coal was subject to Riverstone's lien, "depriving [the lender] of its security interest does not protect the unsecured creditors in this case," but instead "creates a windfall for unsecured creditors where none should exist."

The de btors countered that the case was a "textbook" equities of the case situation. They argued that:

(i) It was undisputed that, when the debtors filed for bankruptcy, no accounts receivable remained outstanding on the coal supply contracts in which the lender asserted a security interest;
(ii) After the petition date, the debtors took several steps to increase the value of the lender's collateral, including obtaining postpetition financing, resolving disputes with their employees, business partners, and the federal government, and resuming limited mining operations in Wyoming;
(iii) Through these efforts, the debtors converted "raw materials" (unextracted coal) into "inventory," and "inventory into accounts";
(iv) The residual proceeds represented the remainder of the debtor's postpetition coal sales in Wyoming, after the debtors, BJMS, and Riverstone settled and mutually released all claims against each other, and therefore, the proceeds were unencumbered assets of the estate;
(v) Even if the coal was encumbered by Riverstone's lien, the lender failed to explain why a lien held (and released) by a different secured party would affect the bankruptcy court's conclusion that it was "inequitable" for the lender to receive the postpetition residual proceeds; and
(vi) Allowing the lender to receive the proceeds of sales generated solely by the postpetition efforts of the debtors "would create a windfall to the bank at the expense of the estate and unsecured creditors," who owned the coal at issue and were directly responsible for any increase in value realized through the postpetition sales.

Id. at *6.

U.S. District Judge Robert C. Chambers rejected the lender's argument that depriving it of its security interest would create an unearned windfall for unsecured creditors. He noted that the lender's contention hinged on the bankruptcy court's decision in *Laurel Hill*, where the court found that "payments at the expense of secured creditors rather than at the expense of the estate, do not support an equities of the case award to the unsecured creditors."

According to Judge Chambers, *Laurel Hill* is distinguishable. In that case, he explained, the assets in question were encumbered by the very creditors who sought payment pursuant to their security interest, leading the court to conclude that the equities of the case exception could not be applied to deprive the secured creditors access to the sale proceeds, because "[t]he costs of the alleged enhancement thus were paid from encumbered funds and not from unencumbered funds of the estate." By contrast, Judge Chambers noted, in this case, estate assets sold to create the BJMS settlement proceeds were encumbered by a different creditor (Riverstone) that released its lien and never claimed any right to the residual proceeds. *Id.* at *7.

In addition, Judge Chambers explained, even if the lender had a security interest in the proceeds generated by the BJMS coal agreement, it did not have a security interest in Blackjewel's coal, which it converted into inventory and then into accounts, and, in doing so, depleted estate assets that would otherwise be available to pay unsecured creditors. Moreover, although those assets may have been encumbered by a different secured creditor at the time they were converted into inventory, they were released from that encumbrance when the BJMS settlement became effective.

The district court accordingly ruled that the bankruptcy court did not abuse its discretion in concluding that it would be inequitable for the lender alone to reap the benefits of the residual proceeds from the BJMS settlement.

OUTLOOK

Blackjewel does not break any new ground on section 552 and the "equities of the case" exception. Even so, the ruling is a reminder to secured creditors that a bankruptcy court has broad discretion to disallow liens on postpetition proceeds, products, offspring, or profits based on the equities of the case. It also reinforces the importance of careful drafting of security agreements and financing statements to identify collateral clearly.

The lender appealed the district court's ruling to the U.S. Court of Appeals for the Fourth Circuit, which will have another opportunity to weigh in on the equities of the case exception in section 552(b).

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ANOTHER BANKRUPTCY COURT JOINS THE DEBATE ON THE VALIDITY OF BANKRUPTCY BLOCKING RESTRICTIONS

Mark A. Cody • Mark G. Douglas

Courts disagree over whether provisions in a borrower's organizational documents designed to prevent the borrower from filing for bankruptcy are enforceable as a matter of federal public policy or applicable state law. There have been a handful of court rulings addressing this issue in recent years, with mixed outcomes. The U.S. Bankruptcy Court for the District of New Jersey weighed in on this controversial issue in *In re 3P Hightstown, LLC*, 631 B.R. 205 (Bankr. D.N.J. 2021). The court dismissed a chapter 11 case filed by a Delaware limited liability company ("LLC") because the LLC agreement precluded a bankruptcy filing without the consent of a holder of preferred membership interests whose capital contributions had not been repaid. According to the court, the bankruptcy blocking provision was not void as a matter of public policy because, under both Delaware law and the express terms of the LLC agreement, the holder of the preferred membership interests, which held a noncontrolling position, had no fiduciary duties.

BANKRUPTCY RISK MANAGEMENT BY LENDERS

Astute lenders are always looking for ways to minimize risk exposure, protect remedies, and maximize recoveries in connection with a loan, especially with respect to borrowers that have the potential to become financially distressed. Some of these efforts have been directed toward minimizing the likelihood of a borrower's bankruptcy filing by making the borrower "bankruptcy remote," such as by implementing a "blocking director" organizational structure or issuing "golden shares" that, as the term is used in a bankruptcy context, give the holder the right to preempt a bankruptcy filing. Depending on the jurisdiction involved and the particular circumstances, including the terms of the relevant documents, these mechanisms may or may not be enforceable.

As a rule, corporate formalities and applicable state law must be satisfied in commencing a bankruptcy case. *See In re NNN 123 N. Wacker, LLC*, 510 B.R. 854 (Bankr. N.D. Ill. 2014) (citing *Price v. Gurney*, 324 U.S. 100 (1945)); *In re Comscape Telecommunications, Inc.*, 423 B.R. 816 (Bankr. S.D. Ohio 2010); *In re Gen-Air Plumbing & Remodeling, Inc.*, 208 B.R. 426 (Bankr. N.D. Ill. 1997). As a result, while contractual provisions that prohibit a bankruptcy filing may be unenforceable as a matter of public policy, other measures designed to preclude a debtor from filing for bankruptcy may be available.

Lenders, investors, and other parties seeking to prevent or limit the possibility of a bankruptcy filing have attempted to sidestep the public policy invalidating contractual waivers of a debtor's right to file for bankruptcy protection by eroding or eliminating the debtor's authority to file for bankruptcy under its governing organizational documents. *See, e.g., In re DB Capital Holdings, LLC*, 2010 WL 4925811 (B.A.P. 10th Cir. Dec. 6, 2010); *NNN 123 N. Wacker*, 510 B.R. at 862; *In re Houston Regional Sports Network, LP*, 505 B.R. 468 (Bankr. S.D. Tex. 2014); *In re Quad-C Funding LLC*, 496 B.R. 135 (Bankr. S.D.N.Y. 2013); *In re FKF Madison Park Group Owner, LLC*, 2011 WL 350306 (Bankr. D. Del. Jan. 31, 2011); *In re Global Ship Sys. LLC*, 391 B.R. 193 (Bankr. S.D. Ga. 2007); *In re Kingston Square Associates*, 214 B.R. 713 (Bankr. S.D.N.Y. 1997).

These types of provisions have not always been enforced, particularly where the organizational documents include an outright prohibition of any bankruptcy filing. *See In re Lexington Hospitality Group*, 577 B.R. 676 (Bankr. E.D. Ky. 2017) (where an LLC debtor's operating agreement provided for a lender representative to be a 50% member of the debtor until the loan was repaid and included various restrictions on the debtor's ability to file for bankruptcy while the loan was outstanding, the bankruptcy filing restrictions acted as an absolute bar to a bankruptcy filing, which is void as against public policy); *In re Bay Club Partners-472, LLC*, 2014 WL 1796688 (Bankr. D. Or. May 6, 2014) (refusing to enforce a restrictive covenant in a debtor LLC's operating agreement prohibiting a bankruptcy filing and stating that the covenant "is no less the maneuver of an 'astute creditor' to preclude [the LLC] from availing itself of the protections of the Bankruptcy Code prepetition, and it is unenforceable as such, as a matter of public policy").

Many of these efforts have been directed toward "bankruptcy remote" special purpose entities (sometimes referred to as special purpose vehicles) ("SPEs"). An SPE is an entity created in connection with a financing or securitization transaction structured to ring-fence the SPE's assets from creditors other than secured creditors or investors (e.g., trust certificate holders) that provide financing or capital to the SPE.

For example, in *In re Gen. Growth Props., Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009), the court denied a motion by secured lenders to dismiss voluntary chapter 11 filings by several SPE subsidiaries of a real estate investment trust. The lenders argued, among other things, that the loan agreements with the SPEs provided that an SPE could not file for bankruptcy without the approval of an independent director nominated by the lenders. The lenders also argued that, because the SPEs had no business need to file for bankruptcy and because the trust exercised its right to replace the independent directors less than 30 days before the bankruptcy filings, the SPE's chapter 11 filings had not been undertaken in good faith.

The *General Growth* court ruled that it was not bad faith to replace the SPEs' independent directors with new independent directors days before the bankruptcy filings because the new directors had expertise in real estate, commercial mortgage-backed securities, and bankruptcy matters. The court determined that, even though the SPEs had strong cash flows, bankruptcy remote structures, and no debt defaults, the chapter 11 filings had not been made in bad faith. The court found that it could consider the interests of the entire group of affiliated debtors as well as each individual debtor in assessing the legitimacy of the chapter 11 filings.

Among the potential flaws in the bankruptcy remote SPE structure brought to light by *General Growth* is the requirement under applicable Delaware law for independent directors to consider not only the interests of creditors, as mandated in the charter or other organizational documents, but also the interests of shareholders. Thus, an independent director or manager who simply votes to block a bankruptcy filing at the behest of a secured creditor without considering the impact on shareholders could be deemed to have violated his or her fiduciary duties of care and loyalty. *See In re Lake Mich. Beach Pottawattamie Resort LLC*, 547 B.R. 899 (Bankr. N.D. Ill. 2016) (a "blocking" member provision in the membership agreement of a special purpose limited liability company was unenforceable because it did not require the member to comply with its fiduciary obligations under applicable non-bankruptcy law).

