JONES DAY®

VOL. 21 • NO. 1
JANUARY–FEBRUARY
2022

BUSINESS RESTRUCTURING REVIEW

THE YEAR IN BANKRUPTCY: 2021

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One year ago, we wrote that, unlike in 2019, when the large business bankruptcy landscape was generally shaped by economic, market, and leverage factors, the COVID-19 pandemic dominated the narrative in 2020. The pandemic may not have been responsible for every reversal of corporate fortune in 2020, but it weighed heavily on the scale, particularly for companies in the energy, retail, restaurant, entertainment, health care, travel, and hospitality industries. Mandatory shutdowns beginning in the spring of 2020 wreaked havoc on the bottom lines of thousands of companies confronting a precipitous drop in demand for their products and services. Many were able to weather the worst of the storm with packages of government assistance or by adapting their business models to meet the unique challenges of the pandemic. Others could not and either closed their doors or sought bankruptcy protection to attempt to restructure their balance sheets or sell their assets.

At the end of 2020 and into early 2021, it was widely anticipated that the unprecedented pressure the pandemic brought to bear on the U.S. economy would lead to a boom in corporate bankruptcy filings. That boom never materialized. Instead, business bankruptcy filings in the United States plummeted in 2021. The reasons for the decrease (discussed in more detail in "Recent Trends in Corporate Debt and Reorganizations: Laying the Groundwork for Future Large Chapter 11 Cases or Just More Runway?") included:

- Improvement in the U.S. economy in the spring of 2021 that coincided with the widespread deployment of vaccines;
- A 10 percentage point drop in the unemployment rate from the height of the pandemic;
- Fewer restrictions on businesses and their customers;
- Historically low interest rates, robust capital market access, and other readily available financing;
- The willingness of lenders to forbear and extend maturities on loans; and
- Government assistance during the pandemic.

The drop-off persisted despite the highest inflation rate in 40 years (as of November 2021), a malfunctioning supply chain, and continuing pandemic uncertainty due to variants Delta and Omicron as well as vaccine hesitancy.

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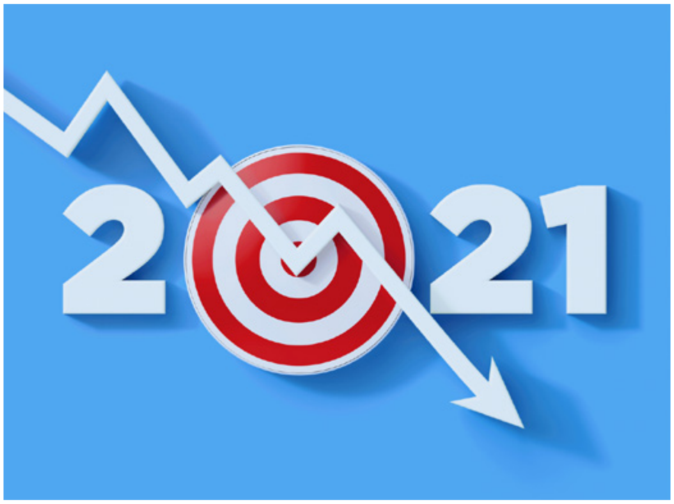

BUSINESS BANKRUPTCY FILINGS

According to New Generation Research, Inc.'s BankruptcyData.com, there were 6,691 commercial bankruptcy filings in 2021, compared to 11,375 in 2020 and 10,056 in 2019. The real estate sector led the charge in 2021, with more than 1,100 filings. Other industries with the greatest volume of filings in 2021 included construction and supplies, health care and medical, banking and finance, restaurant, and transportation.

There were 3,587 commercial chapter 11 filings in 2021, compared to 6,870 in 2020 and 5,236 in 2019. One hundred fifty-seven debtors filed petitions for recognition in the United States of foreign bankruptcy cases under chapter 15 of the Bankruptcy Code in 2021. Three municipalities filed petitions to adjust their debts under chapter 9.

Bankruptcy data and research firm Reorg similarly reported that 2021, with a total of 275 chapter 11 filings by companies with at least $10 million in liabilities, was the slowest since 2012 and the first in at least six years to record fewer than 300 cases. Of those 275 chapter 11 filings, companies in the real estate (28%), consumer discretionary (20%), health care (10%), energy (9%), industrials (8%), and financials (5%) sectors recorded the largest number of cases. Filings by companies in all sectors decreased from 2020, except for the utilities sector, which experienced increased activity in the wake of Winter Storm Uri in Texas.

PUBLIC COMPANY BANKRUPTCIES

According to BankruptcyData.com, bankruptcy filings for "public companies" (defined as companies with publicly traded stock or debt), after reaching the highest level in more than a decade in 2020 (with 110 filings), plummeted to 22 in 2021. At the height of the Great Recession, 138 public companies filed for bankruptcy in 2008 and 211 in 2009.

The combined asset value of the 22 public companies that filed for bankruptcy in 2021 was $19.2 billion, compared to $292.7 billion in 2020. By contrast, the 138 public companies that filed for bankruptcy in 2008 had prepetition assets valued at $1.2 trillion in aggregate.

Companies in the oil and gas sector grabbed the brass ring in public company bankruptcy filings in 2021, with 23% (five cases) of the year's 22 public company bankruptcies. The other sector with a significant number of public company filings in 2021 was banking and finance, with four cases (18%). Other industries with public filings in 2021 included telecom, construction and supplies, transportation, computers and software, apparel and textiles, chemicals and allied products, aviation, retail, hotel and gaming, automotive, restaurant, and mining (each with one case).

The year 2021 added only eight public company names to the billion-dollar bankruptcy club (measured by value of assets), compared to 51 in 2020.

The largest public company bankruptcy filing of 2021—oil and gas exploration and production company Seadrill Limited, with $7.3 billion in assets—did not even make it onto the top-50 list of the largest public bankruptcies of all time. By asset value, the remaining public companies among the 10 largest bankruptcy filings in 2021 were real estate investment trust Washington Prime Group Inc. ($4.0 billion in assets); internet services and infrastructure company GTT Communications, Inc. ($2.8 billion in assets); gas utility company Ferrellgas Partners, L.P. ($1.7 billion in assets); coffee shop chain Luckin Coffee Inc. ($1.2 billion in assets); multi-utility company Just Energy Group Inc. ($1.09 billion in assets); hotel, resort, and cruise line owner Carlson Travel Inc. ($1.0 billion in assets); application software company Riverbed Technology, Inc. ($1.0 billion in assets); hotel operator Grupo Posadas S.A.B. de C.V. ($946 million in assets); and oil and gas exploration company HighPoint Resources Corp. ($826 million in assets).

Eighteen public companies with assets valued at more than $1 billion exited from bankruptcy in 2021, compared to 25 in the previous year. Continuing a trend begun in 2012, many more of those companies reorganized than were liquidated or sold. More than half of the chapter 11 plans confirmed in 2021 by billion-dollar public companies were in prepackaged or prenegotiated bankruptcy cases.

Notable exits from bankruptcy in 2021 included:

- The Commonwealth of Puerto Rico, which largely wrapped up its four-year restructuring when the island territory's legislature voted on November 7 to approve a deal that settles $35 billion in debt;
- Car rental company Hertz Global Holdings Inc., which obtained confirmation of a chapter 11 plan in June that paid unsecured creditors in full and distributions to stockholders due to the company's rare status as solvent debtor; and

- Pan-regional Latin American multinational airline company LATAM Airlines Group S.A., which exited bankruptcy in December after obtaining confirmation of a chapter 11 plan that restructured $7.3 billion in debt.

NOTABLE BANKRUPTCY RULINGS

Notable bankruptcy and appellate court rulings in 2021 examined, among other things:

- The validity of nonconsensual third-party releases in chapter 11 plans;
- The doctrine of "equitable mootness" precluding appeals of certain bankruptcy court orders;
- The "solvent debtor exception" requiring solvent debtors to pay postpetition interest to unsecured creditors;
- Whether unsecured noteholders are entitled to a contractual "make-whole premium" if a debtor redeems the notes prior to maturity during bankruptcy;
- The automatic stay;
- Cross-border bankruptcy cases under chapter 15 of the Bankruptcy Code;
- The rejection of executory contracts in bankruptcy;
- Subordination agreements and chapter 11 plan voting rights;
- Bankruptcy blocking restrictions in loan and organizational documents;
- Credit bidding in bankruptcy asset sales; and
- "Structured dismissals" of chapter 11 cases.

Automatic Stay. In *City of Chicago v. Fulton*, 141 S. Ct. 585 (2021), the U.S. Supreme Court held that a creditor in possession of a debtor's property does not violate the automatic stay in section 362(a)(3) of the Bankruptcy Code by retaining the property after the filing of a bankruptcy petition.

Avoidance of Transfers. In *In re Trib. Co. Fraudulent Conv. Litig.*, 10 F.4th 147 (2d Cir. 2021), *reh'g denied*, No. 19-3049 (2d Cir. Oct. 7, 2021), the U.S. Court of Appeals for the Second Circuit largely upheld lower court dismissals of claims asserted by the debtor'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 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.

In *In re Bernard L. Madoff Inv. Sec. 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 seeking to recover hundreds of millions of dollars in allegedly fraudulent transfers made to former 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:

- "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 ("SIPA"); and
- A defendant, rather than the SIPA trustee, bears the burden of pleading on the issue of good faith. The ruling, which involves test cases for approximately 90 dismissed actions, breathed 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.

In *Holliday, Liquidating Trustee of the BosGen Liq. Trust v. Credit Suisse Secs. (USA) LLC*, 2021 WL 4150523 (S.D.N.Y. Sept. 13, 2021), *appeal filed*, No. 21-2543 (2d Cir. Oct. 8, 2021) (discussed elsewhere in this edition), the U.S. District Court for the Southern District of New York affirmed a bankruptcy court ruling that:

- The securities transactions safe harbor in section 546(e) of the Bankruptcy Code preempts intentional fraudulent transfer claims under state law; and
- Payments made to the members of limited liability company debtors as part of a prebankruptcy recapitalization transaction were protected from avoidance under section 546(e) because, for that section's purposes, the debtors were "financial institutions," as customers of banks that acted as their depositories and agents in connection with the transaction.

U.S. Trustee Bankruptcy Fees. Several court rulings in 2020–21 addressed the constitutionality of 2017 legislation that, beginning in 2018, significantly increased fees levied in chapter 11 cases by the U.S. Trustee Program, which oversees bankruptcy cases filed in all federal districts except for those in the two states (Alabama and North Carolina) that are covered by the Bankruptcy Administrator ("BA") Program. That same increase was not imposed in BA districts until nine months after the January 1, 2018, effective date of the legislation, and the BA fee increase applied only to cases filed after that date. The four circuits that had addressed the question at the end of 2021 were evenly divided. A fifth circuit—the Eleventh Circuit—broke the deadlock in early 2022 when it ruled that the fee increase was constitutionally sound. See In re Mosaic Management Group, Inc., 2022 WL 136707 (11th Cir. Jan. 14, 2022).

The Second and Tenth Circuits found violations of the uniformity requirement of the Bankruptcy Clause of the U.S. Constitution (Art. I, § 8, cl. 4) because the increase did not apply immediately to chapter 11 debtors in the two states with BAs rather than U.S. Trustees. *See Clinton Nurseries Inc. v. Harrington (In re Clinton Nurseries Inc.)*, 998 F.3d 56 (2d Cir. 2021), and *John Q. Hammons Fall 2006 LLC v. U.S. Trustee (In re John Q. Hammons Fall 2006 LLC)*, 15 F.4th 1011 (10th Cir. 2021). By contrast, the Fourth and Fifth Circuits found no constitutional infirmity. *See Siegel v. Fitzgerald (In re Circuit City Stores Inc.)*, 996 F.3d 156 (4th Cir. 2021), and *Hobbs v. Buffets LLC (In re Buffets LLC)*, 979 F.3d 366 (5th Cir.

2020). The debtor in the Fourth Circuit case filed a petition asking the U.S. Supreme Court to resolve the circuit split. The Court agreed to hear the appeal on January 10, 2022. *See Siegel v. Fitzgerald*, No. 21-441 (U.S. Jan. 10, 2022).

Bankruptcy Filing Restrictions. In *In re 3P Hightstown, LLC*, 631 B.R. 205 (Bankr. D.N.J. 2021), the U.S. Bankruptcy Court for the District of New Jersey 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.

Chapter 11 Plan Provisions. In *In re Purdue Pharma, L.P.*, 2021 WL 5979108 (S.D.N.Y. Dec. 16, 2021), *appeal certified*, No. 21 cv 7532 (CM) (S.D.N.Y. Jan. 7, 2022), the U.S. District Court for the Southern District of New York vacated a bankruptcy court order confirming the chapter 11 plan of pharmaceutical company Purdue Pharma, Inc. and its affiliate debtors ("Purdue"). The district court ruled that the bankruptcy court did not have the authority under the Bankruptcy Code to approve nonconsensual releases granted under the plan to Purdue's owners, the Sackler family, from liabilities associated with Purdue's sale of OxyContin in exchange for the Sacklers' ownership interest in the companies and more than $4 billion to settle OxyContin litigation claims. According to the district court, "Contrary to the bankruptcy judge's conclusion, Sections 105(a) and 1123(a)(5) & (b)(6) [of the Bankruptcy Code], whether read individually or together, do not provide a bankruptcy court with such authority; and there is no such thing as 'equitable authority' or 'residual authority' in a bankruptcy court untethered to some specific, substantive grant of authority in the Bankruptcy Code."

In *In re Nuverra Environmental Solutions, Inc.*, 834 Fed. App'x 729 (3d Cir. 2021), *cert. denied*, 142 S. Ct. 337 (2021), the U.S. Court of Appeals for the Third Circuit handed down a long-awaited ruling that could have, but ultimately did not, address the validity of "gifting" chapter 11 plans under which a senior creditor class gives a portion of its statutorily entitled recovery to one or more junior classes as a means of achieving consensual confirmation. By avoiding the merits and holding that an appeal of an order confirming a "horizontal gifting" plan was equitably moot, the Third Circuit skirted a question that continues to linger in the aftermath of the U.S. Supreme Court decision in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), which invalidated final distributions to creditors departing from the Bankruptcy Code's priority scheme as part of a nonconsensual "structured dismissal" of a chapter 11 case.

