ALSTON & BIRD
Finance

STRUCTURED FINANCE SPECTRUM

FEBRUARY 2019

SECURITIZATION SIDE NOTES – EU Risk Retention: Did This Come with a Gift Receipt? We'd Like to Return It

A new year brings new laws and regulations into effect, in this case a complicated and confusing gift from our friends across the pond.

READ ARTICLE

POLITICS AND THE MARKET – Pass the Antacid: A Brief Briefing on Political and Economic Cross-Currents

Consider the vantage point of Federal Reserve's Beige Book (January 2019):

Economic activity increased in most of the U.S., with eight of twelve Federal Reserve Districts reporting modest to moderate growth. Nonauto sales grew modestly.… Auto sales were flat on balance.…

READ ARTICLE

PRACTITIONER NOTES – "These need to go on the DTC . . ." – A Tax Perspective

The Depository Trust Company (DTC) serves as a securities listing and trading platform providing needed liquidity and payment processing support for securities issuers, financial institutions (e.g., in their capacities as banks, underwriters, placement agents, broker-dealers, trustees/paying agents), institutional investors, and their respective investors. At a high-level, listing a security on the DTC involves...

READ ARTICLE

REGULATORY REPORT – For the Resi Crowd: Loosening FIRREA's Reins on Appraisal Requirements

On December 7, the Comptroller of the Currency, Federal Reserve System, and Federal Deposit Insurance Corporation (the "agencies") published in the *Federal Register* a proposed rule that would make four principal changes to the existing Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requirements for appraisals in connection with residential real-estate-related transactions. Comments on the proposal were due by February 5, 2019.

READ ARTICLE

BANKRUPTCY BEAT – Feeling Entitled to Make-Whole Premiums and Post-Petition Default Interest? Might Want to Avoid the Fifth Circuit

On January 17, 2019, the Fifth Circuit Court of Appeals issued another significant opinion concerning the viability/enforceability of a contractual "make-whole" provision...

READ ARTICLE

ALSTON & BIRD ANNOTATIONS

Asset-Backed Alert recently ranked Alston & Bird among the top counsel for both issuers and underwriters of asset-backed and mortgage-backed securities.

READ MORE

EU Risk Retention: Did This Come with a Gift Receipt? We'd Like to Return It

A new year brings new laws and regulations into effect, in this case a complicated and confusing gift from our friends across the pond. EU Risk Retention (EU RR) has changed as of January 1, 2019, with the effectiveness of Regulation (EU) 2017/2402 bringing with it considerable concerns. EU RR had previously been "investor based," meaning U.S. issuers had no obligation to meet the EU RR requirements, and it was incumbent upon EU investors to determine if their issuer met the requirements. Starting in January, however, domestic issuers may be required to comply with newly effective "transparency" requirements if they wish to sell to investors who are subject to EU RR. Currently, EU RR application to U.S. issuers is perhaps unclear, although some investors are already insisting on compliance. Clarification on its application may need to be sought and obtained from EU regulators.

On February 1, 2019, the European Securities and Markets Authority (ESMA) published templates, set out by asset class, for the two main ongoing reporting requirements of Section 7(1)(a) of the EU RR Regulation covering asset-level reporting and Section 7(1)(e) of the EU RR Regulation covering investor reporting. ESMA also clarified on January 31, 2019 in a Q&A response and an opinion on the regulatory technical standards that in order for the deal to be compliant from the perspective of EU-located investors, reporting entities must use the templates to prepare those reports. The templates can be accessed at the ESMA library.

We are aware of three approaches taken by domestic issuers before the release of the templates: (1) the sponsor discloses that it will undertake no effort to comply; (2) the sponsor discloses that it intends to fully comply and takes any risk that the final guidance for the rule will be onerous; and (3) the sponsor discloses that it may comply, leaving it to the investor to determine whether or not it actually has. With the publication of the templates, these approaches may be modified in light of the ability (or inability) of the sponsor to comply, even if it wants to.

If you're thinking about keeping a deal onshore to avoid EU RR compliance, note that EU RR may now apply to investors that are U.S. subsidiaries of EU financial institutions, in particular for certain regulatory capital purposes. In a statement made by European regulators in November 2018, however, this was not an intended con-

(continued on next page)

sequence of EU RR, and it is anticipated that a clarifying amendment will be put together. Until then, broker-dealers should confirm that their U.S. investors in securitizations are comfortable with their investments from this perspective.