Courts disagree as to the enforceability of blocking provisions and, in particular, "golden shares" that, as the term is used in a bankruptcy context, give the shareholder the right to preempt a bankruptcy filing. For example, in *Lexington Hospitality*, the bankruptcy court denied a motion to dismiss a bankruptcy case filed by an entity wholly owned by a creditor that held a golden share / blocking provision because the court concluded that the entity was not truly independent. 577 B.R. at 684–85. In addition, in *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016), the court ruled that a provision in a limited liability company's governance document:

> the sole purpose and effect of which is to place into the hands of a single, minority equity holder [by means of a "golden share"] the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor—not equity holder—and which owes no duty to anyone but itself in connection with an LLC's decision to seek federal bankruptcy relief, is tantamount to an absolute waiver of that right, and, even if arguably permitted by state law, is void as contrary to federal public policy.

Id. at 265; *see also In re Tara Retail Group, LLC*, 2017 WL 1788428 (Bankr. N.D. W. Va. May 4, 2017) (even though a creditor held a golden share or blocking provision, it ratified the debtor's bankruptcy filing by its silence), *appeal dismissed*, 2017 WL 2837015 (N.D. W. Va. June 30, 2017).

By contrast, in *In re Squire Court Partners*, 574 B.R. 701, 704 (E.D. Ark. 2017), the court ruled that, where a partnership agreement required the unanimous consent of the partners before the limited partnership could "file a petition seeking, or consent to, reorganization or relief under any applicable federal or state law relating to bankruptcy," the bankruptcy court properly dismissed a bankruptcy filing by the managing partner without the consent of the other partners.

One of the seminal cases addressing this issue is *In re Franchise Services of North America, Inc.*, 891 F.3d 198 (5th Cir. 2018). In *Franchise Services*, as a condition to an investment by a majority preferred stockholder that was controlled by one of the debtor's creditors, the debtor amended its certificate of incorporation to provide that it could not "effect any Liquidation Event" (defined to include a bankruptcy filing) without the approval of the holders of a majority of both its preferred and common stock. The U.S. Court of Appeals for the Fifth Circuit ruled that "[t]here is no prohibition in federal bankruptcy law against granting a preferred shareholder the right to prevent a voluntary bankruptcy filing just because the shareholder also happens to be [controlled by] an unsecured creditor. . . ." *Id.* at 208. The Fifth Circuit rejected the argument that, even if a shareholder-creditor can hold a bankruptcy veto right, such a right "remains void in the absence of a concomitant fiduciary duty." No statute or binding case law, the court explained, "licenses this court to ignore corporate foundational documents, deprive a bona fide shareholder of its voting rights, and reallocate corporate authority to file for bankruptcy just because the shareholder also happens to be an unsecured creditor." *Id.* at 209.

Other notable cases include *In re Insight Terminal Solutions, LLC*, 2019 WL 4640773 (Bankr. W.D. Ky. Sept. 23, 2019), and *In re Pace Industries, LLC*, No. 20-10927 (MFW) (Bankr. D. Del. May 5, 2020).

In *Insight*, a lender, as a condition to extending the maturity date of a loan to a Delaware LLC, demanded that the borrower and its guarantor amend their operating agreements so that neither would be permitted to file for bankruptcy unless they first obtained the prior written consent of all holders of the membership units in the borrower that had been pledged to secure the loan. After defaulting on the loan, but before the lender could foreclose on the pledged membership units, the borrower and the guarantor again amended their operating agreements to remove the lender consent provision and filed for chapter 11 protection. The lender moved to dismiss. The bankruptcy court denied the motion, finding that the debtors had authority under Delaware law to file for bankruptcy in accordance with their amended operating agreements, and ruling that "attempts to limit the Debtors' access to the bankruptcy process were against public policy and invalid." *Insight*, 2019 WL 4640773, at *3.

In *Pace*, a Delaware corporation amended its certificate of incorporation in connection with a pre-bankruptcy debt-for-equity swap to provide that any voluntary bankruptcy filing by the company or its affiliates "shall require the written consent or affirmative vote of the holders of a majority in interest of the [new preferred stock]. . ., and any such action taken without such consent or vote shall be null and void ab initio, and of no force or effect." The company and certain affiliates later filed prepackaged chapter 11 cases, without the consent of a majority of the preferred stockholders, who moved to dismiss the bankruptcy filings as unauthorized. The stockholders acknowledged cases finding that shareholder bankruptcy consent rights violate public policy if exercised by a shareholder that is also a creditor holding a "golden share," but argued that they were preferred stockholders only, not creditors. They also argued that, consistent with *Franchise Services*, a minority shareholder (which they all were) is not a controlling shareholder with fiduciary duties.

Ruling from the bench, the bankruptcy court denied the motion to dismiss, holding as a matter of first impression that, on these facts, "a blocking right by a shareholder who is not a creditor is void as contrary to federal public policy that favors the constitutional right to file bankruptcy." *Pace*, No. 20-10927 (MFW) (Bankr. D. Del. May 6, 2020), Transcript of Telephonic Hearing at 38 [Doc. No. 147].

The *Pace* court "respectfully declined" to follow *Franchise Services*, noting that it saw "no reason to conclude that a minority shareholder has any more right to block a bankruptcy—the constitutional right to file a bankruptcy by a corporation—than a creditor does." *Id.* at 40. Moreover, it explained, contrary to the Fifth Circuit's interpretation of Delaware law in *Franchise Services*, under Delaware law, "a blocking right, such as exercised in the circumstances of this case, would create a fiduciary duty on the part of the shareholder; a fiduciary duty that, with the debtor in the zone of insolvency, is owed not only to other shareholders, but also to all creditors." *Id.* at 41. Other factors combined with the blocking right, the court noted (i.e., the debtors were in the zone of insolvency, lacked liquidity, and could not pay their debts as they matured without debtor-in-possession financing, coupled with severe operational disruption due to the pandemic), supported a finding that the preferred shareholders' blocking right created a fiduciary duty.

3P HIGHTSTOWN

In 2019, 3P Equity Capital Inc. ("3PEC"), an affiliate of Delaware LLC 3P Hightstown, LLC ("debtor"), borrowed $420,000 from Progress Direct LLC ("Progress"). The loan was secured by a minority membership interest held by 3PEC in a joint venture known as 3PRC, LLC. In September 2019, 3PEC assigned that membership interest, subject to Progress's lien, to the debtor.

In December 2019, the debtor raised $500,000 in new capital from an investor group ("4J Group") in exchange for preferred membership interests. The 4J Group also loaned the debtor $125,000 on a subordinated basis. In July 2020, Hightstown

Enterprises, LLC ("HEL") paid $625,000 to acquire the 4J Group loan as well as its preferred membership interests in the debtor. In September 2020, Progress also sold its secured loan to HEL.

The LLC agreement between the debtor and its members included a provision limiting the ability of the debtor's management to take certain actions, including filing for bankruptcy:

> Notwithstanding anything to the contrary contained in this Agreement, until such time as the Preferred Unreturned Capital Value has been reduced to zero, the Company shall not, and shall not permit any of the Company Subsidiaries to engage in or cause any of the following transactions or take any of the following actions, and the Board shall not permit or cause the Company or any of the Company Subsidiaries to engage in, take, or cause any such action, in each case except with the prior approval of the holders of a majority of the outstanding [preferred membership interests] voting separately as a class: . . . (xi) the initiation by the Company or any Company Subsidiary of a bankruptcy proceeding (or consent to any involuntary bankruptcy proceeding).

The LLC agreement also included a "limitation of liability" provision stating as follows:

> This Agreement is not intended to, and does not, create or impose any fiduciary duty on any Covered Person. Furthermore, each of the Members and the Company hereby waives any and all fiduciary duties that, absent such waiver, may be implied by Applicable Law, and in doing so, acknowledges and agrees that the duties and obligations of each Covered Person to each other and to the Company are only as expressly set forth in this Agreement. The provisions of this Agreement, to the extent that they restrict the duties and liabilities of a Covered Person otherwise existing at law or in equity, are agreed by the Members to replace such other duties and liabilities of such Covered Person.

In April 2021, the debtor filed a chapter 11 petition in the District of New Jersey, where its joint venture real estate holdings were located. HEL moved to dismiss the case, arguing that the debtor lacked the authority to file for bankruptcy under the LLC agreement. The debtor countered that HEL lacked standing to seek dismissal of the case because the 4J Group's assignment of its loan and preferred membership interests in the debtor failed to comply with the LLC agreement's notice procedures. The debtor also argued that the LLC agreement provision restricting its ability to file for bankruptcy was invalid as a matter of public policy.

THE BANKRUPTCY COURT'S RULING

Initially, U.S. Bankruptcy Judge Michael B. Kaplan ruled that HEL's standing to seek dismissal was irrelevant because the court had the authority to dismiss a chapter 11 case "for cause" under section 1112(b) of the Bankruptcy Code on its own initiative.

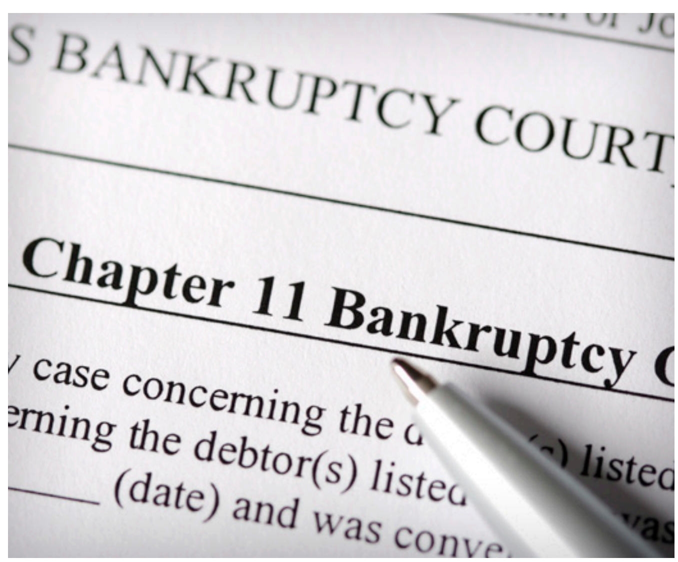
Next, Judge Kaplan found that the plain language of the LLC agreement prohibited the bankruptcy filing because all preferred capital had not been returned to the preferred membership interest holders and those holders had not approved the chapter 11 filing. Regardless of whether the assignment to HEL was valid, he explained, under the circumstances, the consent of either HEL or its predecessor the 4J Group was required for the bankruptcy filing, yet the debtor obtained neither.