In *In re Mullins*, 2021 WL 2948685 (Bankr. D. Mass. July 13, 2021), the U.S. Bankruptcy Court for the District of Massachusetts held that the "solvent debtor exception" established under the former Bankruptcy Act and common law, which required a solvent debtor to pay its creditors in full, survived the enactment of the Bankruptcy Code in 1978. According to the court, 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.

In *In re The Hertz Corp.*, 2021 WL 6068390 (Bankr. D. Del. Dec. 22, 2021), the U.S. Bankruptcy Court for the District of Delaware similarly ruled that solvent chapter 11 debtors must pay postpetition interest to unsecured creditors under a chapter 11 plan at the federal judgment rate rather than the higher contract rate. The court also held that:

An indenture trustee plausibly stated a claim that a make-whole premium was due to some (but not all) of the debtors' noteholders because the debtors voluntarily redeemed the notes prematurely during the bankruptcy case;

The court was not prepared at that juncture to conclude as a legal matter that make-whole premiums can be disallowed as the economic equivalent of "unmatured interest" under section 502(b)(2) of the Bankruptcy Code;

Any modification of the noteholders' claim to a make-whole premium was an impairment of the noteholders' contract claims by operation of section 502(b)(2) rather than the debtors' chapter 11 plan; and

The court was "convinced that the solvent debtor exception survived passage of the Bankruptcy Code only to a limited extent," and that in the rare case of a solvent debtor, a chapter 11 plan need pay postpetition interest on unsecured claims only at the federal judgment rate to render the claims "unimpaired" within the meaning of section 1124(1) of the Bankruptcy Code.

Creditors' Rights. In *In re Orexigen Therapeutics, Inc.*, 990 F.3d 748 (3d Cir. 2021), the U.S. Court of Appeals for the Third Circuit ruled as a matter of first impression that "triangular setoff" does not satisfy the Bankruptcy Code's "mutuality" requirement. In a typical triangular setoff, "A" might have a business relationship with "B" and "C," where B and C are related parties. Triangular setoff occurs when A owes B, and A attempts to set off that amount against amounts C owes to A. The validity of triangular setoff in the bankruptcy context, as distinguished from under state contract or common law, is subject to debate.

In *In re Fencepost Productions Inc.*, 629 B.R. 289 (Bankr. D. Kan. 2021), the U.S. Bankruptcy Court for the District of Kansas addressed the enforceability of a provision in a prebankruptcy subordination agreement under which a subordinated creditor assigned to a senior creditor its right to vote on any chapter 11 plan proposed for the borrower. The bankruptcy court ruled that such a provision is not enforceable because it conflicts with the

Bankruptcy Code. In a twist, however, the court concluded that the subordinated creditor lacked "prudential standing" to participate in the confirmation process because it was extremely out-of-the-money and therefore had no stake in the outcome of the case, but rather was attempting to assert the rights of third parties.

In *In re Figueroa Mountain Brewing, LLC*, 2021 WL 2787880 (Bankr. C.D. Cal. July 2, 2021), the U.S. Bankruptcy Court for the Central District of California denied a secured lender the right to "credit bid" its disputed claim in a bankruptcy sale of its collateral based on colorable allegations that, among other things, its loan agreement and all payments made by the debtor under it were fraudulent transfers and the lender had dominated and controlled the debtor in an effort to take control of its assets.

Cross-Border Bankruptcy Cases. In *In re PT Bakrie Telecom TBK*, 628 B.R. 859 (Bankr. S.D.N.Y. 2021), the U.S. Bankruptcy Court for the Southern District of New York entered an order recognizing an Indonesian "suspension of payments proceeding" under chapter 15 of the Bankruptcy Code. However, the court refused to grant a foreign representative's request for "additional relief" in the form of enforcement of an Indonesian court order approving a restructuring plan because the order included third-party releases (a nonstandard practice under Indonesian law). According to the court, there was "nothing in the record about the justification for any third-party release" or any indication "the foreign court considered the rights of creditors when considering this third-party release."

In *In re Bankr. Est. of Norske Skogindustrier ASA*, 629 B.R. 717 (Bankr. S.D.N.Y. 2021), the U.S. Bankruptcy Court for the Southern District of New York held that a foreign representative in a case under chapter 15 of the Bankruptcy Code can rely on the Bankruptcy Code's statute of limitations tolling provision to extend the deadline under foreign bankruptcy law to commence avoidance litigation. The decision illustrates the increasing extent to which chapter 15 has become an invaluable resource for the representatives of foreign debtors in cross-border bankruptcy cases.

In *In re Condor Flugdienst GMBH*, 627 B.R. 366 (Bankr. N.D. Ill. 2021), the U.S. Bankruptcy Court for the Northern District of Illinois ruled that, if requested relief is not specifically authorized under chapter 15 of the Bankruptcy Code, a bankruptcy court still has the discretion to grant such relief provided it would have been authorized in a cross-border "ancillary" bankruptcy proceeding under chapter 15's repealed predecessor, section 304. In this case, the court held that it was expressly authorized under section 1521 of the Bankruptcy Code, as guided by section 1522, to recognize and enforce a foreign court order confirming a German debtor's liquidation plan. The court also permanently enjoined prepetition litigation commenced by certain creditors because such relief was necessary to effectuate the liquidation plan.

In *Moyal v. Munsterland Gruppe GmbH & Co.*, 2021 WL 1963899 (S.D.N.Y. May 17, 2021), the U.S. District Court for the Southern District of New York dismissed litigation against a German company, finding that, under principles of comity, the lawsuit was stayed by operation of German law when the company filed for bankruptcy in Germany, even though a U.S. bankruptcy court had not entered an order recognizing the German bankruptcy proceeding under chapter 15 of the Bankruptcy Code.

In *In re Culligan Ltd.*, 2021 WL 2787926 (Bankr. S.D.N.Y. July 2, 2021), the U.S. Bankruptcy Court for the Southern District of New York 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."

In *In re Talal Qais Abdulmunem al Zawawi*, 2021 WL 3890597 (Bankr. M.D. Fla. Aug. 31, 2021) (discussed elsewhere in this edition), the U.S. Bankruptcy Court for the Middle District of Florida distanced itself from a 2013 decision by the U.S. Court of Appeals for the Second Circuit, which 2013 decision concluded that, like debtors in cases under other chapters of the Bankruptcy Code, a chapter 15 debtor must reside or have assets or a place of business in the United States to be eligible for chapter 15 relief. According to the bankruptcy court, chapter 15 has its own eligibility requirements, and the eligibility requirements for debtors in cases under other chapters of the Bankruptcy Code do not apply in chapter 15 cases.

Executory Contracts. In *Caliber North Dakota, LLC v. Nine Point Energy Holdings, Inc. (In re Nine Point Energy Holdings, Inc.)*, 2021 WL 3269210 (D. Del. July 30, 2021) (discussed elsewhere in this edition), the U.S. District Court for the District of Delaware held that the U.S. Supreme Court's holding in *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (2019), did not prevent a chapter 11 debtor from eliminating a midstream services provider's exclusive right to provide services to the debtor under a rejected contract. According to the district court, the exclusivity provisions' only value was the leverage it created for the midstream provider to force the debtor to perform its rejected executory obligations, which would defeat the purposes of section 365 of the Bankruptcy Code. The case is an important clarification on the implications of *Mission Product*, as it confirms that creative contracting cannot prevent a debtor from exercising, and receiving the benefits of, its rejection rights under the Bankruptcy Code.

Priority of Claims and Interests. In *In re KG Winddown, LLC*, 628 B.R. 739 (Bankr. S.D.N.Y. 2021), the U.S. Bankruptcy Court for the Southern District of New York held that the Supreme Court's 2017 ruling in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), that the Bankruptcy Code does not allow courts to approve distributions to creditors in a "structured dismissal" of a chapter 11 case that violate the Bankruptcy Code's ordinary priority rules without the consent of creditors, "left the door open where such dismissals do not violate the absolute priority rule and otherwise comply with the applicable provisions of the Bankruptcy Code." "Here," the court wrote, "the Debtors' request for structured dismissals fits neatly through that open door."

In *In re Energy Future Holdings Corp.*, 990 F.3d 728 (3d Cir. 2021), the U.S. Court of Appeals for the Third Circuit ruled that even though a "stalking horse" bidder failed to obtain necessary regulatory approvals to close an anticipated bankruptcy asset sale, the bidder could receive an administrative claim for a break-up fee and expenses if it could demonstrate that its efforts provided value to the estate.

Issues the U.S. Supreme Court Declined to Consider. The U.S. Supreme Court declined petitions to review several notable cases addressing bankruptcy issues in 2021. Those cases involved, among other issues:

- The doctrine of "equitable mootness," which precludes an appellate court from hearing an appeal of certain bankruptcy court orders (principally, but not exclusively, chapter 11 plan confirmation orders) (*see GLM DFW Inc. v. Windstream Holdings Inc.*, No. 20-1275 (U.S. Oct. 4, 2021); *Hargreaves v. Nuverra Environmental Solutions Inc.*, No. 21-17 (U.S. Oct. 12, 2021)).
- The "safe harbor" in the Bankruptcy Code shielding from avoidance transfers made in connection with certain securities, commodity, or forward contracts in the absence of actual fraud (*see Deutsche Bank Trust Co. Americas v. Robert R. McCormick Foundation*, No. 20-8 (U.S. Apr. 19, 2021)).
- The Bankruptcy Code's provisions authorizing the avoidance and recovery of fraudulent prebankruptcy transfers as well as the defense available to transferees who receive such transfers in good faith and for value (*see Gettinger v. Picard*, No. 20-1382 (U.S. May 3, 2021)).
- The Bankruptcy Code's rules and procedures for modifying contractual retiree and health care benefits provided by a chapter 11 debtor-employer (*see Holland v. Westmoreland Coal Co.*, No. 20-880 (U.S. May 24, 2021)).
- Whether the doctrine of federal preemption bars a non-debtor third party's tortious interference claims against other non-debtor third parties for actions taken in anticipation of a debtor's chapter 11 filing (*see Pilevsky v. Sutton 58 Associates LLC*, 20-1483 (U.S. Sept. 24, 2021)).

COMMERCIAL BANKRUPTCY LEGISLATIVE DEVELOPMENTS

A handful of measures of business bankruptcy legislation were enacted in 2021.

On January 12, 2021, former President Trump signed into law the "**Bankruptcy Administration Improvement Act of 2020**" (Public Law No. 116-325). The law extended 25 temporary bankruptcy court judgeships for an additional five years in an effort to ensure the integrity and effectiveness of the country's bankruptcy system during a period of increased filings by large corporations in the wake of the COVID-19 pandemic. The law also extended a temporary increase in fees owed to the U.S. Trustee Program for its work in overseeing chapter 11 cases. Originally set to expire in 2022, the new fee structure was extended through 2025.

On February 1, 2021, amendments to Part 190 of the bankruptcy regulations of the Commodity Futures Trading Commission ("CFTC") for commodity brokers became effective. The amendments represented the first comprehensive update to the CFTC's bankruptcy rules since the Part 190 rules were initially adopted in 1983. They modernize and revise the CFTC's regulations to reflect changes in the commodity brokerage industry over that time.

On March 27, 2021, President Biden signed into law the "**COVID-19 Bankruptcy Relief Extension Act**" (Public Law No. 117-5) to extend provisions providing financially distressed consumers and small businesses greater access to bankruptcy relief, which provisions were originally due to sunset on March 27, 2021. The legislation extended personal and small-business bankruptcy relief provisions that were part of the Coronavirus Aid, Relief and Economic Security Act of 2020 through March 27, 2022.

Business bankruptcy legislation that was proposed in 2021, but never enacted, included:

The "**PROTECT Asbestos Victims Act**" (S. 574, introduced March 3, 2021), which would reform the asbestos bankruptcy trust system by providing oversight of asbestos bankruptcy trusts, ensuring those harmed by asbestos receive fair and just compensation, and eliminate fraud and abuse within the trust system. It would empower the U.S. Trustee Program of the Department of Justice to investigate fraud against asbestos trusts, make it a crime to knowingly submit a false claim to a trust, and require trusts to comply with subpoenas from state courts seeking information related to trust payments, to better help prevent fraudulent claims in both state and federal proceedings. The act would also provide for the appointment of a special, disinterested representative to advise future victims in a bankruptcy case.

The "**Bankruptcy Venue Reform Act of 2021**" (H.R. 4193, introduced June 28, 2021, and S. 2827, introduced Sept. 23, 2021), which would require that chapter 11 bankruptcy cases be filed in the district where the principal place of business or principal assets of the corporation are located.

The "**Nondebtor Release Prohibition Act of 2021**" (S. 2497 and H.R. 4777, introduced July 28, 2021), which would prohibit provisions in chapter 11 plans or bankruptcy court orders releasing (or enjoining litigation against) non-debtor insiders of bankrupt companies from liabilities. It would also empower a bankruptcy court to dismiss a chapter 11 case if the debtor was involved in certain restructuring activity that, during the 10-year period preceding a bankruptcy filing, was intended or had the foreseeable effect of separating a debtor's assets from its liabilities and causing the debtor to assume or retain liabilities.

The "**No Bonuses Ahead of Bankruptcy Filing Act of 2021**" (H.R. 428, introduced Jan. 21, 2021) and the "**No Bonuses in Bankruptcy Act of 2021**" (H.R. 5554, introduced Oct. 12, 2021), which would prohibit debtors from paying "retention, incentive, or reward" bonuses to insiders and employees, consultants, or contractors making more than $250,000 per year and would allow the debtor to recover as preferences any such bonuses paid in the 180 days prior to filing.

The "**Stop Wall Street Looting Act of 2021**" (H.R. 5648 and S. 3022, introduced Oct. 20, 2021), which would make private investment funds bear the debt and employee benefit obligations of their acquisitions, put a two-year ban on post-acquisition dividends, and require private equity firms to disclose their fees and returns. It would also prioritize employee pay in bankruptcy, bolster the ability of workers to collect severance and pension payments, end private funds' immunity from liability when portfolio companies break the law, and extend the Bankruptcy Code's statute of limitations for litigation to claw back funds transferred out of a bankruptcy company from two to eight years for transfers connected to a change of corporate control. The bill would also give creditors' committees the exclusive right to bring or settle fraudulent transfer actions instead of a chapter 11 debtor.