Not to bury the lede, but perhaps most significantly, the long arm of EU RR may now extend to financial transactions that are not traditional "securitizations" from a U.S. perspective. A key component of the analysis is whether the transaction involves "tranching" of credit risk. Warehouse transactions, quasi-securitizations, and other bespoke financing structures with multiple classes of debt and EU investors or lenders could very well be subject to EU RR, so make sure to consult with your counsel as you are structuring deals to see if EU RR needs to be considered.

On the positive side, we expect that, like many other regulations, EU RR will undergo a period of finessing when many of these details will be worked through and worked out. And unlike the U.S. version of risk retention, which given the number of regulators involved, has been a tad challenging to get answers for, we have had success thus far in getting verbal answers in the EU (although sometimes not consistent answers). We will take what we can get. The European Banking Authority has been receptive to questions and has provided written responses that can be relied on. Regardless, the EU RR Regulation is in many places vague and open to interpretation, and the advice of EU counsel is strongly recommended.

We are grateful for the opportunity to work with the law firm of Gide Loyrette Nouel on many of these issues, and for their review of this article. ■

Pass the Antacid: A Brief Briefing on Political and Economic Cross-Currents

Consider the vantage point of the Federal Reserve's Beige Book (January 2019):

> Economic activity increased in most of the U.S., with eight of twelve Federal Reserve Districts reporting modest to moderate growth. Nonauto sales grew modestly…. Auto sales were flat on balance.… [M]anufacturing expanded, but growth slowed, particularly in the auto and energy sectors. New home construction and existing home sales were little changed, … [reflecting impacts of] rising prices and low inventory. Commercial real estate was also little changed on balance. Most Districts reported modest to moderate growth in activity in the nonfinancial services sector, though a few Districts noted that growth there had slowed. The energy sector expanded at a slower pace, and lower energy prices contributed to a pullback in the industry's capital spending expectations. [Agriculture] struggled as prices generally remained generally low despite recent increases. Overall, lending volumes grew modestly, though a few Districts noted that growth had slowed. *Outlooks generally remained positive, but many Districts reported that contacts had become less optimistic in response to increased financial market volatility, rising short-term interest rates, falling energy prices, and elevated trade and political uncertainty.* [Emphasis added]

At the CREFC conference in January, participants at an industry leaders' roundtable forecasting the next 12 months expressed similar sentiments:

> U.S. economy: Mixed. World economy: declining. Real estate business: Mostly stable. Finance business: Mixed. CMBS: Declining to $50–75 billion. Coupon: Up. Real estate values: Same. LTV for new loans: Up or the same.

Other symptomatic catch phrases: "More volatility. Transition year. 10-year cycles versus 5-year memories. Challenging times. Late-cycle behavior. Markets stay strong as long as nothing seriously wrong. The Fed's speech and

its tone helped change direction. The new normal is that you bump your head and you move on from it. Banks are better capitalized heading into recession than ever before. Trough should be lesser than last recession."

And yet, against that predominantly neutral-to-somber outlook, there are some encouraging signs: The latest CMBS deals were oversubscribed and priced tighter than in 2018. The CLO issuance market has rebounded. On the RMBS side, jumbo mortgage securitizations are poised to resume. Within ABS, prime auto and credit card deals since the latter part of January have benefited from a respite in market volatility and high demand to beat price talk.

What of Washington? Immigration continues to hold center stage. A "tiny wall" deal garnered bipartisan majorities sufficient to override a presidential veto, averting another government shutdown. But, facing a national emergency declaration by the President for additional border wall funding, congressional majorities of two-thirds would be necessary to overturn a veto of any measure nullifying the emergency declaration. The stakes of rebuking the President will be high for swing Republicans. Going into the election season, cooperation across the aisle could be in short supply.