Judge Kaplan rejected the debtor's public policy argument. Other cases holding that such bankruptcy filing restrictions were unenforceable, he wrote, were factually distinguishable, "and the concerns articulated by courts that have stricken such contractual provisions are not present in this case." *3P Hightstown*, 631 B.R. at 211.

Noting the absence of any Third Circuit precedent, Judge Kaplan looked to *Franchise Services*, *Lexington Hospitality*, *Intervention Energy*, and *Pace* for guidance. He found *Franchise Services* to be "strikingly analogous" because it also involved a motion to dismiss filed by an equity holder that was also a creditor (or controlled by one). Like the Fifth Circuit, Judge Kaplan concluded that the blocking provision in the LLC agreement was "not void merely due to [HEL's] (or the 4J Group's) status as both an equity holder and a creditor." *Id.*

Judge Kaplan found that the case before him was distinguishable from *Lexington Hospitality* and *Intervention Energy*. He noted that the lenders in those cases conditioned financing or loan forbearance on being given a "golden share" with which they could block a bankruptcy filing. In this case, Judge Kaplan explained, there was no evidence to suggest that HEL's contribution, which was substantial and significantly exceeded the amount of its loan, was "merely a ruse to ensure" that the debtor repaid the loan.

According to Judge Kaplan, *Pace* and other decisions addressing the public policy issue have attempted to balance the



constitutional right to file for bankruptcy against the constitutional right to contract and enforce agreements with creditors and other stakeholders. *Pace*, he wrote, is distinguishable, because it was "bottomed on the narrow specific facts of the case. . ., which are dramatically different." He explained that the debtor in *Pace* needed to file for bankruptcy to preserve value and protect employees and creditors, and the court accordingly concluded that the bankruptcy case would benefit most stakeholders.

The *Pace* court's finding that the blocking provision was void as a matter of public policy, Judge Kaplan noted, was premised on its finding that the majority shareholders owed a fiduciary duty to other shareholders and all creditors because the company was in the "zone of insolvency." The *Pace* court, he explained, concluded that the blocking provision allowed the minority shareholder to "violate, or side-step, its fiduciary duty and infringe on the debtor's constitutional right to file for bankruptcy." *Id.*

Judge Kaplan declined to follow this approach for two reasons. First, he noted that the debtor before him was a non-operating investor in a joint venture without any employees, significant creditors, or other stakeholders that would stand to benefit from the bankruptcy. Second, Judge Kaplan had "serious reservations" that HEL, as a noncontrolling minority member, had any fiduciary duties because Delaware law establishes that only managing members of an LLC have such duties, the Delaware LLC Act expressly permits members to contract around even those duties, and, in fact, the limitation of liability provision in the LLC agreement between the debtor and its members did precisely that. "In sum," Judge Kaplan wrote, "there is no breach of fiduciary duty which renders the provision at issue violative of public policy." *Id.* at 214.

OUTLOOK

Recent court rulings have not resolved the ongoing dispute over the enforceability of blocking provisions, golden shares, and other provisions designed to manage access to bankruptcy protection. *Hightstown*, *Pace*, *Franchise Services*, and *Insight* indicate that the validity of such provisions may hinge on whether the holder of a blocking right has fiduciary duties as a matter of law or contract, in which case the courts have expressed heightened public policy concerns. More generally, these and other relevant decisions reinforce the importance of knowing what approach the courts have endorsed in any likely bankruptcy venue. Given the trillions of dollars of securities issued in connection with SPEs, the enforceability of such provisions in various venues may be economically significant.

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ELEVENTH CIRCUIT SPLITS FROM SECOND CIRCUIT ON FINALITY OF CHAPTER 15 DISCOVERY ORDERS

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Chapter 15 petitions seeking recognition in the United States of foreign bankruptcy proceedings have increased significantly during the more than 16 years since chapter 15 was enacted in 2005. Among the relief commonly sought in such cases is discovery concerning the debtor's assets or asset transfers involving U.S.-based entities. A nonprecedential ruling recently handed down by the U.S. Court of Appeals for the Eleventh Circuit has created a circuit split on the issue of whether discovery orders entered by a U.S. bankruptcy court in a chapter 15 case are immediately appealable. Disagreeing with the Second Circuit and based upon the "framework" recently established by the U.S. Supreme Court for determining the finality of bankruptcy court orders, the Eleventh Circuit ruled in *In re Transbrasil S.A. Linhas Aéreas*, 2021 WL 3028768 (11th Cir. July 19, 2021), that an order denying a request to quash a subpoena was not final and could not be appealed immediately because the order was "merely a preliminary step" in the context of a broader proceeding. In *dicta*, however, the Eleventh Circuit appeared to cabin its ruling to the facts before it and noted that if the only purpose of the chapter 15 case is to obtain discovery, a discovery order may be final and immediately appealable because the discovery order is effectively the entire proceeding.

PROCEDURES, RECOGNITION, AND RELIEF UNDER CHAPTER 15

Chapter 15 was enacted in 2005 to govern cross-border bankruptcy and insolvency proceedings. It is patterned on the 1997 UNCITRAL Model Law on Cross-Border Insolvency, which has been enacted in some form by more than 50 countries.

Under section 1515 of the Bankruptcy Code, the representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding." Section 101(24) of the Bankruptcy Code defines "foreign representative" as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

"Foreign proceeding" is defined in section 101(23) of the Bankruptcy Code as:

> [A] collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

More than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries. Chapter 15 therefore contemplates recognition in the United States of both a foreign "main" proceeding—a case pending in the country where the debtor's center of main interests ("COMI") is located (*see* 11 U.S.C. § 1502(4))—and foreign "nonmain" proceedings, which may be pending in countries where the debtor merely has an "establishment" (*see* 11 U.S.C. § 1502(5)). A debtor's COMI is presumed to be the location of the debtor's registered office, or habitual residence in the case of an individual. *See* 11 U.S.C. § 1516(c). An establishment is defined by section 1502(2) as "any place of operations where the debtor carries out a nontransitory economic activity."

Upon recognition of a foreign "main" proceeding, section 1520(a) of the Bankruptcy Code provides that certain provisions of the Bankruptcy Code automatically come into force, including: (i) the automatic stay preventing creditor collection efforts with respect to the debtor or its U.S. assets (section 362, subject to certain enumerated exceptions); (ii) the right of any entity asserting an interest in the debtor's U.S. assets to "adequate protection" of that interest (section 361); and (iii) restrictions on use, sale, lease, transfer, or encumbrance of the debtor's U.S. assets (sections 363, 549, and 552).

Following recognition of a main or nonmain proceeding, section 1521(a) provides that, to the extent not already in effect, and "where necessary to effectuate the purpose of [chapter 15] and to protect the assets of the debtor or the interests of the creditors," the bankruptcy court may grant "any appropriate relief," including a stay of any action against the debtor or its U.S. assets not covered by the automatic stay, an order suspending the debtor's right to transfer or encumber its U.S. assets, and, with certain exceptions, "any additional relief that may be available to a trustee." Under section 1521(b), the court may entrust the distribution of the debtor's U.S. assets to the foreign representative or another person, provided the court is satisfied that the interests of U.S. creditors are "sufficiently protected."

Section 1507(a) of the Bankruptcy Code provides that, upon recognition of a main or nonmain proceeding, the bankruptcy court may provide "additional assistance" to a foreign representative "under [the Bankruptcy Code] or under other laws of the United States." However, the court must consider whether any such assistance, "consistent with principles of comity," will reasonably ensure that: (i) all stakeholders are treated fairly; (ii) U.S. creditors are not prejudiced or inconvenienced by asserting their claims in the foreign proceeding; (iii) the debtor's assets are not preferentially or fraudulently transferred; (iv) proceeds of the debtor's assets are distributed substantially in accordance with the order prescribed by the Bankruptcy Code; and (v) if appropriate, an individual foreign debtor is given the opportunity for a fresh start. *See* 11 U.S.C. § 1507(b).

Section 1522(a) provides that the bankruptcy court may exercise its discretion to order the relief authorized by sections 1517 and 1521 upon the commencement of a case or recognition of a foreign proceeding "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected."

Finally, section 1506 sets forth a public policy exception to the relief otherwise authorized in chapter 15, providing that "[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States." However, section 1506 requires a "narrow reading" and "does not create an exception for *any* action under Chapter 15 that may conflict with public policy, but only an action that is '*manifestly* contrary.'" *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 139 (2d Cir. 2013).

DISCOVERY IN BANKRUPTCY CASES

Rule 2004 of the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules") provides a broad-ranging discovery mechanism in bankruptcy cases. It provides that "[o]n motion of any party in interest, the court may order the examination of any entity." Such an examination "may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge." In addition, in a non-railroad "reorganization case under chapter 11" (among other cases), the examination "may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan."

Discovery may also be sought in "adversary proceedings" (*see* Bankruptcy Rule 7001) or "contested matters" (*see* Bankruptcy Rule 9014) commenced during a bankruptcy case, and in certain other contexts, such as contested involuntary bankruptcy or chapter 15 petitions. Such discovery is governed by Bankruptcy Rules 7026-7037 and 9016, which incorporate many of the discovery procedures under the Federal Rules of Civil Procedure that apply to other kinds of federal litigation. These rules include specific procedures governing disclosure, witnesses, subpoenas, depositions, interrogatories, document production, physical and mental examinations, requests for admission, and other discovery-related matters.