DELAWARE COURT HOLDS REJECTION ELIMINATES NON-DEBTOR'S EXCLUSIVE RIGHT TO PROVIDE SERVICES TO THE DEBTOR

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Nick Buchta

Nine Point Energy Holdings, Inc. and its affiliates (collectively, "Nine Point" or "Nine Point debtors") constituted an oil and gas production and exploration company that sought to reorganize in chapter 11 through a going concern sale of substantially all of their assets. To maximize value, Nine Point sought to sell those assets free and clear of its midstream services contracts, which included provisions that prevented Nine Point from acquiring midstream services from anyone other than its counterparty, Caliber North Dakota, LLC ("Caliber"). The dispute over Nine Point's ability to do so was the driving factor in its bankruptcy case.

One of the issues involved in the dispute was whether the U.S. Supreme Court's decision in *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (2019), prevented the contracts' rejection from eliminating Caliber's exclusive right to provide midstream services to Nine Point. The U.S. Bankruptcy Court for the District Delaware held that it did not. On appeal, the Delaware District Court agreed in *Caliber North Dakota, LLC v. Nine Point Energy Holdings, Inc. (In re Nine Point Energy Holdings, Inc.)*, 2021 WL 3269210 (D. Del. July 30, 2021). The district court held that *Mission Product*'s holding did not apply because the exclusivity provisions' only value was the leverage it created for Caliber to force Nine Point to perform Nine Point's rejected executory obligations, which would defeat the purposes of section 365 of the Bankruptcy Code. This case is an important clarification on the implications of *Mission Product* as it confirms that creative contracting cannot prevent a debtor from exercising, and receiving the benefits of, its rejection rights under the Bankruptcy Code.

REJECTION AND *MISSION PRODUCT*

Section 365(a) provides debtors with a broad grant of authority to assume or reject executory contracts and unexpired leases. Section 365(g) further explains that rejection "constitutes a breach" of the underlying contract immediately before the bankruptcy filing, and counterparties to rejected contracts are generally treated as prepetition creditors with respect to the damages that flow from rejection.

A circuit split emerged, however, over the impact of rejection on individual provisions in rejected contracts—particularly provisions granting a counterparty a non-exclusive license to use the debtor's intellectual property, which may entitle the licensee to the protections set forth in section 365(n) of the Bankruptcy Code. The Seventh Circuit, in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC,* 686 F.3d 372, 376-77 (7th Cir.

2012), focused on the treatment of rejection as breach. Because breaches outside of the bankruptcy context do not "vaporize[]" a nonbreaching party's rights, the court reasoned, rejection similarly could not eliminate the patent and trademark license. The First Circuit, however, took the opposite position in *In re Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018), holding that it would frustrate the Bankruptcy Code's underlying objective of "releasing the debtor's estate from burdensome obligations," *id.* at 402, to allow a licensee to retain non-exclusive rights to use a trademark post-rejection. Thus, the court concluded, rejection in the context of a trademark licensing agreement would constitute a rescission of the underlying contract.

In *Mission Product*, the Supreme Court resolved the "breach-versus-rescission" dispute in favor of the "rejection as breach" jurisdictions. There, the debtor, Tempnology, LLC ("Tempnology"), entered into an agreement giving Mission Product Holdings, Inc. ("MPH") a non-exclusive license to use Tempnology's trademarks. After filing for bankruptcy, Tempnology sought to reject this agreement and asked the bankruptcy court to hold that rejection would eliminate the non-exclusive license granted to MPH. MPH argued that rejection did not eliminate the non-exclusive license.

The Supreme Court held that rejection constitutes a breach of contract and that breach did not eliminate MPH's non-exclusive license. To analyze the latter question, the Court conjured a hypothetical for how breach is treated in the nonbankruptcy context. In its hypothetical, a dealer leases a photocopier to a law firm and agrees to service it every month in exchange for a monthly fee. During the term of the lease, however, the dealer stops servicing the photocopier. The law firm is left with a choice: It can continue paying the dealer rent while suing for breach damages, or it can terminate the contract and return the photocopier (simultaneously halting payment and suing for damages). Critically, the Court noted, the choice is with the law firm, not the breaching dealer, whether to continue enjoying the rights granted under the contract.

Applying this hypothetical in the bankruptcy context, the Court explained that if the dealer had filed for bankruptcy and chosen to reject its lease with the law firm, the rejection would relieve the debtor from the obligation to service the copier. However, the firm would have a choice either to: (i) keep the copier and continue paying the rental fees and file a claim against the estate for damages incurred from no servicing going forward; or (ii) return the copier and file a claim against the estate for damages. The Court acknowledged that the first option typically would not be attractive to the firm because its breach claim likely would be treated as a general unsecured claim. The Court held that a counterparty to a rejected contract does not have to give up non-exclusive licensing rights it received under a rejected prepetition contract.

NINE POINT

On March 15, 2021, the Nine Point debtors filed chapter 11 bankruptcy cases in Delaware. The same day they filed for bankruptcy, certain of the Nine Point debtors sought to reject their midstream services contracts and filed an adversary proceeding seeking, among other things, a ruling that the rejection would allow Nine Point to sell its assets free and clear of those contracts. Caliber opposed the relief, arguing, among other things, that even if the contracts could be rejected, under *Mission Product*, its exclusive right to provide midstream services to Nine Point would remain in force. Caliber also drew parallels to covenants not to compete, which some courts have held survive rejection. *See, e.g., Sir Speedy, Inc. v. Morse*, 256 B.R. 657, 660 (D. Mass. 2000) (holding that debtor was not relieved of obligations under noncompete clause even though the underlying franchise agreement was validly rejected); *In re Spooner*, 2012 WL 909515, at *4 (Bankr. N.D. Ohio Mar. 16, 2012) ("[R]elieving Debtor of the burdensome obligation of refraining from engaging in competitive activities cannot be accomplished by rejecting the Non-Compete Agreement.").

The bankruptcy court held that Caliber's exclusivity rights would not survive rejection. The court distinguished *Mission Product* because the non-debtor counterparty there "had the right to continue to use that license after rejection, notwithstanding the fact that the debtor was relieved of its obligation to perform." *Nine Point Energy Holdings, Inc. v. Caliber Measurement Services LLC (In re Nine Point Energy Holdings, Inc.*, 2021 WL 2212007, at *6 (Bankr. D. Del. June 1, 2021). In *Nine Point*, by contrast, Caliber had "no right to use the [exclusivity rights] except in its performance of the contracts." *Id.*

Affirming the bankruptcy court's order, the district court similarly distinguished *Mission Product*. The district court explained that the non-exclusive license at issue in *Mission Product* did "not allow a non-debtor to force the debtor to perform under a contract after its rejection." *Caliber North Dakota, LLC v. Nine Point Energy Holdings, Inc. (In re Nine Point Energy Holdings, Inc.)*, 2021 WL 3269210, at *8 (D. Del. July 30, 2021). "The fundamental flaw in Caliber's argument," the court continued, "is that an 'exclusivity' provision requires future performance by both parties. Thus, while it is possible to view an exclusivity provision as something that belongs to Caliber, it only has meaning if it is an obligation of [Nine Point]." *Id.* at *8 n.7. Because rejection allows a debtor to eliminate its executory obligations under the contract, the district court reasoned, rejection eliminates contractual rights that would allow the counterparty to compel performance of those obligations by the debtor.

OUTLOOK

The courts' rulings in *Nine Point* present an important clarification of the *Mission Product* holding. Rights granted prepetition that would effectively allow a non-debtor to thwart rejection do not survive rejection. In analyzing whether particular contractual rights will survive rejection, one needs to examine whether the underlying rights confer value or can be effectively enforced without the debtor's subsequent performance of its rejected executory obligations. While noncompete clauses or non-exclusive licenses confer value without the need for subsequent affirmative action by a debtor, an obligation that a debtor buy services exclusively from the counterparty does not confer value unless the debtor uses those services. As a result, rejection eliminates these types of exclusivity obligations.

The courts' decisions also have practical implications on the ability of parties to contract around section 365 of the Bankruptcy Code. Creative provisions designed to prevent a debtor from later exercising its rejection rights effectively will likely not survive rejection under the *Nine Point* courts' analyses.

Jones Day represents the Nine Point debtors in their chapter 11 cases.

THE ELEVENTH CIRCUIT REVISITS THE DOCTRINE OF STATUTORY MOOTNESS IN BANKRUPTCY SALES

Daniel J. Merrett • Mark G. Douglas

The finality of sales of assets in bankruptcy is an indispensable feature of U.S. bankruptcy law, designed to maximize the value of a bankruptcy estate as expeditiously as possible for the benefit of all stakeholders. Promoting the finality of bankruptcy asset sales is the Bankruptcy Code's prohibition of reversal or modification on appeal of an order approving a sale to a good-faith purchaser unless the party challenging the sale obtains a stay pending appeal. This bar of appellate review is commonly referred to as "statutory mootness."

The U.S. Court of Appeals for the Eleventh Circuit recently addressed the statutory mootness concept in *Reynolds v. ServisFirst Bank (In re Stanford)*, 17 F.4th 116 (11th Cir. 2021). Two of the three judges on the Eleventh Circuit panel ruled that an unstayed order approving a sale to a good-faith purchaser is moot on appeal, even if the sale was not properly authorized under the Bankruptcy Code. The third judge reached the same result, but for a different reason, because he determined that the debtors were precluded from challenging a sale that they had requested.

DISMISSAL OF APPEALS UNDER THE DOCTRINE OF MOOTNESS

"Mootness" is a doctrine that precludes a reviewing court from reaching the underlying merits of a controversy. An appeal can be either constitutionally, equitably, or statutorily moot. Constitutional mootness is derived from Article III of the U.S. Constitution, which limits the jurisdiction of federal courts to actual cases or controversies and, in furtherance of the goal of conserving judicial resources, precludes adjudication of cases that are hypothetical or merely advisory.

The court-fashioned remedy of "equitable mootness" bars adjudication of an appeal when a comprehensive change of circumstances has occurred such that it would be inequitable for a reviewing court to address the merits of the appeal. In bankruptcy cases, appellees often invoke equitable mootness as a basis for precluding appellate review of an order confirming a chapter 11 plan. The doctrine of equitable mootness is sometimes criticized as an abrogation of federal courts' "virtually unflagging obligation" to hear appeals within their jurisdiction. *See In re One2One Commc'ns, LLC*, 805 F.3d 428, 433 (3d Cir. 2015); *In re Charter Commc'ns, Inc.*, 691 F.3d 476, 481 (2d Cir. 2012). The U.S. Supreme Court in 2021 declined invitations to address this doctrine (*see GLM DFW, Inc. v. Windstream Holdings, Inc.*, No. 21-78 (U.S. Oct. 4, 2021) (denying petition for *certiorari*).

An appeal can also be rendered moot (or otherwise foreclosed) by statute. For example, section 363(m) of the Bankruptcy Code provides that, absent a stay pending appeal, "[t]he reversal or modification on appeal of an authorization . . . of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith." Although courts disagree on the point, section 363(m) has been interpreted "to render statutorily moot any appellate challenge to a sale that is both to a good faith purchaser, and not stayed." *Mission Product Holdings, Inc. v. Old Cold, LLC (In re Old Cold, LLC)*, 879 F.3d 376, 383 (1st Cir. 2018).

Section 363(m) is a powerful protection for good-faith purchasers because it limits appellate review of a consummated sale irrespective of the legal merits of the appeal. *See Made in Detroit, Inc. v. Official Comm. of Unsecured Creditors of Made in Detroit, Inc. (In re Made in Detroit, Inc.)*, 414 F.3d 576 (6th Cir. 2005); *see also In re Palmer Equip., LLC*, 623 B.R. 804, 808 (Bankr. D. Utah 2020) (section 363(m)'s protection is vital to encouraging buyers to purchase the debtor's property and thus ensuring that adequate sources of financing are available).

The circuits are split regarding whether section 363(m) automatically moots an appeal of an order approving an unstayed sale under all circumstances. Some circuits, including the First, Second, Fifth, Eleventh, and D.C. Circuits, have held that, in the absence of a stay of the sale order, the court must dismiss a pending appeal as moot unless the purchaser did not act in good faith. *Old Cold*, 879 F.3d at 383; *U.S. v. Salerno*, 932 F.2d 117 (2d Cir. 1991); *In re Walker County Hospital Corp.*, 3 F.4th 229 (5th Cir. 2021); *In re Steffen*, 552 F. App'x 946 (11th Cir. 2014); *In re Magwood*, 785 F.2d 1077 (D.C. Cir. 1986); *see also In re Ern, LLC*, 124 F. App'x 151, 152 (4th Cir. 2005) (dismissing an appeal of a sale order as moot because the assets had been transferred and the party challenging the sale failed to obtain a stay pending appeal); *In re Rimoldi*, 172 F.3d 876, 1999 WL 132260, *1 (9th Cir. 1999) ("This court has recognized only two exceptions to section 363(m)'s rule of mootness. The first applies where real property is sold subject to a statutory right of redemption; the second applies where state law otherwise would permit the transaction to be set aside.").

Statutory mootness under section 363(m) can preclude appellate review not only of an unstayed sale order, but also orders approving transactions that are an integral part of the sale. *See, e.g.*, *In re Sears Holdings Corp.*, 2021 WL 5986997 (2d Cir. Dec. 17, 2021) (in a nonprecedential summary order, affirming a district court order dismissing an appeal of an order approving an assignment of a lease that was "integral" to a sale transaction and noting that, "We have held in no ambiguous terms that section 363(m) is a limit on our jurisdiction and that, absent an entry of a stay of the Sale Order, we only retain authority to review challenges to the 'good faith' aspect of the sale" (internal quotation marks and citations omitted)); *In re Pursuit Holdings (NY), LLC*, 845 Fed. App'x 60 (2d Cir. 2021) (the statutory mootness rule indisputably applies to challenges to any integral provision of an order approving a sale, such as a settlement); *In re Trism, Inc.*, 328 F.3d 1003, 1007 (8th Cir. 2003) (mooting under section 363(m) "a challenge to a related provision of an order authorizing the sale of the debtor's assets" because the related provision was integral to the sale of the assets and reversing the provision would alter the parties' bargained-for exchange).