DISCOVERY IN CHAPTER 15 CASES

In a chapter 15 case, section 1521(a) of the Bankruptcy Code provides that, upon recognition of a foreign main or nonmain proceeding, the court may, upon the request of the foreign representative, grant any appropriate relief, including "providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities." 11 U.S.C. § 1521(a)(4). *See In re Millennium Glob. Emerging Credit Master Fund Ltd.*, 471 B.R. 342, 346 (Bankr. S.D.N.Y. 2012) (discovery under section 1521(a)(4) "enables a Foreign Representative to take broad discovery concerning the property and affairs of a [foreign] debtor").

Where discovery is requested, however, section 1522 provides that the court may grant such relief "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected." *See In re AJW Offshore, Ltd.*, 488 B.R. 551, 561 (Bankr. E.D.N.Y. 2013) (discovery under section 1521(a)(4) "will only be permitted by motion on notice with an opportunity for hearing to the adverse parties and by making examination and production of documents. . ., with any discovery to be allowed to be subject to conditions imposed in accordance with §1522").

Discovery under section 1521(a)(4) need not "concern the preservation or recovery of property in the United States" because chapter 15 "is not an independent in rem proceeding but an ancillary proceeding designed to assist a foreign representative in administering the foreign estate." *Millennium*, 471 B.R. at 347; *In re Fairfield Sentry Ltd. Lit.*, 458 B.R. 665, 679 n.5 (S.D.N.Y. 2011) (stating that section 1521(a)(4) "allows for discovery in the United States whether or not a debtor has assets here").

Chapter 15 discovery is not limited to documents located in the United States but also extends to documents in the possession, custody, or control of a party, including documents held by a party's attorneys or agents. *See In re Markus*, 607 B.R. 379, 389 (Bankr. S.D.N.Y. 2019), *aff'd in part, vacated in part and remanded*, 615 B.R. 679 (S.D.N.Y. 2020). A subpoena issued under Fed. R. Civ. P. 45, which is made applicable to all bankruptcy cases by Bankruptcy Rule 9016, requires the production of documents responsive to the subpoena, wherever the documents may be located. *Sergeeva v. Tripleton Int'l Ltd.*, 834 F.3d 1194, 1200 (11th Cir. 2016); *In re Hulley Enters.*, 358 F. Supp. 3d 331, 345 (S.D.N.Y. 2019); *Marcus*, 607 B.R. at 391.

Most of the ordinary discovery mechanisms applying to adversary proceedings or contested matters expressly apply to contested recognition petitions in chapter 15 cases (*see* Bankruptcy Rule 1018). And, outside contested recognition proceedings, broad discovery under Bankruptcy Rule 2004 is available in chapter 15 cases as a form of "additional assistance" that can be granted in the court's discretion under section 1507(a). *See Millennium*, 471 B.R. at 346–47; *accord In re Platinum Partners Value Arbitrage Fund L.P.*, 583 B.R. 803, 810 (Bankr. S.D.N.Y. 2018) (noting that "[r]elief sought pursuant to Bankruptcy Rule 2004 may also be available pursuant to sections 1507, 1521(a)(4) or 1521(a)(7)"); *In re Petroforte Brasileiro de Petroleo Ltda.*, 542 B.R. 899, 911 (Bankr. S.D. Fla. 2015) (concluding that scope of chapter 15 discovery was not solely controlled by section 1521; Bankruptcy Rule 2004 is also applicable). As the court in *Millennium* noted, "one of the main purposes of chapter 15 is to assist a foreign representative in the administration of the foreign estate, . . . which would militate in favor of granting a foreign representative broad discovery rights using the full scope of Rule 2004." *Millenium*, 471 B.R. at 347.

Discovery in chapter 15 cases has also been sought by foreign representatives under section 542(e) of the Bankruptcy Code, which provides that, "[s]ubject to any applicable privilege, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs, to turn over or disclose such recorded information to the trustee." 11 U.S.C. § 542(e); *see, e.g., AJW*, 488 B.R. at 564.

Discovery in connection with foreign court proceedings is also authorized by 28 U.S.C. § 1782(a), which provides in relevant part that:

> The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation. The order may be made pursuant to a letter rogatory issued, or

request made, by a foreign or international tribunal or upon the application of any interested person and may direct that the testimony or statement be given, or the document or other thing be produced, before a person appointed by the court.

Even though section 1509 of the Bankruptcy Code indicates that chapter 15 recognition is a condition to enforcing foreign bankruptcy court orders or judgments under principles of international comity, courts disagree over whether such recognition is necessary. *Compare EMA Garp Fund v. Banro Corp.*, 2019 WL 773988 (S.D.N.Y. Feb. 21, 2019) (despite the absence of any order issued by a U.S. bankruptcy court recognizing a Canadian bankruptcy proceeding under chapter 15, dismissing litigation against the company and its CEO under principles of comity because the lawsuit was barred by orders approving the company's Canadian bankruptcy proceeding and releasing all claims against the defendants), *aff'd*, 783 Fed. Appx. 82 (2d Cir. Nov. 5, 2019), *with Halo Creative Design Ltd. v. Comptoir Des Indes Inc.*, 2018 WL 4742066 (N.D. Ill. Oct. 2, 2018) (a foreign representative must comply with the requirements of chapter 15 to obtain the various forms of relief or assistance contemplated by the chapter, including a stay or dismissal of U.S. court proceedings against a foreign debtor or its assets).

Courts are also uncertain as to whether chapter 15 recognition is a necessary "ticket to entry" to U.S. courts to seek discovery for use in a foreign bankruptcy court under 28 U.S.C. § 1782(a). *See In re Soundview Elite, Ltd.*, 503 B.R. 571, 592 n.56, 594 (Bankr. S.D.N.Y. 2014) (discussing the interplay between chapter 15 and 28 U.S.C. § 1782 and noting uncertainty among the courts as to whether chapter 15 recognition is necessary to seek discovery under 28 U.S.C. § 1782) (citing and discussing *In re Glitnir banki hf.*, 2011 WL 3652764 (Bankr. S.D.N.Y. Aug. 19, 2011); *In re Toft*, 453 B.R. 186 (Bankr. S.D.N.Y. 2011)).

APPEALS OF BANKRUPTCY COURT ORDERS AND THE RELAXED FINAL JUDGMENT RULE

Sections 158, 1291, and 1292 of title 28 of the U.S. Code determine whether federal appellate courts other than the U.S. Supreme Court have jurisdiction to hear appeals of orders or judgments issued by lower courts. That determination hinges on whether the order or judgment is "final" or merely "interlocutory."

Section 1291 provides that, with certain exceptions, the federal courts of appeals "shall have jurisdiction of appeals from all final decisions of the district courts of the United States." Section 1292 gives the courts of appeals jurisdiction over certain interlocutory appeals.

In ordinary civil litigation, a final order or judgment "ends litigation on the merits and leaves nothing for the . . . court to do but execute the judgment." *Hooker v. Cont'l Life Ins. Co.*, 965 F.2d 903, 904 (10th Cir. 1992). Therefore, an interlocutory order is an order that does not constitute a final judgment on the merits. *See* Black's Law Dictionary (11th ed. 2019) (defining "interlocutory" as "interim or temporary; not constituting a final resolution of the whole controversy").

A bankruptcy case differs from ordinary civil litigation because it is a framework within which the court resolves a wide variety of disputes that precede the closure of the bankruptcy case after confirmation of a plan, discharge of the debtor following administration of its non-exempt assets, or dismissal.

Thus, the rules governing appeals in bankruptcy cases permit appeals of orders or judgments that would not be regarded as final and therefore immediately appealable in other civil litigation. *See Ritzen Grp., Inc. v. Jackson Masonry, LLC,* 140 S. Ct. 582, 586 (2020) ("The ordinary understanding of 'final decision' is not attuned to the distinctive character of bankruptcy litigation."); *Matter of Forty-Eight Insulations, Inc.*, 115 F.3d 1294, 1299 (7th Cir. 1997) (finality is applied with a "relaxed eye" in the bankruptcy context); *In re Dow Corning Corp.*, 86 F.3d 482, 488 (6th Cir. 1996) (the finality requirement in bankruptcy "is considered in a more pragmatic and less technical way in bankruptcy cases than in other situations").

Twenty-eight U.S.C. § 158(a) reflects this by providing that federal district courts shall have jurisdiction to hear appeals: (i) from final bankruptcy court judgments, orders, and decrees; (ii) from interlocutory orders and decrees increasing or reducing a debtor's exclusive right to propose and seek acceptances for a chapter 11 plan; and (iii) "with leave of the court, from other interlocutory orders or decrees."

Appeals from the same types of bankruptcy court orders may instead be heard by bankruptcy appellate panels under the circumstances specified in section 158(b).

Section 158(d)(1) provides that federal circuit courts shall have jurisdiction over appeals from "all final decisions, judgments, orders, and decrees entered [by district courts or bankruptcy appellate panels] under subsections (a) and (b)." Finally, section 158(d)(2) provides that a circuit court, in its discretion, shall have jurisdiction to hear appeals from final judgments, orders, and decrees if a bankruptcy court, district court, or bankruptcy appellate panel certifies that the judgment, order, or decree: (i) involves a question of law as to which there is no controlling circuit court or U.S. Supreme Court precedent or "involves a matter of public importance"; (ii) involves a question of law requiring the resolution of conflicting rulings; or (iii) if immediately appealed, "may materially advance the progress of the case or proceeding in which the appeal is taken."

Reviewing courts have considered several factors to determine whether a lower court's decision in a bankruptcy case is final. For example, in the Third Circuit, courts typically examine: (i) the impact on the bankruptcy estate's assets; (ii) the need for further fact-finding on remand; (iii) the preclusive effect of a ruling on the merits; and (iv) the interests of judicial economy. *See In re Armstrong World Indus.*, 432 F.3d 507, 511 (3d Cir. 2005) (citing *In re Owens*, 419 F.3d 195, 203 (3d Cir. 2005)). In the Ninth Circuit, courts applying the flexible finality standard in bankruptcy cases will treat an order as final if it "1) resolves and seriously affects substantive rights and 2) finally determines the discrete issue to which it is addressed." *Elliott v. Four Seasons Props. (In re Frontier Props.)*, 979 F.2d 1358, 1363 (9th Cir. 1992); *accord In re GACN, Inc.*, 555 B.R. 684, 691 (B.A.P. 9th Cir. 2016).

APPEALS OF DISCOVERY ORDERS

Discovery orders, whether in civil litigation or bankruptcy, are generally regarded as interlocutory and therefore not appealable as of right. *See Am. Bank v. City of Menasha*, 627 F.3d 261, 264 (7th Cir. 2010) ("[D]iscovery orders, being interlocutory, generally are not appealable in the federal court system."); *In re Bryson*, 406 F.3d 284, 288 (4th Cir. 2005) (describing a discovery order as a "clearly interlocutory decision"); *In re Royce Homes LP*, 466 B.R. 81, 89 (S.D. Tex. 2012) (noting "extensive case law holding bankruptcy discovery orders to be interlocutory"); *In re Kaiser Grp. Int'l, Inc.*, 400 B.R. 140, 144 (D. Del. 2009) (noting that the majority of courts have concluded that [bankruptcy discovery] orders are interlocutory); *In re Betteroads Asphalt, LLC*, 2019 WL 3070241, *6 (Bankr. D.P.R. July 12, 2019) ("[I]t is well recognized that bankruptcy court discovery orders are interlocutory and not final appealable orders."), *appeal dismissed*, 2020 WL 7048697 (D.P.R. Nov. 30, 2020).

However, there are exceptions to this rule, especially in chapter 15 cases where the primary purpose of the chapter 15 case is to obtain discovery in the United States. For example, in *In re Barnet*, 737 F.3d 238 (2d Cir. 2013), foreign representatives seeking recognition under chapter 15 of a debtor's Australian "external administration" proceeding also sought discovery from the debtor's U.S. affiliate. The bankruptcy court granted the petition for chapter 15 recognition and denied the affiliate's motion to stay the discovery.

The U.S. Court of Appeals for the Second Circuit granted the parties' joint motion for a direct appeal. Initially, it acknowledged that "the general rule is that discovery orders are not appealable unless the object of the discovery order refuses to comply and is held in contempt." *Id.* at 244. Even so, the court of appeals held that the order denying discovery in the case before it was immediately appealable for two reasons.

First, the Second Circuit compared discovery under chapter 15 to discovery under 28 U.S.C. § 1782(a), which permits discovery "for use in a proceeding in a foreign or international tribunal." *Id.* (quotation marks omitted). According to the court, like discovery under 28 U.S.C. § 1782(a), discovery under chapter 15 is "ancillary to a suit in another tribunal, such that there will never be a final resolution on the merits beyond the discovery itself." *Id.* (quotation marks and citation omitted).

Second, the Second Circuit noted that "a party aggrieved by the automatic relief imposed by Section 1520" upon recognition of a foreign main proceeding (e.g., the automatic stay) could immediately appeal, as "the imposition of automatic relief requires no further action by the Bankruptcy Court." *Id.* Therefore, the Second Circuit reasoned, if "appellate review is available to one, . . . it should be available to the other." *Id.*

Other courts have adopted the *Barnet* rationale in finding that that chapter 15 discovery orders are immediately appealable. *See, e.g., Markus*, 615 B.R. at 698.

THE SUPREME COURT WEIGHS IN ON THE FINALITY OF BANKRUPTCY COURT ORDERS

Seven years after *Barnet* was handed down, the U.S. Supreme Court weighed in on the finality of bankruptcy court orders in *Ritzen*. The unanimous Court held that bankruptcy court orders conclusively denying relief from the automatic stay imposed by section 362(a) of the Bankruptcy Code are appealable.

The Court relied heavily on its 2015 opinion in *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015). In *Bullard*, the Court had held that an order denying confirmation of a proposed chapter 13 plan was not "final" under 28 U.S.C. § 158(a) because a request to confirm a plan was one step in a broader "plan-confirmation process" and thus the order "did not conclusively resolve the relevant 'proceeding.'" Under *Bullard*, "orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case," fixing the rights and obligations of the parties. 575 U.S. at 501.

Applying that rule, the Court in *Ritzen* held that, as a category, "the adjudication of a motion for relief from the automatic stay forms a discrete procedural unit within the embracive bankruptcy case," which makes an order conclusively resolving such a motion appealable—and made the appellant's appeal untimely. The Court rejected the appellant's argument that such orders are "merely a preliminary step" of an overall claims adjudication process, noting their potentially significant consequences. The Court also expressed its belief that its decision would "avoid . . . 'delays and inefficiencies'" by allowing appellate consideration of automatic stay issues as they occur (quoting *Bullard*, 575 U.S. at 504).

Although *Ritzen* did not specifically address bankruptcy discovery orders, the Eleventh Circuit applied *Ritzen*'s holding as it considered the question in *Transbrasil*.

TRANSBRASIL

Airline Transbrasil S.A. Linhas Aéreas ("debtor") was placed into involuntary bankruptcy in Brazil in 2002. In 2011, the trustee in the Brazilian bankruptcy case, as the debtor's foreign representative, filed a petition in the U.S. Bankruptcy Court for the Southern District of Florida seeking recognition of the debtor's Brazilian bankruptcy under chapter 15 for the purpose of obtaining information regarding any assets of the debtor or its affiliates that might have been located or transferred in the United States. The U.S. bankruptcy court entered an order on May 11, 2011, recognizing the debtor's Brazilian bankruptcy under chapter 15 as a foreign main proceeding.

In 2015, the trustee petitioned the Brazilian court to extend the debtor's bankruptcy case to include various affiliates ("affiliates") and their assets under a veil-piercing theory. The trustee also asked for a "freeze order" preventing the affiliates from transferring their assets due to their alleged misconduct. The Brazilian court entered the freeze order and directed the trustee to seek enforcement of the order in the United States.

In 2019, to support claims against the affiliates and to aid in implementing the freeze order, the trustee sought discovery from various U.S.-based financial entities regarding the affiliates' financial affairs. The affiliates sought a protective order, which the U.S. bankruptcy court denied. The U.S. District Court for the Southern District of Florida, relying on a 2015 Eleventh Circuit ruling in the same chapter 15 case, dismissed the affiliates' appeal for lack of jurisdiction because the discovery order was not final. The affiliates appealed to the Eleventh Circuit.

THE ELEVENTH CIRCUIT'S RULING

A three-judge panel of the Eleventh Circuit affirmed.

Writing for the panel, U.S. Circuit Judge Beverly B. Martin noted that "[i]t is well established that, as a 'general proposition,' discovery orders are 'not final orders' and therefore 'not immediately appealable.'" *Transbrasil*, 2021 WL 3028769, at *3 (citations omitted). She also explained that the "framework for deciding whether a bankruptcy court order is final" comes from *Ritzen*. *Id.*

Applying that framework, Judge Martin concluded that the U.S. bankruptcy court's order denying the affiliates' motion to quash the trustee's subpoenas was not a final order because, unlike in *Ritzen*, it was not "discrete" or "separate" from the proceeding for which the discovery was sought. Instead, it was "merely a preliminary step" to obtain information that could be used to support the trustee's claims against the affiliates in the Brazilian bankruptcy and to implement the freeze order in the United States as part of the debtor's chapter 15 case. *Id.* at *4.

Judge Martin rejected the affiliates' argument, relying on *Barnet*, that chapter 15 discovery orders "should receive special treatment in terms of finality" because "chapter 15 proceedings are, by definition, proceedings ancillary to bankruptcy cases in foreign courts," and thus "a bankruptcy court has nothing left to do after granting or denying discovery." In this case, she noted, the U.S. bankruptcy court might be asked to implement the freeze order based on the requested discovery.

Moreover, Judge Martin concluded that *Barnet* was both noncontrolling and distinguishable. First, she explained, in *Barnet*, the Second Circuit did not have the benefit of the *Ritzen* framework for examining the finality of bankruptcy court orders. Second, she wrote, unlike in this case, "there is no indication in Barnet that any proceedings other than discovery were contemplated in that Chapter 15 case." *Id.* at *5.

In ruling on the facts before the court, Judge Martin noted that "if a Chapter 15 case exists solely to obtain discovery for use in a foreign bankruptcy case, then the discovery might not be 'merely a preliminary step' in some other Chapter 15 proceeding . . . [and] it would seem the discovery is the only proceeding" and, as such, be a final order that is immediately appealable. *Id.*

Judge Martin declined to embrace *Barnet*'s analogy between chapter 15 discovery orders and discovery orders issued pursuant to 28 U.S.C. § 1782, which both the Second and Eleventh Circuits have held to be immediately appealable because the underlying case is pending in a foreign court and nothing remains for a U.S. district court to do after it has ruled on the discovery request. "[I]t does not follow from the section 1782(a) context," she wrote, "that all discovery orders in the Chapter 15 context are also categorically final and thus immediately appealable." Instead, a chapter 15 discovery order may be "merely a preliminary step" in a larger proceeding. *Id.* at *5 n.8.

Finally, Judge Martin rejected the affiliates' argument that the discovery order fell under the exception to the final judgment rule articulated in *Gillespie v. U.S. Steel Corp.*, 379 U.S. 148, 153-54 (1964), because immediate resolution of the issue was "fundamental to the merits of the case." According to Judge Martin, the U.S. Supreme Court has since limited the *Gillespie* exception to its "unique facts" based on the Court's concerns that the final judgment rule "would be stripped of all significance," and moreover, the affiliates had not claimed that such unique facts existed in this case. In addition, she noted, the affiliates failed to show how the validity of the discovery order was fundamental to the conduct of the debtor's chapter 15 case because "[t]he record does not indicate that the Chapter 15 case exists solely to obtain information about the [affiliates'] financial affairs." *Id.* at *6.