Other circuits, including the Third, Sixth, and Tenth Circuits, have rejected the view that section 363(m) automatically moots an appeal. Instead, these courts have held that an appeal is not moot as long as it is possible to grant effective relief without impacting the validity of the sale. *See In re ICL Holding Co., Inc.*, 802 F.3d 547, 554 (3d Cir. 2015) (section 363(m) did not moot the government's appeal of the terms for the ordered distribution of escrowed funds for administrative expenses and settlement proceeds from the sale of substantially all of the debtors' assets since the court could order redistribution of the sale proceeds without disturbing the sale); *Brown v. Ellmann (In re Brown)*, 851 F.3d 619 (6th Cir. 2017) (holding that parties alleging statutory mootness under section 363(m) must prove that the reviewing court is unable to grant effective relief); *Osborn v. Duran Bank & Trust Co. (In re Osborn)*, 24 F.3d 1199 (10th Cir. 1994) (holding that an appeal of a sale order was not mooted by section 363(m) when under Texas state law a constructive trust could be imposed on the sale proceeds), *abrogated in part on other grounds by Eastman v. Union Pac. R.R.*, 493 F.3d 1151 (10th Cir. 2007); *In re C.W. Min. Co.*, 740 F.3d 548, 555 (10th Cir. 2014) (section 363(m) will moot appeals in cases where the only remedies available are those that affect the validity of the sale).

In *Trinity 83 Dev., LLC v. ColFin Midwest Funding, LLC*, 917 F.3d 599 (7th Cir. 2019), the Seventh Circuit held that section 363(m) did not moot an appeal involving a dispute over the proceeds of a sale of assets in bankruptcy. In concluding that section 363(m) merely provided the purchaser with a defense in litigation challenging the sale, the Seventh Circuit overruled its prior decision strictly construing the scope of section 363(m) in *In re River West Plaza-Chicago, LLC*, 664 F.3d 668, 671-72 (7th Cir. 2011). According to the Seventh Circuit in *Trinity 83*, "We now hold that § 363(m) does not make any dispute moot or prevent a bankruptcy court from deciding what shall be done with the proceeds of a sale or lease." *Trinity 83*, 917 F.3d at 602.

The Eleventh Circuit revisited statutory mootness under section 363(m) in *Stanford*.

STANFORD

Robert and Frances Stanford were the owners of American Printing Company ("APC"). The Stanfords and APC filed separate chapter 11 cases in May 2019 in the Northern District of Alabama. At that time, the Stanfords owed ServisFirst Bank ("SFB") approximately $5 million. The loan was secured by a lien on a parcel of commercial real estate ("Property") and certain other property owned by the couple. APC guaranteed the loan. APC was also indebted to SFB for approximately $7.2 million on a secured basis under a separate loan guaranteed by the Stanfords.

APC sought bankruptcy court approval to incur up to $13.2 million in debtor-in-possession ("DIP") financing from SFB that would "roll up" the $12.2 million in prepetition debt that it owed or guaranteed and provide the company with an additional $1 million in working capital. The court authorized the loan.

Shortly afterward, the Stanfords sought court approval in their chapter 11 case to sell the Property to SFB for $3.5 million via a "credit bid" of SFB's secured claim. Section 363(k) of the Bankruptcy Code provides that a creditor with a lien on assets to be sold outside the ordinary course of business under section 363(b) may credit bid its "allowed claim" at the sale, "unless the court for cause orders otherwise."

The bankruptcy court approved the sale. In its order, the court found that SFB was a good-faith purchaser under section 363(m) of the Bankruptcy Code, that the credit-bid consideration was the highest and/or best offer for the Property, and that the consideration to be paid to the Stanfords exceeded the liquidation value of the Property.

After the court approved the sale, however, the Stanfords claimed that SFB did not have the right to credit bid. They argued that: (i) the SFB roll-up loan to APC satisfied their debt to SFB and extinguished SFB's lien on the Property; (ii) the roll-up loan converted SFB's prepetition claims against them and APC into postpetition administrative claims solely against APC; and (iii) because SFB never required them to guarantee the roll-up loan, they had no remaining prepetition obligations to SFB. The Stanfords accordingly filed a motion to amend the sale order and to stay the sale.

The bankruptcy court denied the motion. It ruled that, except for making APC a co-obligor on the Stanfords' $7.2 million debt to SFB, the roll-up loan to APC had no impact on that debt or the lien securing it. The court also held that the Stanfords were foreclosed from arguing, after final approval of their motion to sell the Property, that SFB lacked "a biddable interest" in the Property.

The Stanfords appealed the sale order and the order denying their motion to amend it to the district court. They also asked the bankruptcy court to stay the sale order pending appeal, which relief the court granted conditioned on the posting of a $1.5 million bond. The Stanfords failed to post the bond, after which the sale of the Property was duly recorded.

SFB moved for dismissal of the appeal to the district court as moot under section 363(m). The district court granted the motion, explaining that it lacked authority to grant any effective relief because the Stanfords neither obtained a stay nor prevented the sale from being completed.

The Stanfords appealed to the Eleventh Circuit.

THE ELEVENTH CIRCUIT'S RULING

Writing for two judges on a three-judge panel, Circuit Judge Andrew L. Brasher explained that, although statutory mootness precludes review of an unstayed order approving a sale to a good-faith purchaser, mootness under section 363(m) is not jurisdictional but acts as a defense.

Judge Brasher rejected the Stanfords' argument that section 363(m) does not protect from review all transactions authorized by bankruptcy courts but only transactions specifically authorized by the Bankruptcy Code, which they claimed was not the case here because SFB's credit bid was invalid. He explained that the plain language of section 363(m)—"an authorization under subsection (b) or (c) of this section"—makes it clear "that *all* 'authorizations' are covered, not just those that may be *proper* under the Code." *Stanford*, 17 F.4th at 123.

Moreover, Judge Brasher noted, the applicability of the rule is "further clarified by the conditional phrase 'unless such authorization . . . were stayed[,]' . . . which further establishes that Section 363(m) moots appeals from any authorization by a court, because a court order—unlike a Code provision—can be stayed." *Id.* According to Judge Brasher, this interpretation is consistent with its previous ruling on the scope of section 363(m) in *In re The Charter Co.*, 829 F.2d 1054 (11th Cir. 1987).

Judge Brasher further noted that the Stanfords were not challenging the credit bidding "mechanism" under section 363(k) but merely a specific transaction involving a credit bid that they claimed was invalid.

The Stanfords asserted that SFB was not entitled to section 363(m)'s protections because they did not purchase the Property in good faith. In particular, they argued that, as a result of the roll-up loan's alleged extinguishment of the lien on the Property, SFB lacked any interest in the Property, and its credit bid failed to "give value" for the transaction, which is typically required for a purchase to be in good faith. Once again, Judge Brasher rejected the Stanfords' argument. In doing so, Judge Brasher found no fault with the bankruptcy court's findings that the sale was noncollusive, fair, and reasonable, conducted at arm's length, and resulted in the estate's realization of the highest and best value for the Property. He also emphasized that the Stanfords themselves previously asserted in their motion to approve the sale that SFB was a good-faith purchaser within the meaning of section 363(m).

Judge Brasher explained that, even if SFB's lien were disputed, courts have permitted credit bidding of disputed secured claims. In addition, he observed, SFB's credit bid was of sufficient value and SFB's lien "had value enough" to support the bankruptcy court's finding that SFB was a good-faith purchaser. *Id.* at 125.

Finally, the Eleventh Circuit ruled that the relief sought by the Stanfords—ordering SFB to pay $3.5 million in cash rather than unwinding the sale—was foreclosed by section 363(m). As the court had previously explained in *Charter Company*, Judge Brasher wrote, "by ordering [SFB] to pay something other than what it bid and the bankruptcy court approved, we would be undoing the sale itself, which we are powerless to do under [section] 363(m)." *Id.*

Concurring in the ruling, Circuit Judge Adalberto Jordan found "tension" between two Eleventh Circuit decisions on whether section 363(m) moots appeals when the appellant is challenging the underlying authorization. However, he skirted the issue because the Stanfords had not challenged "the credit bid mechanism." *Id.* at 127 (concurring opinion).

Instead, Judge Jordan concurred by invoking the "invited error doctrine," under which litigants (including debtors) cannot "appeal an order, action, or ruling that they invited or requested." *Id.*

Judge Jordan also questioned the validity of roll-up DIP loans, noting that the Eleventh Circuit previously banned the cross-collateralization of prepetition debt with pre- and postpetition assets. *Id.* (citing *In re Saybrook Manufacturing Co., Inc.*, 963 F.2d 1490 (11th Cir. 1992)).

OUTLOOK

In *Stanford*, the Eleventh Circuit doubled down on its view that section 363(m) acts as a formidable roadblock to appellate review of unstayed bankruptcy sale orders, particularly where a challenge to an authorized sale does not involve the purchaser's good faith. Notably, it appeared that both the majority and concurring judges were critical of the debtors' efforts to challenge a sale that they had requested.

FLORIDA BANKRUPTCY COURT RULES THAT FOREIGN DEBTOR NEED NOT HAVE U.S. RESIDENCE, ASSETS, OR PLACE OF BUSINESS TO BE ELIGIBLE FOR CHAPTER 15 RECOGNITION

Corinne Ball • Dan T. Moss • Michael C. Schneidereit
Isel M. Perez • Mark G. Douglas

Courts disagree over whether a foreign bankruptcy case can be recognized under chapter 15 of the Bankruptcy Code if the foreign debtor does not reside or have assets or a place of business in the United States. In 2013, the U.S. Court of Appeals for the Second Circuit staked out its position on this issue in *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013), ruling that the provision of the Bankruptcy Code requiring U.S. residency, assets, or a place of business applies in chapter 15 cases as well as cases filed under other chapters.

The U.S. Bankruptcy Court for the Middle District of Florida recently weighed in on this controversial issue in *In re Talal Qais Abdulmunem al Zawawi*, 2021 WL 3890597 (Bankr. M.D. Fla. Aug. 31, 2021). Distancing itself from *Barnet* as nonbinding precedent and widely criticized, the bankruptcy court ruled that chapter 15 has its own eligibility requirements, and that the eligibility requirements for debtors in cases under other chapters of the Bankruptcy Code do not apply in chapter 15 cases.

PROCEDURES, RECOGNITION, RELIEF, AND ELIGIBILITY 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.

Chapter 15 replaced section 304 of the Bankruptcy Code. Section 304 allowed an accredited representative of a debtor in a foreign bankruptcy proceeding to commence a limited "ancillary" bankruptcy case in the United States for the purpose of enjoining actions against the foreign debtor or its assets located in the United States or, in some cases, repatriating such assets or their proceeds abroad for administration in the debtor's foreign bankruptcy.

The policy behind section 304 was to provide any assistance necessary to ensure the economic and expeditious administration of foreign bankruptcy proceedings. In deciding whether to grant injunctive, turnover, or other appropriate relief under former section 304, a U.S. bankruptcy court had to consider "what will best assure an economical and expeditious administration" of the foreign debtor's estate, consistent with a number of factors, including comity. *See* 11 U.S.C. § 304(c) (repealed 2005) (listing factors that are now included in section 1507(b) as a condition to the court's decision to grant "additional assistance, consistent with the principles of comity," under chapter 15 or other U.S. law).

Section 1501(a) of the Bankruptcy Code similarly states that the purpose of chapter 15 is to "incorporate the [Model Law] so as to provide effective mechanisms for dealing with cases of cross-border insolvency with the objectives of," among other things, cooperation between U.S. and foreign courts, greater legal certainty for trade and investment, fair and efficient administration of cross-border cases to protect the interests of all stakeholders, protection and maximization of the value of a debtor's assets, and the rehabilitation of financially troubled businesses.

Section 1508 requires U.S. courts interpreting chapter 15 to "consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions."

Under section 1515, the "foreign representative" of a foreign "debtor" may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding."

Section 1502 provides that "for the purposes of [chapter 15] . . . 'debtor' means an entity that is the subject of a foreign proceeding."

However, section 101 of the Bankruptcy Code also includes a definition of the term "debtor," and section 109 limits the entities that can qualify as a debtor. Section 101(13) provides that "debtor" means "person or municipality concerning which a case under this title has been commenced." Section 109(a) states 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 this title." Section 103(a) provides that "this chapter"—i.e., chapter 1, including section 109(a)—"appl[ies] in a case under chapter 15."

The basic requirements for recognition under chapter 15 are outlined in section 1517(a), namely: (i) the proceeding must be "a foreign main proceeding or foreign nonmain proceeding" within the meaning of section 1502; (ii) the "foreign representative" applying for recognition must be a "person or body"; and (iii) the petition must satisfy the requirements of section 1515, including that it be supported by the documentary evidence specified in section 1515(b).

Section 1506 sets forth a public policy exception to any of 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."

Section 101(24) 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 U.S. 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 1517(b)(1))—and foreign "nonmain" proceedings, which may be pending in countries where the debtor merely has an "establishment" (*see* 11 U.S.C. §§ 1502(5) and 1517(b)(2)). 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."

DISPUTE OVER ELIGIBILITY FOR CHAPTER 15 RELIEF

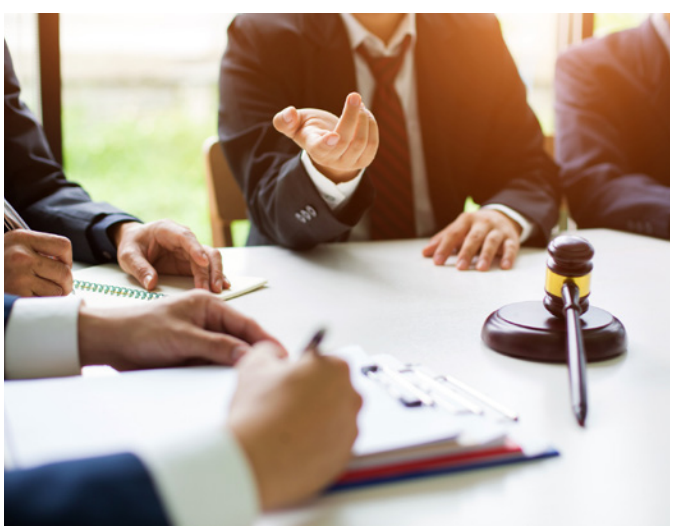
Despite the express language of section 103(a), courts disagree over whether a foreign debtor must satisfy both sections 109(a) and 1502 to be eligible for chapter 15 relief.

In *Barnet*, the Second Circuit ruled that section 109(a) applies in a chapter 15 case on the basis of a "straightforward" interpretation of the statutory provisions.