OUTLOOK

Even though the ruling in *Transbrasil* is nonprecedential, the Eleventh Circuit's departure from the approach adopted in *Barnet* creates a circuit split regarding whether chapter 15 discovery orders are immediately appealable. The volume of chapter 15 cases seeking recognition of foreign bankruptcy and insolvency proceedings has more than doubled since 2017. Discovery has been sought in many of these cases concerning the debtor's U.S. assets and asset transfers involving U.S.-based entities. Whether discovery orders issued by a U.S. bankruptcy court can be appealed immediately, or must await the resolution of litigation commenced during the chapter 15 case, may be an important issue in these cases. *Transbrasil* and *Barnet* indicate that the answer to this question may depend on the venue of the chapter 15 case and how the discovery requested fits into the larger context of the chapter 15 proceeding.

CASE UPDATE: SECOND CIRCUIT BREATHES NEW LIFE INTO MADOFF TRUSTEE'S EFFORTS TO RECOVER PONZI SCHEME PAYMENTS

Charles M. Oellermann • Mark G. Douglas

In *In re Bernard L. Madoff Investment Securities LLC*, 12 F.4th 171 (2d Cir. 2021), the U.S. Court of Appeals for the Second Circuit revived litigation filed by the trustee administering the assets of defunct investment firm Bernard L. Madoff Inv. Sec. LLC ("MIS") seeking to recover hundreds of millions of dollars in allegedly fraudulent transfers made to former MIS customers and certain other defendants as part of the Madoff Ponzi scheme. The court of appeals vacated a 2019 bankruptcy court ruling dismissing the trustee's claims against certain defendants because he failed to allege that they had not received the transferred funds in "good faith."

The Second Circuit also reversed a 2014 district court decision in holding that: (i) "inquiry notice," rather than "willful blindness," is the proper standard for pleading a lack of good faith in fraudulent transfer actions commenced as part of a stockbroker liquidation case under the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa *et seq.* ("SIPA"); and (ii) the defendants, rather than the SIPA trustee, bear the burden of pleading on the issue of good faith. The ruling, which involves test cases for approximately 90 dismissed actions, breathes new life into avoidance litigation seeking recovery of $3.75 billion from global financial institutions, hedge funds, and other participants in the global financial markets.

GOOD-FAITH DEFENSE TO AVOIDANCE OF FRAUDULENT TRANSFERS

Section 548(a)(1) of the Bankruptcy Code authorizes a bankruptcy trustee to avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor "on or within 2 years before the date of the filing of the petition" if: (i) the transfer was made, or the obligation was incurred, "with actual intent to hinder, delay, or defraud" any creditor; or (ii) the debtor received "less than a reasonably equivalent value in exchange for such transfer or obligation" and was, among other things, insolvent, undercapitalized, or unable to pay its debts as such debts matured.

Section 548(c) provides a defense to avoidance of a fraudulent transfer for a "good faith" transferee or obligee who gives value in exchange for the transfer or obligation at issue:

> Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title [dealing with a trustee's power to avoid, respectively, transfers that are voidable under state law, statutory liens, and preferential transfers], a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

11 U.S.C. § 548(c).

Section 550(a) of the Bankruptcy Code provides that, after avoidance of a transfer, the trustee may recover the property transferred or its value from the initial transferee (or the entity for whose benefit such transfer was made) or any "immediate or mediate transferee" of the initial transferee. However, pursuant to section 550(b), the trustee may not recover the property transferred or its value from an initial or subsequent ("immediate" or "mediate") transferee "that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided."

The main difference between section 550(b) and section 548(c) is that section 550(b) provides "a complete defense to recovery of the property transferred," whereas under section 548(c), "the transaction is still avoided, but the transferee is given a lien to the extent value was given in good faith." COLLIER ON BANKRUPTCY ¶ 548.09 (16th ed. 2021).

"Good faith" is not defined by the Bankruptcy Code. In determining whether it exists, some courts have applied a two-part analysis, examining: (i) whether the transferee was on "inquiry notice" of suspicious facts amounting to "red flags"; and (ii) if so, whether the transferee reasonably followed up with due diligence to determine whether a transaction may not have been bona fide. *See, e.g., Horton v. O'Cheskey (In re Am. Hous. Found.)*, 544 Fed. App'x 516 (5th Cir. 2013); *Christian Bros. High School Endowment v. Bayou No Leverage Fund LLC (In re Bayou Group, LLC)*, 439 B.R. 284 (S.D.N.Y. 2010).

STOCKBROKER LIQUIDATIONS UNDER SIPA

Congress enacted SIPA in 1970 to deal with a crisis in customer and investor confidence and the prospect that capital markets might fail altogether after overexpansion in the securities brokerage industry led to a wave of failed brokers. The law was substantially revamped in 1978 in conjunction with the enactment of the Bankruptcy Code.

A SIPA proceeding is commenced when the Securities Investor Protection Corporation ("SIPC") files an application for a protective decree regarding one of its member broker-dealers in a federal district court. If the district court issues the decree, it appoints a trustee to oversee the broker-dealer's liquidation and refers the case to the bankruptcy court.

SIPA affords limited financial protection to the customers of registered broker-dealers. SIPC advances funds to the SIPA trustee as necessary to satisfy customer claims but limits them to $500,000 per customer, of which no more than $250,000 may be based on a customer claim for cash. SIPC is subrogated to customer claims paid to the extent of such advances. Those advances are repaid from funds in the general estate prior to payments on account of general unsecured claims.

If property in the customer estate is not sufficient to pay customer net equity claims in full, "the [SIPA] trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property if and to the extent that such transfer is voidable or void under the provisions of [the Bankruptcy Code]." SIPA § 78fff-2(c)(3).

As noted, the bankruptcy court presides over a SIPA case, and the case proceeds very much like a chapter 7 liquidation, with certain exceptions. SIPA expressly provides that "[t]o the extent consistent with the provisions of this chapter, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7 of [the Bankruptcy Code]." SIPA § 78fff(b).

This means, for example, that the automatic stay precludes the continuation of most collection efforts against the debtor or its property but not the exercise of the contractual rights of a qualifying entity (e.g., a stockbroker or a financial participant) under a financial or securities contract or a repurchase agreement. *See* 11 U.S.C. §§ 362(b)(6) and (7)). Similarly, the SIPA trustee has substantially all of a bankruptcy trustee's powers, including the avoidance powers. However, neither a SIPA trustee nor a bankruptcy trustee may avoid certain transfers made by, to, or for the benefit of stockbrokers, repurchase agreement participants, swap agreement participants, and certain other entities, unless the transfer was made with actual intent to hinder, delay, or defraud creditors in accordance with section 548(a)(1)(A). *See* 11 U.S.C. §§ 546(e), (f), and (g).

MADOFF

MIS was the brokerage firm that carried out Bernard Madoff's infamous Ponzi scheme by collecting customer funds that it never invested and making distributions of principal and fictitious "profits" to old customers with funds it received from new customers. After the scheme collapsed in December 2008, the U.S. District Court for the Southern District of New York issued a protective decree for MIS under SIPA.

Because the customer property held by MIS was inadequate to pay customer net equity claims, the SIPA trustee sought to recover funds that would have been customer property had MIS not transferred them to others. Certain customers had "net equity" claims, because they had withdrawn less than the full amount of their investments from their MIS accounts before entry of the protective decree. Other customers had no net equity claims, because they withdrew more money from their accounts than they had deposited. These customers received not only a return of their principal investment but also fictitious "profits" that were actually other customers' money.

In 2010, the SIPA trustee commenced hundreds of adversary proceedings in the bankruptcy court against former MIS customers and third parties seeking to avoid and recover many payments as actual and constructive fraudulent transfers under sections 548(a)(1)(A) and 548(a)(1)(B) of the Bankruptcy Code. That litigation included, among others, separate adversary proceedings against former MIS customer Legacy Capital Ltd. ("Legacy"), which received approximately $213 million in principal and net profits from MIS; two lenders ("Lenders") that received approximately $343 million in repayment of funds loaned to a "feeder fund" that invested with MIS; and Khronos LLC (together with the Lenders, "subsequent transferees"), which received approximately $6.6 million in investment management fees from Legacy.

Legacy and the subsequent transferees (collectively, "defendants") moved to withdraw the reference of the litigation to the bankruptcy court, asking the district court to decide whether SIPA and other securities laws alter the standard a trustee must meet in order to show that a defendant did not receive transfers in good faith under either section 548(c) or section 550(b). After withdrawing the reference, Judge Jed Rakoff of the U.S. District Court for the Southern District of New York held in *Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 516 B.R. 18 (S.D.N.Y. 2014), that: (i) contrary to normal practice, a SIPA trustee bears the burden of pleading the affirmative defense of lack of good faith because placing the burden on the defendants would undercut SIPA's goal of encouraging investor confidence; and (ii) because SIPA is part of federal securities law, the trustee must plead the "willful blindness" standard applied to some securities law claims, which requires "a showing that the defendant acted with willful blindness to the truth, that is, he intentionally chose to blind himself to the red flags that suggest a high probability of fraud," rather than the "inquiry notice" standard, "under which a transferee may be found to lack good faith when the information the transferee learned would have caused a reasonable person in the transferee's position to investigate the matter further." *Id.* at 21 (citations and internal quotation marks omitted).

Applying that decision on remand, the bankruptcy court dismissed the trustee's actions against the defendants and denied the trustee's request for leave to amend his complaints, reasoning that the trustee could not plausibly show willful blindness. *See Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 608 B.R. 181, 183 (Bankr. S.D.N.Y. 2019); *Picard v. Legacy Capital Ltd. (In re BLMIS)*, 548 B.R. 13 (Bankr. S.D.N.Y. 2016). The Second Circuit accepted a direct appeal of the dismissal orders in both adversary proceedings.

THE SECOND CIRCUIT'S RULING

A three-judge panel of the Second Circuit vacated the bankruptcy court's orders and remanded the case below.

Writing for the panel, U.S. Circuit Judge Richard Wesley examined dictionary definitions, fraudulent transfer case law, the former Bankruptcy Act of 1898 (as amended in 1938), and "typical legal usage" at the time the Bankruptcy Code was enacted in 1978. He concluded, consistent with all other circuits that that have addressed the issue, that "the plain meaning of good faith in sections 548 and 550 of the Bankruptcy Code, embraces an inquiry notice standard," rather than the "willful blindness" standard adopted by Judge Rakoff in his 2014 ruling and applied by the bankruptcy court in dismissing the trustee's complaints. *Madoff*, 12 F.4th at 188.

The panel rejected the argument that federal securities laws impose a willful blindness standard for good faith in a SIPA liquidation. The panel reasoned that: (i) because SIPA is an amendment to the Securities Act of 1934 ("1934 Act"), lawmakers intended for SIPA to apply if the 1934 Act was "inapplicable or inconsistent with SIPA"; and (ii) because SIPA does not regulate fraud on the securities markets, but instead protects investors from the financial troubles of broker-dealers, "the *general* 'fraudulent intent' requirement in the 1934 Act is irrelevant to the *specific* context of a SIPA liquidation." *Id.* at 193.

The panel also rejected the argument that the inquiry notice standard is "'unworkable' and contrary to SIPA's goals" because inquiry notice does not "universally impose an affirmative duty to investigate." *Id.* at 195. According to Judge Wesley, "[T]he duty to conduct a diligent investigation arises only when a transferee is actually aware of suspicious facts that would lead a reasonable investor to inquire further into a debtor-transferor's potential fraud." The adequacy of an investigation, he wrote, "is of course, a fact-intensive inquiry to be determined on a case-by-case basis, which naturally takes into account the disparate circumstances of differently-situated transferees." *Id.*

In addition, the Second Circuit rejected the burden-shifting rule applied by Judge Rakoff and the bankruptcy court on remand, finding that sections 548 and 550 create affirmative defenses. Therefore, the panel explained, the defendant bears the burden of showing that it accepted a transfer in good faith, and the trustee need not plead or prove a lack of good faith.

The Second Circuit panel articulated a three-step inquiry for reviewing a good-faith defense at the pleading stage under both sections 548(c) and 550(b)(1):

> First, a court must examine what facts the defendant knew; this is a subjective inquiry and not "a theory of constructive notice." . . . Second, a court determines whether these facts put the transferee on inquiry notice of the fraudulent purpose behind a transaction—that is, whether the facts the transferee knew would have led a reasonable person in the transferee's position to conduct further inquiry into a debtor-or-transferor's possible fraud. . . . Third, once the court has determined that a transferee had been put on inquiry notice, the court must inquire whether "diligent inquiry [by the transferee] would have discovered the fraudulent purpose" of the transfer.

Id. at 191-92 (citations omitted).

In a concurring opinion, Circuit Judge Steven Menashi questioned whether, under the circumstances of this particular case (i.e., subsequent transferees that unquestionably provided value in exchange, albeit not to MIS), the court properly applied the "Ponzi scheme presumption," under which transfers by a Ponzi scheme are deemed made with actual intent to hinder, delay or defraud solely by virtue of the existence of the scheme. According to Judge Menashi, the presumption "obscures the essential distinction between fraudulent transfers and preferences" and improperly uses fraudulent transfer law to provide equal distributions to creditors. *Id.* at 202 (concurring opinion).

He also observed that the presumption "necessarily" treats a creditor-transferee's inquiry notice as indicating a lack of good faith, contrary to the "normal" rule that creditors with knowledge of a debtor's fraudulent purpose are not charged with fraud as a result of that knowledge. "It may be that there are better arguments for the Ponzi scheme presumption," Judge Menashi wrote, "but consideration of that issue must await an appropriately contested case." *Id.* at 204.

Descriptions of other significant rulings in the more-than-decade-long MIS avoidance litigation saga can be found here, here, and here.

KUMTOR GOLD CHALLENGES THE PRACTICAL APPLICATION OF THE AUTOMATIC STAY'S GLOBAL REACH

Anna Kordas

Although the automatic stay contained in section 362 of the Bankruptcy Code theoretically extends worldwide, enforcing it against international creditors, particularly sovereigns, can present practical problems in its application. The chapter 11 cases of Kumtor Gold Company CJSC and Kumtor Operating Company CJSC (collectively, "Kumtor") pending before Judge Lisa Beckerman in the U.S. Bankruptcy Court for the Southern District of New York (Case No. 21-11051) have been testing the practical application of the automatic stay's global reach since the commencement of the cases in late May 2021. Kumtor's bankruptcy is riddled with international and sovereign creditor issues and showcases difficulties that may arise for Western companies when their investments enmesh with unstable governmental regimes.

THE AUTOMATIC STAY

Section 362(a) of the Bankruptcy Code prevents creditors from taking actions to collect on their claims or, among other things, to gain possession of "property of the estate." By operation of section 541, the automatic stay thus applies to the debtor's asset "wherever located and by whomever held." One purpose of the automatic stay is to allow the debtor to centralize all disputes regarding the bankruptcy estate's property so that the debtor can reorganize under the supervision of a single court. *See SEC v. Brennan*, 230 F.3d 65, 70 (2d Cir. 2000) ("[T]he automatic stay provision is intended to allow the bankruptcy court to centralize all disputes concerning property of the debtor's estate so that reorganization can proceed efficiently, unimpeded by uncoordinated proceedings in other arenas.").

A debt collection moratorium or stay applying in all countries is not a notion exclusive to U.S. law. Insolvency laws in many countries provide for a moratorium against collection actions outside of an insolvency proceeding, and in many countries this moratorium extends internationally. For example, for all nations belonging to the European Union, the moratorium imposed under the law of the member nation where the insolvency proceeding is opened applies throughout the European Union, as well as in all other countries. *See* Council Regulation 1346/2000 on Insolvency Proceedings, as amended, 2000 O.J. (L.160/1) 1, art. 17.

However, the extraterritorial jurisdiction of the U.S. courts for the purposes of the automatic stay is *in personam* rather than *in rem*. This means that, although a creditor that seizes non-U.S. property of a debtor in a U.S. bankruptcy case violates the automatic stay, whether or not a U.S. bankruptcy court can do anything about it is a function of that creditor's susceptibility to U.S. process. *See Sinatra v. Gucci (In re Gucci)*, 309 B.R. 679, 683-84 (S.D.N.Y. 2004) (citing COLLIER ON BANKRUPTCY ¶ 3.01[5], at 3-32 to 3-33 (15th ed. rev. 2003)); *see also* David P. Stromes, Note: *The Extraterritorial Reach of the Bankruptcy Code's Automatic Stay: Theory vs. Practice*, 33 Brooklyn J. Int'l L. 277, 284 (2007) ("[I]f foreign creditors violate the automatic stay, U.S. bankruptcy courts cannot protect the debtor's assets unless the courts can exercise *in personam* jurisdiction over the violating entities."). If there is no personal jurisdiction against the violating entity, the court is unlikely to be able to protect the estate's non-U.S. assets.

However, if the foreign country where a U.S. debtor's assets are located has enacted the UNCITRAL Model Law on Cross-Border Insolvency ("Model Law"), which has been adopted in some form by more than 50 countries (including the United States, in chapter 15 of the Bankruptcy Code), the U.S. debtor or its bankruptcy trustee could seek to enforce the automatic stay extraterritorially by obtaining recognition of the stay by a foreign court in an appropriate proceeding.

KUMTOR GOLD

On May 31, 2021, Kumtor filed for chapter 11 protection in the Southern District of New York after a former Soviet satellite, the Kyrgyz Republic ("Republic"), seized Kumtor's gold mine in the country ("Kumtor Mine") to secure repayment of $3 billion in alleged claims for environmental damages as a result of mine operations and approximately $350 million in alleged tax claims.

Kumtor is wholly owned by Canadian gold mining company Centerra Gold Inc. ("Centerra"). Kumtor mines gold doré—a semi-pure alloy of gold and silver—which is then purchased by Kyrgyzaltyn JSC ("Kyrgyzaltyn"), a state-owned corporation incorporated under the laws of, and wholly owned and controlled by, the Republic. Kyrgyzaltyn then refines and sells the gold outside of the Republic. Kyrgyzaltyn is Centerra's largest shareholder, owning approximately 26% of Centerra's issued and outstanding common shares. The Republic has certain approval rights over the operations of the mine, including, among other things, approval of the structure and management of the mine's environmental operations. In 2020, Kumtor's shares in the Republic's gross domestic product and aggregate industrial output were 12.5% and 23.3%, respectively. *See* Kumtor Gold Company official website, "Contribution to the Economy" (last visited Oct. 6, 2021).

Kumtor's business relationship with the Republic began in 1992, shortly after the collapse of the Soviet Union, when Centerra's predecessor entered into a project development agreement with the Republic giving Centerra the exclusive right to evaluate and develop gold deposits in the area that would become the Kumtor Mine. According to Kumtor, its relationship with the Republic had been historically difficult and grew more acrimonious over time. Over the years, the Republic made several efforts to pressure and coerce Centerra into making concessions with respect to previously negotiated agreements, including by issuing an arrest order for the company's former CEO, commencing criminal cases against certain of Kumtor's managers, and asserting claims against Kumtor in Kyrgyz courts for alleged violations of environmental laws. Kumtor maintains that these actions were aimed at nationalizing the company.

In the fall of 2020, the Republic experienced a political crisis, after which a nationalist candidate for president was installed and the Republic took steps toward what the U.K. and Canadian governments characterized as a "probable nationalization" of the mine. In March 2021, four citizens of the Republic filed a lawsuit against Kumtor seeking financial sanctions for alleged environmental damage from mining operations. In addition, the Republic imposed certain tax penalties against the company.

Simultaneously, the Republic began passing legislation aimed at Kumtor's operations. In February 2021, Kyrgyzstan's Parliament formed a new State Commission tasked with reviewing "the effectiveness of the Kumtor Mine's activities." The State Commission proposed new legislation in April 2021 that would amend Kyrgyz laws implementing certain agreements among Kumtor, Centerra, Kyrgyzaltyn, and the Republic.

In early May 2021, the Republic enacted a law giving it the power to temporarily take control of the mine and appoint "external management" to address purported violations of occupational health, environmental, or industrial safety laws. The temporary management law criminalized opposition to the law, thereby exposing Kumtor's officers, directors, and legal representatives to criminal liability for taking any action to protect Kumtor's assets.