The Second Circuit rejected the foreign representatives' argument that section 109(a) does not apply because the Australian company in the case was a "debtor" under the Australian Corporations Act (rather than under the Bankruptcy Code) and the foreign representatives (rather than the debtor) were seeking recognition of the foreign proceeding. According to the court:

> [T]he presence of a debtor is inextricably intertwined with the very nature of a Chapter 15 proceeding . . . [and] [i]t stretches credulity to argue that the ubiquitous references to a debtor in both Chapter 15 and the relevant definitions of Chapter 1 do not refer to a debtor under the title [title 11] that contains both chapters.

Barnet, 737 F.3d at 248. In addition to the statutory definitions of "foreign representative," "foreign main proceeding," "debtor," and "foreign proceeding," the court noted, the automatic and discretionary relief provisions that accompany recognition of a foreign main proceeding (*see* sections 1520 and 1521) are similarly "directed towards debtors." *Barnet*, 737 F.3d at 248.



The Second Circuit flatly rejected the foreign representatives' argument that a foreign debtor need satisfy only the chapter 15-specific definition of "debtor" in section 1502(1), and not the section 109 requirements. "This argument also fails," the court wrote, "as we cannot see how such a preclusive reading of Section 1502 is reconcilable with the explicit instruction in Section 103(a) to apply Chapter 1 to Chapter 15." *Id.* at 249.

According to the Second Circuit, not only a "plain meaning" analysis but also the context and purpose of chapter 15 support the application of section 109(a) to chapter 15. The court explained that Congress amended section 103 to state that chapter 1 applies in cases under chapter 15 at the same time it enacted chapter 15, which strongly supports the conclusion that lawmakers intended section 103(a) to mean what it says—namely, that chapter 1 applies in cases under chapter 15.

The court acknowledged that the strongest support for the foreign representatives' arguments lies in 28 U.S.C. § 1410, which provides a U.S. venue for chapter 15 cases even when "the debtor does not have a place of business or assets in the United States." However, the Second Circuit explained that this venue statute "is purely procedural" and that, "[g]iven the unambiguous nature of the substantive and restrictive language used in Sections 103 and 109 of Chapter 15, to allow the venue statute to control the outcome would be to allow the tail to wag the dog." *Id.* at 250.

Finally, the Second Circuit found that the purpose of chapter 15 would not be undermined by making section 109(a) applicable in chapter 15 cases. As noted above, section 1501(a) of the Bankruptcy Code provides that the purpose of chapter 15 "is to incorporate the Model Law . . . so as to provide effective mechanisms for dealing with cases of cross-border insolvency." Although section 109(a), or its equivalent, is not included in the Model Law, the Second Circuit emphasized, the Model Law allows a country enacting it to "modify or leave out some of its provisions." In any case, the court concluded, the omission of a provision similar to section 109(a) from the Model Law does not suffice to outweigh the express language Congress used in adopting sections 103(a) and 109(a). *Id.* at 251.

The Second Circuit accordingly vacated the recognition order and remanded the case to the bankruptcy court for further proceedings consistent with its ruling.

The Second Circuit did not provide any guidance as to how extensive a foreign debtor's property holdings in the United States must be to qualify for chapter 15 relief. On remand, the bankruptcy court answered that question in *In re Octaviar Administration Pty Ltd.*, 511 B.R. 361 (Bankr. S.D.N.Y. 2014), ruling that, consistent with case law analyzing the scope of section 109 for the purpose of determining who is eligible to commence a case under chapter 11, the requirement of property in the United States should be interpreted broadly. Because the Australian debtor had causes of action governed under U.S. law against parties in the United States and also had an undrawn retainer maintained in the United States, the bankruptcy court held that the requirement for the debtor to have property located in the United States was satisfied.

Other bankruptcy courts within the Second Circuit have similarly concluded that it takes little to satisfy section 109(a) in chapter 15 cases. *See, e.g., In re Olinda Star Ltd.*, 614 B.R. 28 (Bankr. S.D.N.Y. 2020) (small retainer and rights under New York law debt instruments); *In re Serviços de Petróleo Constellation*, 613 B.R. 497 (Bankr. S.D.N.Y. 2019) (rights under New York law-governed debt and retainer); *In re Ascot Fund Ltd.*, 603 B.R. 271 (Bankr. S.D.N.Y. 2019) (retainer, interest in a New York partnership, and contract rights); *In re P.T. Bakrie Telecom TBK*, 601 B.R. 707 (Bankr. S.D.N.Y. 2019) (rights under New York law indenture, New York law notes).

Barnet has received a considerable amount of criticism. For example, a leading commentator noted that the decision:

> clearly misconstrues the intent of the statute to focus on eligibility of the foreign proceeding, not of the debtor, never mentions the direction of section 1508 to consider the international origin of chapter 15 and does not follow the suggestion of the legislative history of section 1508 to consult the Guide to Enactment . . . [which] makes clear that "the Model Law was formulated to apply to any proceeding that meets the requirements of article 2, subparagraph (a) [definition of foreign proceeding], independently of the nature of the debtor or its particular status under national law."

COLLIER ON BANKRUPTCY ¶ 1517.01 (16th ed. 2021) (citing H.R. Rep. No. 109-31, p. 109 (2005); Guide to Enactment and Interpretation of the Model Law, ¶ 47); *see also* Glosband and Westbrook, "Chapter 15 Recognition in the U.S.: Is a Debtor 'Presence' Required?," 24 Int. Insolv. Rev. 28–56 (2015) (noting that the Second Circuit "confuse[d] the foreign debtor with the foreign insolvency representative" and explaining that section 109(a) does apply in chapter 15 cases, but only in limited circumstances, including: (i) the requirement that a foreign debtor have a presence in the United States when a foreign representative use its power under section 1511 to file a "full" case under another chapter; and (ii) when a foreign debtor files a bankruptcy case in the United States to enforce a foreign discharge).

Several bankruptcy courts outside of the Second Circuit have disagreed with *Barnet*. For example, in *In re Bemarmara Consulting A.S.*, No. 13-13037(KG) (Bankr. D. Del. Dec. 17, 2013), the U.S. Bankruptcy Court for the District of Delaware ruled that section 109(a) does not apply in chapter 15 because it is the foreign representative, and not the debtor in the foreign proceeding, who petitions the court. Moreover, the court wrote, "there is nothing in [the] definition [of 'debtor'] in Section 1502 which reflects upon a requirement that [a] Debtor have assets." *See* Transcript of Hearing at 9, l. 11–18, *In re Bemarmara Consulting A.S.*, No. 13-13037(KG) (Bankr. D. Del. Dec. 17, 2013) [Document No. 39]. "A Debtor," the court noted, "is an entity that is involved in a foreign proceeding."

The U.S. Bankruptcy Court for the Southern District of Florida similarly refused to apply section 109(a) in a chapter 15 case in *In re MMX Sudeste Mineracao S.A.*, No. 17-16113-RAM (Bankr. S.D. Fla. 2017) (Order Granting Recognition, Docket No. 9, June 12, 2017; Transcript of Nov. 1, 2017 Hearing Denying Motion to Dismiss Ch. 15 Case at 5-6, Docket No. 51). An attempted appeal of the recognition order was dismissed for lack of jurisdiction. *See Batista v. Alvarenga Mendes (In re MMX Sudeste Mineracao S.A.)*, No. 17-24038-RNS (S.D. Fla. Apr. 20, 2018).

Apparently, only one court outside of the Second Circuit has relied on the ruling in a published opinion in finding that section 109(a) applies in a chapter 15 case. *See In re Forge Grp. Power Pty Ltd.*, 2018 WL 827913, at *13 (N.D. Cal. Feb. 12, 2018) (vacating a bankruptcy court order denying chapter 15 recognition on the basis of *Barnet*, but noting that "the debtor eligibility requirements of 11 U.S.C. § 109(a) apply in Chapter 15 cases" and "the requirement of 'property in the United States' is satisfied by a security retainer that remains the property of the debtor until the funds are applied by the attorney for services actually rendered").

It should be noted that chapter 15's predecessor—section 304 of the Bankruptcy Code—did not require a foreign debtor to qualify as a "debtor" under section 109(a) as a condition to relief. *See, e.g., Goerg v. Parungao (In re Goerg)*, 844 F.2d 1562 (11th Cir. 1988); *Saleh v. Triton Container Intl., Ltd. (In re Saleh)*, 175 B.R. 422 (Bankr. S.D. Fla. 1994). In *Barnet*, the Second Circuit suggested that the enactment of chapter 15 changed this, a view that was rejected by the court in *Bemarmara*.

AL ZAWAWI

Talal Qais Abdulmunem al Zawawi ("debtor") was a debtor in a bankruptcy case filed in a U.K. court in March 2020. He did not reside in the United States but had indirect ownership interests in several Florida-based companies that owned residential and office buildings in Florida and was listed as a director of each of the companies. Prior to 2020, the debtor also had a 60% ownership interest in a Florida corporation that owned real estate leased to a chain of restaurants. In February 2020, the debtor sold his ownership interest in the corporation to his brother, the only other shareholder, but continued to be listed as a director.

In March 2021, the U.K. court-appointed trustees of the debtor's bankruptcy estate filed a petition with the U.S. Bankruptcy Court for the Middle District of Florida seeking recognition of the U.K. bankruptcy case under chapter 15 as a foreign main proceeding for the purpose of investigating the debtor's affairs, recovering U.S.-based assets, and potentially asserting claims against third parties for the benefit of creditors, including the debtor's former spouse, who held a judgment claim for more than £24 million.

The debtor opposed recognition. He conceded that the foreign representatives met all the requirements for recognition set forth in section 1517 but argued, relying on *Barnet*, that he did not satisfy the definition of "debtor" in section 109(a). The foreign representatives countered that *Barnet* has been discredited and that the court should instead follow the Eleventh Circuit's rationale in *Goerg*, even though it involved an ancillary case filed under repealed section 304 of the Bankruptcy Code. Alternatively, the foreign representatives argued that, if section 109(a) did apply, the court should grant recognition because the debtor was a director and beneficial owner of the Florida-based companies, and the foreign representatives' U.S. counsel held a retainer provided on the debtor's behalf and had possession of the debtor's wallet.

THE BANKRUPTCY COURT'S RULING

U.S. Bankruptcy Judge Lori V. Vaughan granted the petition for recognition. Section 1517(a), she explained, is "unambiguous" and, subject to the public policy exception stated in section 1506, "'chapter 15 recognition must be ordered when a court finds the requisite criteria are met.'" *Al Zawawi*, 2021 WL 3890597, at *4 (quoting *In re ABC Learning Centres, Ltd.*, 728 F.3d 301, 308 (3d Cir. 2013)).

According to Judge Vaughan, a "debtor" under chapter 15 is not the same as a "debtor" under chapter 1 of the Bankruptcy Code. "If the § 101 definition included the subject of a foreign proceeding," she wrote, "then this special definition [in section 1502(1)] would be unnecessary—§ 1502(1) would be superfluous." *Id.*

Judge Vaughan explained that, although section 103 makes chapter 1 applicable in chapter 15, "it does not graft those provisions into chapter 15—meaning the limited definition would not apply when interpreting § 109." *Id.* at *5. Any other interpretation, she noted, would not give effect to the other provisions of chapter 15 and the purpose of the chapter, which is international uniformity and cooperation in cross-border bankruptcy cases.

Judge Vaughan further explained that several provisions of the Bankruptcy Code indicate that lawmakers did not intend section 109 to apply in chapter 15 cases, including:

(i) Section 1528, which provides that "[a]fter *recognition* of a foreign main proceeding, a case under another chapter of this title may be commenced *only if the debtor has assets in the United States*" and would be superfluous if section 109 applied to recognition.
(ii) 28 U.S.C. § 1410, governing venue of chapter 15 cases, which provides that "if the debtor does not have a place of business or assets in the United States, [venue is proper in the district] in which there is pending against the debtor an action or proceeding in a Federal or State court . . . or in which venue will be consistent with the interests of justice and the convenience of the parties, having regard to the relief sought by the foreign representative."
(iii) Section 109, which in subsections (b) through (g) specifies the persons or entities that may be debtors in every chapter of the Bankruptcy Code other than chapter 15, and in subsection (h) requires an individual debtor, absent a court waiver or a specified exception, to obtain credit counseling 180 days to a bankruptcy filing—a requirement that could not be satisfied without a waiver in every case because a foreign bankruptcy case has already been filed by or against a foreign debtor.

Id. at **5-6.

Finally, Judge Vaughan noted that *Barnet* is neither controlling precedent nor persuasive. Moreover, she stated that the Eleventh Circuit would likely disagree with the ruling based upon its previous decision in *Goerg*, where the court "examined the purposes behind § 304 and concluded that a foreign debtor does not have to qualify as a 'debtor' under the Bankruptcy Code" because "the focus is on making the United States processes available in aid of foreign proceedings, not actual bankruptcy administration, [and] it would make little sense to require . . . the subject of the foreign proceeding [to] qualify as a 'debtor' under United States bankruptcy law." *Id.* at *6 (quoting *Goerg*, 844 F.2d at 1568). Even though section 304 has been repealed, Judge Vaughan wrote, "chapter 15 has a similar purpose and given this similar issue—whether a foreign debtor must qualify as a debtor under the Bankruptcy Code—this court finds *Goerg* persuasive, and declines to follow [*Barnet*]." *Id.*

Even so, Judge Vaughan found that the debtor satisfied the eligibility requirements of section 109(a) because he had interests in the Florida companies, he was listed as a director of those companies, and the foreign representatives had potential claims against third parties with respect to the debtor's transfer of its interest in one of the companies prior to the commencement of his U.K. bankruptcy case.

OUTLOOK

The debate continues over chapter 15 eligibility. As applied by many bankruptcy courts, the Second Circuit's approach to the issue in *Barnet* does not act as a serious impediment to chapter 15 recognition in most cases. This is particularly true where the alleged property in the United States could be a law firm retainer, potential causes of action against a U.S. entity or person, or, possibly, recoverable property situated in the United States. Nonetheless, the conflict in the courts and uncertainty regarding the proper interpretation of the statutory framework is unsettling and should be resolved—ideally by Congress. The debtor in *Al Zawawi* appealed the bankruptcy court's ruling to the district court. *See In re Al Zawawi*, No. 21-CV-00894 (M.D. Fla. May 24, 2021). Thus, the Eleventh Circuit may have an opportunity to revisit the issue under the current statute.