The Republic appointed a Kyrgyz national as the temporary manager of Kumtor on May 17, 2021, and effectively seized full operational control of the mine. The appointment came immediately after Kumtor and Centerra commenced contractually authorized international arbitration in Sweden seeking to resolve the Republic's alleged environmental and tax claims.

Kumtor filed for chapter 11 in New York at the end of May 2021 in an effort to protect its assets. At the time of the filing, Kumtor asserted that it was solvent, with $1.1 billion in assets and no bank debt.

After the chapter 11 filing, the Republic obtained an injunction from a Kyrgyz court suspending the corporate resolutions that authorized the chapter 11 filing, barring Kumtor from continuing with its U.S. bankruptcy cases and prohibiting certain Kumtor directors and attorneys from representing the company in U.S. courts. Kumtor responded by filing an adversary proceeding in the U.S. bankruptcy court seeking emergency injunctive relief preventing the Republic from seeking relief in another court to dismiss the chapter 11 cases and sanctions for violations of the automatic stay.

After a July 19, 2021, hearing, Judge Beckerman entered an order the following day finding the Republic in contempt for violating the automatic stay and ordered it to pay Kumtor's attorneys' fees as a sanction. However, the court declined to issue an injunction. It concluded that, although the standards for injunctive relief were met, the Republic had not been properly served because its U.S. counsel refused to accept service on the Republic's behalf (despite filing a notice of appearance in the bankruptcy court) and Kumtor's U.S. counsel had difficulty effectuating proper service in Kyrgyzstan, as Kumtor could not retain an attorney in the Republic due to the threat of prosecution under the temporary management law.

Judge Beckerman acknowledged the public policy concern in allowing the Republic to access U.S. courts, including the bankruptcy court, to object to relief and to seek certain other relief with respect to Kumtor's chapter 11 cases, while simultaneously "disregarding in some ways . . . [the U.S.] process." Nevertheless, Judge Beckerman ruled that she was limited by the Bankruptcy Code and applicable procedural rules in the relief she could grant.

Also on July 19, 2021, the Republic filed a motion in the bankruptcy court to dismiss Kumtor's chapter 11 cases as having been filed without the requisite authority.

On August 8, 2021, the Republic appealed Judge Beckerman's July 20, 2021, order to the district court, claiming (as it had before the bankruptcy court) that the court lacked jurisdiction over the Republic because it is immune from suit under the U.S. Foreign Sovereign Immunities Act ("FSIA"), which provides that, with certain exceptions, foreign states are immune from the jurisdiction of U.S. courts. Judge Beckerman had rejected this argument, finding that section 106 of the Bankruptcy Code provides for governmental units' (including foreign states') waiver of sovereign immunity with respect to certain sections of the statute, including sections 105 (giving bankruptcy courts the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]" and 362 (the automatic stay).

In its filings with the district court, the Republic maintained that FSIA prevails in any conflict with the Bankruptcy Code and, moreover, that its conduct since the bankruptcy petition date qualified as a valid exercise of its police powers excepted from the automatic stay pursuant to section 362(b)(4). The Republic also argued that it was entitled to seek relief in its own courts under its own laws governing the authority of Kumtor to file for bankruptcy.

In late August 2021, Kumtor filed another motion seeking the imposition of sanctions on the Republic for continuing violations of the automatic stay by, among other things, continuing to prosecute the Kyrgyz proceedings to nullify Kumtor's corporate resolutions authorizing the chapter 11 filing, extending the mandate of the temporary manager of the mine, taking steps to renounce all of Kumtor's contracts with the Republic, and laying the groundwork to parlay disputed tax and environmental liability claims into a controlling share of the company.

Judge Beckerman denied the sanctions motion on September 15, 2021. Although sympathetic to Kumtor's efforts to protect its assets in the Republic and characterizing as "obstreperous" the Republic's continued efforts to evade service of process in Kyrgyzstan, she found that the Republic's actions did not violate the automatic stay.

On September 15, 2021, the Republic filed a motion seeking a direct appeal of Judge Beckerman's July 20, 2021, contempt order to the U.S. Court of Appeals for the Second Circuit.

The district court denied the Republic's motion for leave to appeal to the Second Circuit on October 20, 2021. Among other things, U.S. District Judge Alvin K. Hellerstein ruled that, although the questions of how section 106 of the Bankruptcy Code interacts with FSIA, "including whether a bankruptcy court may enforce an automatic stay against a foreign sovereign asserting immunity and whether that court can sanction such a foreign sovereign, are interesting, and may even be ones upon which there is substantial disagreement, none is a controlling question of only law, nor one that will materially advance the litigation." *See In re Kumtor Gold Co. CJSC*, 21 Civ. 6578 (AKH) (S.D.N.Y. Oct. 20, 2021). He further noted that the Republic remains free to advance its foreign sovereign immunity claim in support of its pending motion to dismiss Kumtor's chapter 11 cases. The parties are gearing up to litigate that motion in mid-November 2021.

OUTLOOK

Kumtor Gold serves as a cautionary tale for foreign investors in developing countries, where a change in political regime can bring drastic changes to business dealings between the parties. The outcome of Kumtor's battle with the Republic is uncertain. Kumtor claims that its property has been wrongfully expropriated and that, although the Kyrgyz constitution allows the government to take private property in exchange for just compensation, the Republic has manufactured specious claims to wrongfully convert private property without compensation. The Republic argues that it is rightfully acting to protect the health and safety of its populace and preserve the environment, and that it is taking back an asset in the control of a corrupt foreign investor. It remains to be seen whether the Second Circuit will have an opportunity to weigh in on these questions.

NEWSWORTHY

Gregory M. Gordon ***(Dallas)***, ***Dan B. Prieto*** ***(Dallas)***, ***Amanda S. Rush*** ***(Dallas)***, ***Brad B. Erens*** ***(Chicago)***, ***Caitlin K. Cahow*** ***(Chicago)***, and ***Robert W. Hamilton*** ***(Columbus)*** are representing Johnson & Johnson subsidiary LTL Management LLC in the company's chapter 11 case, which was filed on October 14, 2021, in the U.S. Bankruptcy Court for the Western District of North Carolina.

The *National Law Journal* recognized ***Kevyn D. Orr*** ***(Washington)*** by including him in its list of Crisis Trailblazers for 2021. Through the various Trailblazers special supplements, the NLJ recognizes agents of change—movers and shakers in the legal industry who have made significant contributions to, and innovations in, their area of practice.

Bruce Bennett ***(Los Angeles and New York)*** was honored for his work on the "Mega Company Turnaround/Transaction of the Year," representing certain equity interest holders of chapter 11 debtor PG&E Corp., at the 2021 Turnaround Management Association Annual Conference held from October 26–29, 2021, in Nashville, Tennessee.

Ben Larkin ***(London)*** was named to the *Legal 500* Hall of Fame in the 2022 edition of *The Legal 500 United Kingdom* guide in the practice area "Finance–Corporate restructuring and insolvency."

An article written by ***Corinne Ball*** ***(New York)***, ***Dan T. Moss*** ***(Washington)***, ***Michael C. Schneidereit*** ***(New York)***, ***Isel M. Perez*** ***(Miami)***, and ***Mark G. Douglas*** ***(New York)*** titled "N.Y. District Court Rules that Chapter 15 Recognition Not Required to Enforce Foreign Bankruptcy Injunction" was published in the October 2021 *INSOL News Update*.

An article written by ***Dan B. Prieto*** ***(Dallas)*** and ***Mark G. Douglas*** ***(New York)*** titled "Structured Ch. 11 Dismissals Aren't Dead, Despite *Jevic*" was published in the October 6, 2021, edition of Law360.

Ben Larkin ***(London)***, ***John Papadakis*** ***(London)***, and ***Hanna Plumb*** ***(London)*** coauthored an October 2021 Jones Day *Commentary* titled "Pension Schemes Act 2021: Implications for the UK's Rescue Culture." The *Commentary* was prepared with the assistance of ***Stanzi Rosenthal*** ***(London)***.

An article written by ***Charles M. Oellermann*** ***(Columbus)*** and ***Mark G. Douglas*** ***(New York)*** titled "Second Circuit Applies *Taggart* Standard to Orders Declaring Home Mortgage Loans Current" was published on September 28, 2021, in *Lexis Practical Guidance*.

An article written by ***Dan B. Prieto*** ***(Dallas)*** and ***Mark G. Douglas*** ***(New York)*** titled "Voting Rights Assignment Unenforceable, but Subordinated Creditor Lacked Standing to Participate in Chapter 11 Plan Confirmation Process" was posted on the Harvard Law School *Bankruptcy Roundtable* on September 21, 2021.

An article written by ***Brad B. Erens*** ***(Chicago)*** and ***Mark G. Douglas*** ***(New York)*** titled "Stalking-Horse Bidder May Be Entitled to Administrative Priority for Expenses Despite Failure to Close Bankruptcy Sale" was published on September 28, 2021, in *Lexis Practical Guidance*.

An article written by ***Dan B. Prieto*** ***(Dallas)*** and ***Mark G. Douglas*** ***(New York)*** titled "Structured Dismissal of Chapter 11 Cases Did Not Violate *Jevic*" was published on September 28, 2021, in *Lexis Practical Guidance*.

Ben Larkin ***(London)*** was ranked in the field of Restructuring/Insolvency in *Chambers UK* 2022.

Jones Day was named "Law Firm of the Year" in the practice area "Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law" and received a National Tier 1 ranking for its "Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law" and "Litigation-Bankruptcy" practices in the 2022 *U.S. News - Best Lawyers®* "Best Law Firms" list published jointly by *U.S. News and World Report and Best Lawyers®*.

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BOSTON	DETROIT	LONDON	MINNEAPOLIS	SAN FRANCISCO	TAIPEI
BRISBANE	DUBAI	LOS ANGELES	MUNICH	SÃO PAULO	TOKYO
BRUSSELS	DÜSSELDORF	MADRID	NEW YORK	SAUDI ARABIA	WASHINGTON
CHICAGO	FRANKFURT	MELBOURNE	PARIS	SHANGHAI	