ANOTHER NEW YORK DISTRICT COURT WIDENS THE BANKRUPTCY CODE'S SECURITIES CONTRACT SAFE HARBOR

Charles M. Oellermann • Mark G. Douglas

In 2019, the U.S. Court of Appeals for the Second Circuit made headlines when it ruled that creditors' state law fraudulent transfer claims arising from the 2007 leveraged buyout ("LBO") of Tribune Co. ("Tribune") were preempted by the safe harbor for certain securities, commodity, or forward contract payments set forth in section 546(e) of the Bankruptcy Code. In that ruling, *In re Tribune Co. Fraudulent Conveyance Litig.*, 946 F.3d 66 (2d Cir. 2019), *cert. denied*, 209 L. Ed. 2d 568 (U.S. Apr. 19, 2021) ("*Tribune 2*"), the Second Circuit also concluded that a debtor may itself qualify as a "financial institution" covered by the safe harbor, and thus avoid the implications of the U.S. Supreme Court's decision in *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018), by retaining a bank or trust company as an agent to handle LBO payments, redemptions, and cancellations.

In 2020 and 2021, a handful of bankruptcy and district courts in the Second Circuit picked up where the Second Circuit left off in *Tribune 2*, ruling that prebankruptcy recapitalization or LBO transactions were safe-harbored from avoidance as fraudulent transfers because they were effected through a bank or other qualifying financial institution. However, the *Tribune 2* "work-around" to *Merit* has not been universally embraced.

The latest court to jump on the *Tribune 2* bandwagon is the U.S. District Court for the Southern District of New York. In *Holliday, Liquidating Trustee of the BosGen Liq. Trust v. Credit Suisse Secs. (USA) LLC*, 2021 WL 4150523 (S.D.N.Y. Sept. 13, 2021) ("*Boston Generating*"), *appeal filed*, No. 21-2543 (2d Cir. Oct. 8, 2021). District Judge George B. Daniels affirmed a bankruptcy court ruling that: (i) section 546(e) preempts intentional fraudulent transfer claims under state law because the intentional fraud exception expressly included in section 546(e) provision applies only to intentional fraudulent transfer claims under federal law; and (ii) payments made to the members of limited liability company debtors as part of a prebankruptcy recapitalization transaction were protected from avoidance under section 546(e) because for that section's purposes the debtors were "financial institutions," as customers of banks that acted as their depositories and agents in connection with the transaction.

Further developments on this issue are likely. Even though the U.S. Supreme Court declined to review *Tribune 2*, both *Boston Generating* and an earlier ruling on this issue by the U.S. District Court for the Southern District of New York—*In re Nine West LBO Sec. Litig.*, 482 F. Supp. 3d 187 (S.D.N.Y. 2020), *appeal filed*, No. 20-3290 (2d Cir. Sept. 25, 2020)—have been appealed to the Second Circuit.

THE SECTION 546(e) SAFE HARBOR

Section 546 of the Bankruptcy Code imposes a number of limitations on a bankruptcy trustee's avoidance powers, which include the power to avoid certain preferential and fraudulent transfers. Section 546(e) provides that the trustee may not avoid, among other things, a prebankruptcy transfer that is a settlement payment "made by or to (or for the benefit of) a . . . financial institution [or a] financial participant . . . , or that is a transfer made by or to (or for the benefit of)" any such entity in connection with a securities contract, "except under section 548(a)(1)(A) of the [Bankruptcy Code]." Thus, the section 546(e) "safe harbor" bars avoidance claims challenging a qualifying transfer unless the transfer was made with actual intent to hinder, delay, or defraud creditors under section 548(a)(1)(A), as distinguished from being constructively fraudulent under section 548(A)(1)(B) because the debtor was insolvent at the time of the transfer (or became insolvent as a consequence) and received less than reasonably equivalent value in exchange.

Section 101(22) of the Bankruptcy Code defines the term "financial institution" to include, in relevant part:

> [A] Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a "customer", as defined in section 741) in connection with a securities contract (as defined in section 741) such customer . . . .

11 U.S.C. § 101(22). "Customer" and "securities contract" are defined broadly in sections 741(2) and 741(7) of the Bankruptcy Code, respectively. Section 741(8) defines "settlement payment" as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." A similar definition of settlement payment is set forth in section 101(51A).

The purpose of section 546(e) is to prevent "the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market." H.R. Rep. No. 97-420, at 1 (1982). The provision was "intended to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *Id.*

In *Deutsche Bank Trust Co. Ams. v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2d Cir. 2016) ("*Tribune 1*"), the U.S. Court of Appeals for the Second Circuit affirmed lower court decisions dismissing creditors' state law constructive fraudulent transfer claims arising from the 2007 LBO of Tribune. According to the Second Circuit, even though section 546(e) expressly provides that "the trustee" may not avoid certain payments under securities contracts unless such payments were made with the actual intent to defraud, section 546(e)'s language, its history, its purposes, and the policies embedded in the securities laws and elsewhere lead to the conclusion that the safe harbor was intended to preempt constructive fraudulent transfer claims asserted by creditors under state law.

Prior to the Supreme Court's ruling in *Merit*, there was a split among the circuit courts concerning whether the section 546(e) safe harbor barred state law constructive fraud claims to avoid transactions in which the financial institution involved was merely a "conduit" for the transfer of funds from the debtor to the ultimate transferee. For its part, the Second Circuit ruled that the safe harbor applied under those circumstances in *In re Quebecor World (USA) Inc.*, 719 F.3d 94 (2d Cir. 2013). The Supreme Court resolved the circuit split in *Merit*.

In *Merit*, a unanimous Supreme Court held that section 546(e) does not protect transfers made through a "financial institution" to a third party, regardless of whether the financial institution had a beneficial interest in the transferred property. Instead, the relevant inquiry is whether the transferor or the transferee in the transaction sought to be avoided overall is itself a financial institution. Because the selling shareholder in the LBO transaction that was challenged in *Merit* as a constructive fraudulent transfer was not a financial institution (even though the conduit banks through which the payments were made met that definition), the Court ruled that the payments fell outside of the safe harbor.

In a footnote, the Court acknowledged that the Bankruptcy Code defines "financial institution" broadly to include not only entities traditionally viewed as financial institutions, but also the "customers" of those entities, when financial institutions act as agents or custodians in connection with a securities contract. The selling shareholder in *Merit* was a customer of one of the conduit banks, yet never raised the argument that it therefore also qualified as a financial institution for purposes of section 546(e). For this reason, the Court did not address the possible impact of the selling shareholder's status on the scope of the safe harbor.

In April 2018, the Supreme Court issued an order that, in light of its ruling in *Merit*, the Court would defer consideration of a petition seeking review of *Tribune 1*. The Second Circuit later suspended the effectiveness of *Tribune 1* "in anticipation of further panel review." In a revised opinion issued in December 2019—*Tribune 2*—the Second Circuit reaffirmed the court's previous decision that the creditors' state law constructive fraudulent transfer claims in that case were preempted by the section 546(e) safe harbor.

In *Tribune 2*, the Second Circuit acknowledged that one of the holdings in *Tribune 1* (as well as its previous ruling in *Quebecor*) was abrogated by *Merit*'s pronouncement that the section 546(e) safe harbor does not apply if a financial institution is a mere conduit. However, the court again concluded that section 546(e) barred the creditors' state law avoidance claims, but for a different reason.

The Second Circuit explained that, under *Merit*, the payments to Tribune's shareholders were shielded from avoidance under section 546(e) only if either Tribune, which made the payments, or the shareholders who received them, were "covered entities." It then concluded that Tribune was a "financial institution," as defined by section 101(22) of the Bankruptcy Code, and "therefore a covered entity."

According to the Second Circuit, the entity Tribune retained to act as depository in connection with the LBO was a "financial institution" for purposes of section 546(e) because it was a trust company and a bank. Therefore, the court reasoned, Tribune was likewise a financial institution because, under the ordinary meaning of the term as defined by section 101(22), Tribune was the bank's "customer" with respect to the LBO payments, and the bank was Tribune's agent according to the common-law definition of "agency." "Section 546(e)'s language is broad enough under certain circumstances," the Second Circuit wrote, "to cover a bankrupt firm's LBO payments even where, as here, that firm's business was primarily commercial in nature." *Tribune 2*, 946 F.3d at 91.

SOME NOTABLE POST-*TRIBUNE 2* COURT RULINGS

In *Nine West*, Judge Jed S. Rakoff of the U.S. District Court for the Southern District of New York dismissed $1.1 billion in fraudulent transfer and unjust enrichment claims brought by a chapter 11 plan litigation trustee and an indenture trustee against shareholders, officers, and directors seeking to avoid payments made to the defendants as part of a 2014 LBO of women's clothing retailer Nine West Holding Inc. ("Nine West"). Citing *Tribune 2*, the district court ruled that the payments were protected by the section 546(e) safe harbor because they were made by a bank acting as Nine West's agent. According to the court, "When, as here, a bank is acting as an agent in connection with a securities contract, the customer qualifies as a financial institution with respect to that contract, and all payments in connection with that contract are therefore safe harbored under Section 546(e)." *Id.* at 206.

Also in accordance with *Tribune 2*, the district court ruled that the safe harbor preempted both trustees' state law fraudulent transfer claims against the defendants. In addition, the court held that section 546(e) preempted the litigation trustee's unjust enrichment claims against director and officer defendants because such claims, however denominated, sought recovery of the same payments that were protected from avoidance under the safe harbor.

In *SunEdison Litigation Trust v. Seller Note, LLC (In re SunEdison, Inc.)*, 620 B.R. 505 (Bankr. S.D.N.Y. 2020), Judge Stuart M. Bernstein of the U.S. Bankruptcy Court for the Southern District of New York invoked section 546(e) to dismiss a chapter 11 plan litigation trustee's complaint seeking to avoid and recover alleged constructive fraudulent transfers made in 2015 by SunEdison Holdings, a subsidiary of renewable-energy development company SunEdison, Inc., in connection with a the acquisition of a wind and solar power generation project involving two separate sequential transfers, only one of which was effected through a "financial institution."

Under *Merit*, the *Sun Edison* court explained, the "relevant transfer" in this case was "the overarching transfer" even though only one step of the transaction involved a financial institution. According to the court, "[t]his was an integrated transaction," and because one step of the transaction was effected through a qualified financial institution, section 546(e) shielded the "component steps" from avoidance as a constructive fraudulent transfer. *Id.* at 515.

At least one court outside of the Second Circuit has criticized the *Tribune 2* "workaround" approach. In *In re Greektown Holdings, LLC*, 621 B.R. 797 (Bankr. E.D. Mich. 2020), *reh'g denied*, 2020 WL 6701347 (Bankr. E.D. Mich. Nov. 13, 2020), Judge Maria L. Oxholm of the U.S. Bankruptcy Court for the Eastern District of Michigan denied a motion for summary judgment filed in avoidance litigation by the recipients of payments made as part of a prebankruptcy recapitalization transaction that involved the issuance of unsecured notes underwritten by a financial institution and payment of a portion of the proceeds to the defendants. Citing *Merit*, the defendants argued that the transfer was safe-harbored because the transaction was undertaken "for the benefit of" the underwriter, which acted as the debtor-transferor's agent, thereby making the transferor a financial institution as the underwriter's customer.

The court rejected this argument, ruling that the transaction fell outside the section 546(e) safe harbor because: (i) neither the transferor nor the transferees were financial institutions in their own right; (ii) the defendants failed to establish that the transaction was "for the benefit of" the underwriter financial institution by showing that it "received a direct, ascertainable, and quantifiable benefit corresponding in value to the payments"; and (iii) the evidence did not show that the underwriter was acting as either the transferor's agent or custodian in connection with the transaction, such that the transferor itself could be deemed a financial institution. Notably, the court was "not persuaded by the agency analysis in [*Tribune 2*] as it does not distinguish between mere intermediaries contracted for the purpose of effectuating a transaction and agents who are authorized to act on behalf of their customers in such transactions." *Id.* at 827. Under *Tribune 2*, the court wrote, "any intermediary hired to effectuate a transaction would qualify as its customer's agent [, which] . . . would result in a complete workaround of [*Merit*]." *Id.*

BOSTON GENERATING

Boston Generating LLC ("BosGen"), its holding company EBG Holdings LLC ("EBG"), and their subsidiaries (collectively, "debtors") owned and operated electric power generating facilities near Boston. In November 2006, BosGen and EBG launched a leveraged recapitalization transaction whereby they borrowed approximately $2.1 billion from lenders, in part to fund a $925 million tender offer for EBG's member units and warrants, and the distribution of $35 million in dividends to EBG's members. The Bank of New York ("BNY") acted as the depository and agent for both BosGen and EBG in connection with the tender offer.

The $2.1 billion cash infusion from the credit facilities was deposited into BosGen and EBG bank accounts at U.S. Bank National Association ("US Bank"). US Bank then transferred ("BofA transfer") approximately $708 million to EBG's Bank of America ("BofA") account to fund the unit buyback, warrant redemption, and dividend distribution and approximately $50 million to pay fees and expenses incurred in connection with the closing of the credit facilities. Thereafter, EBG caused the funds to be transferred to its accounts at BNY ("BNY transfer" and, together with the BofA transfer, "BosGen transfer"). In December 2006, EBG directed BNY to pay the BosGen transfer funds as part of the $925 million unit and warrant redemption payment and the $35 million dividend payment ("dividend transfer") to EBG's members.

The debtors filed for chapter 11 protection in the Southern District of New York in August 2010. After authorizing the sale of substantially all of the debtors' assets, the bankruptcy court confirmed a liquidating chapter 11 plan for the debtors in August 2011. The plan created a liquidating trust to pursue claims on behalf of the debtors' general unsecured creditors. The liquidating trustee commenced an adversary proceeding seeking, among other things, to avoid and recover the BofA transfer and the dividend transfer as intentional and constructive fraudulent transfers under the New York Debtor & Creditor Law. The defendants moved to dismiss, arguing that the transfers were safe-harbored under section 546(e).

The bankruptcy court granted the motion to dismiss the liquidating trustee's fraudulent transfer claims. The court ruled that: (i) section 546(e) preempted the claims; and (ii) the payments were protected by the section 546(e) safe harbor because BosGen and EBG were "financial institutions," as customers of US Bank and / or BNY. See *Holliday v. K Road Power Management, LLC (In re Boston Generating LLC)*, 617 B.R. 442 (Bankr. S.D.N.Y. 2020), *aff'd*, 2021 WL 4150523 (S.D.N.Y. Sept. 13, 2021).

Initially, the court acknowledged that neither *Tribune 1* nor *Tribune 2* addressed whether section 546(e) preempts intentional (as distinguished from constructive) fraudulent transfer claims under state law. Nonetheless, the court saw "no reason why *Tribune*'s reasoning does not extend to intentional state law fraudulent transfer claims." Examining the plain language of section 546(e), the court declined to extend section 546(e)'s exception for federal intentional fraudulent transfer claims under section 548(a)(1)(A) to include state law intentional fraudulent transfer claims.

According to the bankruptcy court:

> Congress may have specifically excluded state law intentional fraudulent transfer claims from section 546(e)'s exception having determined the need for stability in the securities markets overrode the potential danger of creditors escaping claims for intentional fraud based on a fear that inconsistent application of fifty (50) states' fraudulent transfer statutes would result in instability in the securities markets.

Holliday, 617 B.R. at 480. Looking at the BosGen transfer as an "integrated transaction," the bankruptcy court determined that the transfer satisfied the requirements for the safe harbor because: (i) "a transfer of cash to a financial institution made to repurchase and cancel securities—in other words, to complete a securities transaction—qualifies for the safe harbor as a settlement payment"; (ii) the LLC member units and warrants qualified as "securities" under the Bankruptcy Code's broad definition; (iii) the payments were made "in connection with a securities contract"—the tender offer; (iv) BosGen qualified as a "financial institution" by virtue of its relationship with US Bank, which acted as the agent of its customers BosGen and EBG in connection with the tender offer; and (v) additionally, or in the alternative, both BosGen and EBG qualified as "financial institutions" as customers of BNY, which acted as their agent in connection with the tender offers.

Finally, the court also ruled that section 546(e) preempted the liquidating trustee's constructive fraudulent transfer claims under state law—an issue that was conceded by the trustee.

The liquidating trustee appealed the decision.

THE DISTRICT COURT'S RULING

The district court affirmed the ruling below.

On appeal, the liquidating trustee argued that the BofA transfer was the "relevant transfer" for the purposes of his avoidance complaint and, misapplying *Merit*, the bankruptcy court concluded that the relevant transfer also included the BNY transfer. The avoidance defendants countered that the "'overarching transfer' was the payment by the Debtors of nearly $1 billion . . . to their shareholders in satisfaction of their equity interests."

District Judge George B. Daniels explained that, in accordance with *Merit*, the relevant transfer is defined by the governing substantive avoiding power—here, the N.Y. Debtor & Creditor Law—which requires that, "where a transfer is only a step in a general plan, the plan must be viewed as a whole with all its composite applications." *Boston Generating*, 2021 WL 4150523, at *3 (citation and internal quotation marks omitted). Thus, Judge Daniels concluded, the liquidating trustee improperly sought to avoid only one component—the BofA transfer—of the "overarching" BosGen transfer, which was "an integral transfer" in the leveraged recapitalization transaction. Analyzing the BofA transfer in a vacuum, Judge Daniels wrote, "would permit the trustee to circumvent the safe harbor by carving up an integrated securities transaction consisting of multiple component parts . . . [, which] would unnecessarily restrict the safe harbor and 'seriously undermine . . . markets in which certainty, speed, finality, and stability are necessary to attract capital.'" *Id.* (quoting *Tribune 2*, 946 F.3d at 90).

The district court found no fault with the bankruptcy court's finding that the BosGen transfer was a settlement payment made in connection with a securities contract, as required by section 546(e). According to Judge Daniels, the bankruptcy court also properly found that BosGen was covered by the safe harbor because, as the customer of a bank or trust company—US Bank—that acted as its agent in connection with a securities contract, it was a "financial institution."

Judge Daniels rejected the liquidating trustee's argument that a customer is a financial institution only when a bank makes or receives the relevant transfer on behalf of the customer. According to him, even if the court were to adopt this approach, BosGen would satisfy it, when the transaction was viewed as a whole, rather than piecemeal, as urged by the liquidating trustee. In addition, Judge Daniels rejected the liquidating trustee's contention that a financial institution must be specifically identified as such in a securities contract to serve as a customer's agent.

The district court also held that the bankruptcy court did not err in ruling that the $35 million dividend payment was safe harbored because it was a settlement payment made in connection with the tender offer.

Finally, the district court held that the bankruptcy court properly concluded, in accordance with *Tribune 2*, that the liquidating trustee's state law fraudulent transfer claims (both intentional and constructive) were preempted by section 546(e).

OUTLOOK

By the *Boston Generating* ruling, another lower court in the Second Circuit has now ruled that the results of *Merit* might be avoided by structuring transactions so that the target or recapitalized entity is a "customer" of the financial intermediaries involved. Whether this approach holds up to further appellate scrutiny remains to be seen. Appeals in both *Boston Generating* and *Nine West* are pending before the Second Circuit. It may take a circuit split on the issue to induce the Supreme Court to address the question.

FLORIDA BANKRUPTCY COURT DEFERS TO BRAZILIAN COURT IN DISMISSING CHAPTER 15 ADVERSARY PROCEEDING

Corinne Ball • Dan T. Moss • Michael C. Schneidereit
Isel M. Perez • Mark G. Douglas

The foundation of chapter 15 of the Bankruptcy Code and similar legislation enacted by other countries to govern cross-border bankruptcy cases is "comity" and cooperation among U.S. and foreign courts. The importance of these concepts was recently illustrated by a ruling handed down by the U.S. Bankruptcy Court for the Southern District of Florida. In *In re Varig Logistica S.A.*, 2021 WL 5045684 (Bankr. S.D. Fla. Oct. 29, 2021), the court dismissed an adversary proceeding commenced in the chapter 15 case of a bankrupt Brazilian air carrier due to the pendency of litigation in a Brazilian bankruptcy court.

In *Varig*, the Brazilian debtor's foreign representative sued the debtor's former private-equity owners in the Brazilian bankruptcy court for, among other things, veil-piercing and breach of fiduciary duty. The defendants sought to enjoin the foreign representative from prosecuting those claims, arguing that the debtor released them from liability. After the Brazilian bankruptcy court entered an order stating that it should adjudicate the release issue, the Florida bankruptcy court determined as a matter of comity that the Brazilian bankruptcy court was the better forum for the litigation.

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).

Section 1501(a) of the Bankruptcy Code states that the purpose of chapter 15 is to "incorporate the [Model Law] so as to provide effective mechanisms for dealing with cases of cross-border insolvency with the objectives of," among other things, cooperation between U.S. and foreign courts, greater legal certainty for trade and investment, fair and efficient administration of cross-border cases to protect the interests of all stakeholders, protection and maximization of the value of a debtor's assets, and the rehabilitation of financially troubled businesses.

Section 1508 requires U.S. courts interpreting chapter 15 to "consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions."

Under section 1515, the "foreign representative" of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding."

Section 101(24) 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 1517(b)(1))—and foreign "nonmain" proceedings, which may be pending in countries where the debtor merely has an "establishment" (*see* 11 U.S.C. §§ 1502(5) and 1517(b)(2)). 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) provides that certain provisions of the Bankruptcy Code automatically come into force, including section 362, which imposes an automatic stay preventing creditor collection efforts with respect to the debtor or its U.S. assets. If the bankruptcy court recognizes a foreign proceeding as either a main or nonmain proceeding, section 1521(a) authorizes the court to grant a broad range of provisional and other relief designed to preserve the foreign debtor's assets or otherwise provide assistance to the court or other entity presiding over the debtor's foreign proceeding.

Section 1506 sets forth a public policy exception to any of 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."

VARIG

São Paulo, Brazil-based Varig Logistica S.A. ("debtor") operated an international cargo airline from 2000 to 2012. In 2006, a network of private-equity companies acquired the debtor through a special-purpose entity called Volo Logistics, LLC ("Volo"), whose subsidiaries held 100% of the debtor's stock (Volo, its direct subsidiaries, and the private-equity companies are collectively referred to as the "MP Entities").

In 2006 and 2007, the MP Entities loaned approximately $250 million to the debtor through a series of intercompany loans. However, the debtor's financial condition worsened. In February 2008, aircraft lessor Pegasus Aviation II, Inc. and certain affiliates (collectively, "Pegasus") sued the debtor in Florida state court for nonpayment of aircraft lease amounts. In October 2008, Pegasus also sued the debtor and the MP Entities (under a veil-piercing theory) in New York state court for breach of contract ("NY state action").

In December 2008, the debtor and the MP Entities entered into two debt assumption agreements ("DAAs") whereby certain MP Entities transferred the debtor's obligation to repay more than $250 million in debt to other MP Entities in exchange for the debtor providing the MP Entities with a general release from all claims held by the debtor for any "act, omission, transaction, event or other occurrence taking place on or prior to" December 2008. The DAAs included a New York state or federal court forum selection clause, but provided that Volo and its direct subsidiaries could bring suit to enforce the DAAs in a Brazilian court. The DAAs also included a New York choice of law provision.

In March 2009, the debtor filed for the Brazilian equivalent of chapter 11 relief in Brazil. After the Brazilian bankruptcy court entered an order for relief, Volo provided the debtor with $7.5 million in debtor-in-possession financing. As part of the financing transaction, the debtor released Volo and the other MP Entities from any claims arising from transactions with the debtor.

On March 31, 2009, the debtor's foreign representative filed a petition in the U.S. Bankruptcy Court for the Southern District of Florida ("Florida bankruptcy court") seeking recognition under chapter 15 of the debtor's Brazilian bankruptcy case. He also commenced an adversary proceeding seeking to enjoin Pegasus from commencing or continuing any U.S. litigation against the debtor and the MP Entities. However, the debtor agreed to permit Pegasus to proceed with the NY state action, after which the Florida bankruptcy court dismissed the Pegasus adversary proceeding without prejudice and granted Pegasus relief from the automatic stay.

The Florida bankruptcy court entered an order recognizing the debtor's Brazilian bankruptcy case as a foreign main proceeding under chapter 15 in May 2009.

In September 2012, the Brazilian bankruptcy court converted the debtor's reorganization proceeding into a liquidation proceeding and appointed a new foreign representative ("FR") to liquidate the debtor's assets.

The parties settled the NY state action in September 2017 for $41 million.

In 2017 and 2018, the FR sought discovery in the chapter 15 case from the MP Entities regarding their relationship and loan transaction history with the debtor. In 2019, the FR also sought discovery from Pegasus of relevant information provided to Pegasus by the MP Entities in connection with the NY state action. He requested discovery of the same information from Volo in 2020.

In May 2020, the FR filed a breach-of-fiduciary duty and veil-piercing action against the MP Entities in the Brazilian bankruptcy court alleging that the defendants looted the debtor and forced it into bankruptcy ("Brazilian action").

The MP Entities responded in June 2020 by commencing an adversary proceeding ("MP adversary proceeding") in the Florida bankruptcy court seeking: (i) a determination that the claims asserted in the Brazilian action were released by the debtor in the DAAs ("MP claim release"); (ii) an injunction barring the FR from continuing the Brazilian action; and (iii) in the alternative, relief from the automatic stay to file an action for declaratory and injunctive relief in the NY court.

In July 2020, Volo sought an order from the Florida bankruptcy court quashing the FR's discovery requests. The FR then filed a motion seeking dismissal or abatement of the MP adversary proceeding. The FR also asked the Brazilian bankruptcy court to enjoin the MP Entities from prosecuting the MP adversary proceeding, arguing that the Brazilian bankruptcy court had exclusive jurisdiction to determine the impact of the releases in the DAAs.

In July 2021, the MP Entities (including Volo) filed for chapter 11 protection ("NY bankruptcy case") in the U.S. Bankruptcy Court for the Southern District of New York ("NY bankruptcy court"). At the request of both the FR and the MP Entities, the Brazilian bankruptcy court stayed the Brazilian action. However, although the parties acknowledged that Volo's pending motion to quash was stayed by the chapter 11 filing, the FR argued that the automatic stay did not prevent the Florida bankruptcy court from ruling on his motion to dismiss the MP adversary proceeding. The Florida court agreed, reasoning that its ruling, albeit not determinative on issues that might impact the parties in the MP Entities' chapter 11 cases, might provide guidance regarding the issues that would be useful to the NY bankruptcy court.

In September 2021, the Brazilian bankruptcy court ruled that the claims asserted by the MP Entities in the MP adversary proceeding violated its "absolute jurisdiction" and that the validity and impact of the releases should be adjudicated in Brazil. However, the Brazilian bankruptcy court denied the FR's request for injunctive relief because such relief "would end up unduly intervening in another country's jurisdiction."

THE BANKRUPTCY COURT'S RULING

Bankruptcy Judge Robert A. Mark denied Volo's motion to quash the FR's subpoena as moot due to the automatic stay that arose upon the filing of the NY bankruptcy case. However, his ruling was without prejudice to renewal of the motion if the FR obtained relief from the stay.

Judge Mark then held that comity considerations warranted dismissal of the MP adversary proceeding and denial of the MP Entities' alternative request for relief from the automatic stay. According to Judge Mark, the fundamental issue presented in the proceeding was which court—the Brazilian bankruptcy court, the Florida bankruptcy court, or the NY state court—should determine whether the claims asserted in the Brazilian action were barred by the release in the DAAs.

Because the Brazilian bankruptcy court found that: (i) it had absolute and exclusive jurisdiction to hear the Brazilian action; (ii) the MP adversary proceeding violated the Brazilian bankruptcy court's absolute and exclusive jurisdiction; and (iii) the impact of the MP claim release should be determined by the Brazilian bankruptcy court as a defense to the Brazilian action, Judge Mark, as an exercise of comity, concluded that the Brazilian bankruptcy court was the appropriate forum to adjudicate the Brazilian action. Judge Mark stated that he was exercising discretion out of respect for "the Brazilian bankruptcy court's sovereign interpretation of the claims and defenses that are pending before it." In so ruling, Judge Mark reiterated the emphasis that section 1501(a)(1) of the Bankruptcy Code places on the importance of cooperation between courts in cross-border bankruptcy cases, and the directive in section 1525(a) that U.S. bankruptcy courts "shall cooperate to the maximum extent possible with a foreign court."

Finally, Judge Mark ruled that the MP Entities' alternative request for relief from the automatic stay was moot and therefore must be denied.

OUTLOOK

Varig is an interesting case, and one that is emblematic of the challenges confronted by courts presiding over cross-border bankruptcy and restructuring cases. It involves four different courts in the United States and Brazil and bankruptcy filings in the United States not only on behalf of the foreign debtor but also by its private-equity sponsors. It also involves a more-than-decade-long chapter 15 case that lay relatively dormant for many years until a (then-liquidated) debtor's foreign representative sought discovery from entities alleged to have looted the company.

Varig highlights that chapter 15 cases are increasingly being relied upon as an effective mechanism to facilitate a foreign debtor's discovery into the assets or affairs of the debtor in the U.S. Parties must be aware of the entire litigation landscape and be prepared to appear in multiple jurisdictions to protect and assert their rights.

Varig also illustrates the importance of cooperation and coordination among parties and courts involved in complex cross-border restructurings. Chapter 15 was designed to make such efforts possible, particularly when coupled with cross-border protocols that are agreed upon by parties and endorsed by the courts involved.

DELAWARE BANKRUPTCY COURT: NO IMPLIED ASSUMPTION OF EXECUTORY CONTRACTS IN BANKRUPTCY

Marissa C. Alfano • Mark G. Douglas

The ability of a bankruptcy trustee or chapter 11 debtor-in-possession ("DIP") to assume, assume and assign, or reject executory contracts and unexpired leases is an important tool designed to promote a "fresh start" for debtors and to maximize the value of the bankruptcy estate for the benefit of all stakeholders. However, the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules") establish strict requirements for the assumption, assignment, and rejection of contracts and leases. The U.S. Bankruptcy Court for the District of Delaware addressed the consequences of failing to comply with those requirements in *In re Dura Auto. Sys., LLC*, 628 B.R. 750 (Bankr. D. Del. 2021). The court confirmed that the U.S. Court of Appeals for the Third Circuit—like the majority of other courts that have decided the issue—has rejected the doctrine of "implied assumption" of executory contracts in bankruptcy cases.

ASSUPTION, ASSUMPTION AND ASSIGNMENT, AND REJECTION OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES IN BANKRUPTCY

Section 365(a) of the Bankruptcy Code provides that, with certain exceptions delineated elsewhere in the statute, "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor." The trustee's power to assume or reject is conferred upon a DIP under section 1107(a) of the Bankruptcy Code. Rejection results in a court-authorized breach of the contract, with any claim for damages treated as a prepetition claim against the estate on a par with the claims of other general unsecured creditors (unless the debtor has posted security). 11 U.S.C. § 365(g). Assumption of a contract requires, among other things, that the trustee or DIP cure all existing monetary defaults and provide adequate assurance of its future performance. 11 U.S.C. § 365(b).

One purpose of section 365(a) is to provide the debtor with "a reasonable time within which to determine whether adoption or rejection of the executory contract would be beneficial to an effective reorganization." *Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.)*, 973 F.2d 1065, 1075 (3d Cir. 1992).

Bankruptcy courts will generally approve assumption or rejection of a contract or lease if presented with evidence that either course of action is a good business decision. *See Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019) ("The bankruptcy court will generally approve [the] choice [to assume or reject], under the deferential 'business judgment' rule."). Upon assumption, most kinds of executory contracts may also be assigned by the trustee or DIP to third parties under the circumstances specified in sections 365(c) and 365(f). In chapter 11 cases, except with respect to certain kinds of contracts (such as nonresidential real property leases, aircraft lease agreements, and commitments to a federal depository institutions regulatory agency), the trustee or DIP may decide to assume or reject at any time up to confirmation of a chapter 11 plan. However, any nondebtor party to a contract may seek to compel the trustee or DIP to assume or reject the contract prior to confirmation, in which case the bankruptcy court must decide what period of time is reasonable to make the decision. 11 U.S.C. §§ 365(d)(2), (d)(4), and (o). Pending the decision to assume or reject, the trustee or DIP is generally obligated to keep current on most obligations that become due under the contract postpetition. 11 U.S.C. §§ 365(d)(3) and (d)(5).

Bankruptcy Rule 6006 sets forth procedures governing the assumption, assumption and assignment, or rejection of executory contracts and unexpired leases. Rule 6006(a) provides that "[a] proceeding to assume, reject or assign an executory contract or unexpired lease, other than as part of a plan, is governed by [Bankruptcy] Rule 9014." Under Bankruptcy Rule 9014(a), the trustee or DIP must request the relief by motion filed with the bankruptcy court, with reasonable notice and an opportunity for a hearing provided to the contract counterparty.

DURA AUTOMOTIVE

In October 2019, automotive supply company Dura Automotive Systems, LLC and certain affiliates (collectively, "Dura") filed for chapter 11 protection in the Middle District of Tennessee. Venue of the cases was transferred shortly thereafter to the District of Delaware.

Prior to filing for bankruptcy, Dura contracted with Plasti-Paint, Inc. ("PLP") for the painting of auto roof rails under contracts ("PLP contracts") and related purchase orders. The PLP contracts allowed Dura to place weekly orders without having to issue new purchase orders. As a critical supplier, PLP continued to provide services to Dura under the contracts after the bankruptcy petition date.

In January 2020, Hain Capital Investor Master Fund, Ltd. ("Hain") purchased PLP's claims against Dura under the PLP contracts and all associated rights. Under the claims purchase agreement, if Dura assumed any of the PLP contracts, Hain was entitled to all cure amounts payable upon assumption.

In June 2020, the court approved the sale of substantially all of Dura's North American assets to Dura Buyer DNA, LLC (together with its assignees, including DUS Operating, Inc. ("DUS"), the "Purchaser"). As part of the transaction, which was closed in June 202, Dura assumed and assigned certain executory contracts to the Purchaser in accordance with section 365 and court-approved procedures. Under the sale agreement, the Purchaser was obligated to pay all of Dura's monetary defaults under the assigned executory contracts before the sale closed. Dura, however, never sought to assume and assign or to reject the PLP contracts.

After the sale, PLP rendered performance to the Purchaser under the PLP contracts but announced that it would soon modify its paint process. PLP and the Purchaser accordingly entered into a new contract in June 2020. The new contract substituted DUS as the contract counterparty but otherwise made no significant changes. However, the parties operated under the PLP contracts until September 2020, when PLP implemented its new paint process. The parties then used both the old and new contracts until December 2020, after which they began operating solely under the new contract.

In October 2020, Hain sought an order from the bankruptcy court compelling the Purchaser to pay it approximately $1.8 million to cure alleged defaults under the PLP contracts. Hain argued that, despite Dura's failure to formally assume and assign the PLP contracts as part of the sale transaction, the cure amounts were due under the doctrine of "implied assumption," based on Dura's conduct. According to Hain, Dura impliedly assumed the PLP contracts because: (i) the new contract between PLP and the Purchaser's designee DUS was substantially similar in purpose to the PLP contracts; (ii) the new contract was a continuation of the PLP contracts and the parties intentionally structured their dealings so that they could avoid paying Hain the cure amount; and (iii) DUS benefited from the PLP contracts without taking responsibility for paying the cure amount.

DUS countered that the bankruptcy court never approved Dura's assumption and assignment of the PLP contracts, and the Third Circuit, like many other courts, has rejected the concept of implied assumption.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court denied Hain's motion.

Bankruptcy Judge Karen B. Owens explained that, because Dura neither sought nor obtained court approval to assume and assign the PLP contracts to the Purchaser, the contracts were not assumed and the Purchaser (or its assignee DUS) did not have to pay the cure amount required as a condition to assumption under section 365(b). Citing *University Medical* (Third Circuit precedent by which the bankruptcy court was bound), Judge Owens noted that the Third Circuit has rejected the implied assumption doctrine. *Dura*, 328 B.R. at 754. Although courts outside of the Third Circuit have permitted implied assumption, she wrote, they are "a small minority." *Id.*

In accordance with *University Medical*, Judge Owens emphasized, "'assumption must be approved. It cannot be presumed.'" *Id.* (quoting *University Medical*, 973 F.2d at 1077). In *University Medical*, she explained, the Secretary of the U.S. Department of Health and Human Services asserted that the unique circumstances of the Medicare Act should allow a contract to be assumed if performance continues after the petition date even without formal court approval. However, the Third Circuit refused to depart from the plain language of the Bankruptcy Code that mandates court approval for assumption of an executory contract. In so ruling, Judge Owens noted, the court of appeals stressed the importance of motion practice and court approval so that all of the pros and cons to the estate and stakeholders can be considered and an executory contract's status with respect to the estate can be finalized. *Id.* at 755 (citing *University Medical*, 973 F.3d at 1078-79).

According to Judge Owens, PLP voluntarily provided services after the sale until the new contract became effective, and there was "no motivation" to seek court approval to assume the PLP contracts and pay the cure amount after PLP sold its claims under the contracts to Hain. Instead, the parties focused on continuing PLP's critical services and finalizing the painting process and the new contract. In addition, Hain never requested court approval of assumption of the PLP contracts (as was its right under section 365(d)(2) and the claims purchase agreement) or attempted to stop the parties from continuing their dealings or from entering into a new contract, despite being aware that PLP was continuing to provide services.

Judge Owens rejected Hain's contention that section 105(a) of the Bankruptcy Code (providing that the court can "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code) authorized a finding of implied assumption. This argument, she wrote, was rejected by the Third Circuit in *University Medical* and defies the plain language of the Bankruptcy Code and the Bankruptcy Rules. *Id.* at 756 (citing *Law v. Siegel*, 571 U.S. 415, 421 (2014) (holding that a bankruptcy court cannot use section 105(a) to override explicit mandates of the Bankruptcy Code)).

Finally, Judge Owens noted that Hain could pursue any claim it might have for breach of the claims purchase agreement outside of bankruptcy. Hain's claims under the PLP contracts, by contrast, would be resolved in due course in Dura's bankruptcy.

OUTLOOK

Dura Automotive demonstrates the importance of strict compliance with the rules and procedures established in the Bankruptcy Code and the Bankruptcy Rules for the assumption, rejection, and assignment of executory contracts and unexpired leases. Although a minority of courts have concluded that a contract or lease can be assumed under the doctrine of implied assumption, debtor and nondebtor contract parties (as well as other stakeholders in the bankruptcy case) are better served by adhering to the rules rather than leaving the fate of their interests under a contract or lease to the court's equitable discretion.

The decision also serves as a reminder that claims purchasers must be vigilant and proactive to ensure that their rights under a purchase or assignment agreement are preserved (e.g., by actively participating in the bankruptcy case or including an indemnity in the agreement).

NEWSWORTHY

Heather Lennox ***(Cleveland and New York)*** has been appointed Global Practice Leader of Jones Day's Business Restructuring & Reorganization Practice. Heather has been a partner in the Firm's BRR Practice since 2002 and has led some of the most important restructuring cases in the United States over the past two decades, including work on behalf of the City of Detroit, Peabody Energy, Hostess Brands, and FTD. She is a member of the National Bankruptcy Conference, which advises Congress on national bankruptcy policy, and a Fellow in the American College of Bankruptcy. She has served as Partner-in-Charge of the Firm's Cleveland Office since 2016. She succeeds ***Bruce Bennett*** ***(Los Angeles and New York)***, who has led Jones Day's BRR Practice since 2016, and will continue to advise clients as a partner in the practice.

Jones Day recently welcomed ***Oliver S. Zeltner*** ***(Cleveland)*** and ***T. Daniel Reynolds*** ***(Cleveland)*** to the partnership in its Business Restructuring & Reorganization Practice.

An article written by ***Corinne Ball*** ***(New York)*** titled "District Court Rejects Non-Consensual Third-Party Releases in Purdue Pharma Plan; While Plaintiffs Return to the Race to the Courthouse, Distress Investors Will Reap Opportunities" was published in the December 22, 2021, edition of the *New York Law Journal*.

Roger Dobson ***(Sydney)*** received a Band 1 ranking in the field of Restructuring/Insolvency in the 2022 edition of *Chambers Asia-Pacific*.

Colleen E. Laduzinski ***(Tax; Boston)*** has been appointed as a Conferee to the National Bankruptcy Conference, a select group of nationally known practitioners, academics, and judges that is often called upon to advise Congress and the Executive Branch agencies on bankruptcy policy matters.

Juan Ferré ***(Madrid)*** was recognized in the 2022 edition of *The Best Lawyers in Spain*™ in the practice area "Banking and Finance Law; Insolvency and Reorganization Law."

An article written by ***Charles M. Oellermann*** ***(Columbus)*** and ***Mark G. Douglas*** ***(New York)*** titled "Case Update: Second Circuit Breathes New Life Into Madoff Trustee's Efforts to Recover Ponzi Scheme Payments" was published in the December 2021 issue of *Wall Street Lawyer*.

An article written by ***Mark A. Cody*** ***(Chicago)*** and ***Mark G. Douglas*** ***(New York)*** titled "Another Bankruptcy Court Joins the Debate on the Validity of Bankruptcy Blocking Restrictions" was published on October 25, 2021, in *Lexis Practical Guidance*.

An article written by ***Paul M. Green*** ***(Houston)*** and ***Mark G. Douglas*** ***(New York)*** titled "Another Bankruptcy Court Rules the Solvent Debtor Exception Survived Enactment of the Bankruptcy Code" was published on October 26, 2021, in *Lexis Practical Guidance*.

An article written by ***Dan T. Moss*** ***(Washington)***, ***Taylre C. Janak***, and ***Mark G. Douglas*** ***(New York)*** titled "An Equitable Tightrope: Blackjewel's Balancing Act on After-Acquired Property in Bankruptcy" was published on October 27, 2021, in *Lexis Practical Guidance*.

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 "New York Bankruptcy Court Rules that Good Faith Is Not the Gatekeeper to Chapter 15" appeared in the December 2021 *INSOL News Update*.

Kevyn D. Orr ***(Washington)***, ***Corinne Ball*** ***(New York)***, ***Bruce Bennett*** ***(New York and Los Angeles)***, ***Carl E. Black*** ***(Cleveland)***, ***Jeffrey B. Ellman*** ***(Atlanta)***, ***Brad B. Erens*** ***(Chicago)***, ***Gregory M. Gordon*** ***(Dallas)***, ***Heather Lennox*** ***(Cleveland)***, ***Joshua M. Mester*** ***(Los Angeles)***, and ***Charles M. Oellermann*** ***(Columbus)*** were featured in the practice area "Business Restructuring & Reorganization" or "Bankruptcy & Financial Restructuring" in the 2022 *Lawdragon 500 Leading Bankruptcy & Restructuring Lawyers*.

BUSINESS RESTRUCTURING REVIEW

The *Business Restructuring Review* is a publication of the Business Restructuring & Reorganization Practice of Jones Day.

Executive Editor: Charles M. Oellermann
Managing Editor: Mark G. Douglas

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