It seems that volatility has many manifestations. So, to paraphrase Bette Davis, "Fasten your seatbelts…." ■

"These Need to Go on the DTC . . ." – A Tax Perspective

The Depository Trust Company (DTC) serves as a securities listing and trading platform providing needed liquidity and payment processing support for securities issuers, financial institutions (e.g., in their capacities as banks, underwriters, placement agents, broker-dealers, trustees/paying agents), institutional investors, and their respective investors. At a high level, listing a security on the DTC involves:

- The issuance of DTC-eligible securities (including, generally, various forms of corporate, government, and asset-backed debt), equity, pass-through certificates, and derivatives by an issuer. This issuer may be a corporation, partnership, LLC, or trust.
- Each issued security is assigned a CUSIP number from Standard & Poor's CUSIP Service Bureau. For securities permitted to be traded internationally, the bureau issues International Securities Identification Numbers (ISINs). These identification numbers are printed on each certificate representing the securities issued.
- Each class of securities may be divided into smaller components (e.g., shares, units, minimum debt denominations).
- DTC participants distribute new and secondary offerings to other participants through electronic "book-entry" delivery and settlement through the DTC system.
- Issuers and trustees make payments on a CUSIP security class to the DTC, the DTC makes a pro rata allocation among its participants holding these CUSIP securities, and DTC participants pass along these payments based on their internal records of customer/investor ownership.

Listing with the DTC makes each eligible security fungible and more easily tradeable. This system also allows issuers to primarily deal directly with the DTC and not each of the various DTC participants or their ultimate investors. Accordingly, DTC participants are generally best positioned to collect tax forms and obtain other "know-your-customer" types of information. The DTC is also efficient in facilitating the delivery of payments and other information "downstream" to investors via DTC participants; however, the system's capabilities are less robust in reversing the flow of information "upstream" from investors or DTC participants to an issuer.

We have seen a steady increase in requests for new categories of instruments to be listed with the DTC. While the DTC system works exceptionally well for most purposes, in certain settings the very features that make it an efficient and flexible trading platform from a commercial and corporate perspective present a variety of complicated tax issues.

Different U.S. tax regimes and withholding rules can apply to a payment depending on the type of payment and the U.S. or foreign person status of the payee. These rules also generally impose duties (as well as liabilities) on U.S. "withholding agents" to identify the tax nature of such payments, collect the required tax forms and certifications from the ultimate beneficial owners, and to withhold tax (or not) based on such determinations and information. Sometimes these obligations and liabilities can be shifted to a subsequent payor in the chain of payment (e.g., from the issuer to a DTC participant), and sometimes not. In certain cases, an issuer's lack of knowledge of the ultimate holders of its securities can make complying with these tax rules challenging.

For example, assume a wholly-owned, non-corporate U.S. entity engaged in a financing business issues a security that is likely debt-for-tax. The issuer and the investors agree to treat the instrument as debt-for-tax, but substantial subordination and other factors make it plausible the IRS could successfully reclassify the instrument as equity of the issuer. Assume the IRS does successfully recharacterize the security as equity so that all its holders are treated as holding a partnership interest in a U.S. financing business for tax purposes. Very different withholding tax rules apply to partnership distributions to foreign investors of U.S. business profits than those that apply to passive interest payments on debt. Debt treatment is typically better for all concerned, and the issuer's withholding tax liability from such a potential recharacterization is generally the risk that receives the most attention in investor disclosures.

However, there are other, less obvious, tax issues that may arise and should also be considered. The issuer expected to be treated as a wholly-owned disregarded entity—a tax "nothing burger." Instead, the issuer has been deemed a partnership for tax purposes. Partnership interests are not usually (at least intentionally) listed on the DTC. If the issuer needs to know the identity of its new "partners" for tax compliance reasons (e.g., K-1 info, tax election consents, etc.), what is the best method or system to put in place for acquiring this information? If the issuer holds U.S. real estate subject to special foreign investor withholding rules, what are the issuer's withholding alternatives for a payment where the mix of U.S. and foreign persons is not known and/or is constantly subject to change? If the parties are seeking a tax opinion that requires knowledge of the number and nature of the direct and indirect beneficial holders of a DTC-eligible security class both on and after the issuance date, how will this information be obtained with sufficient certainty that this opinion can be issued?

Structured finance attorneys are familiar with these and similar tax issues arising in the DTC context and have developed a variety of strategies to mitigate any related risks (where possible). The long pause from the tax advisor after hearing "These need to go on the DTC" is merely their application of the particular characteristics of that security to the unique tax issues that may arise from this book-entry request and a weighing of the potentially available techniques to address such issues. ■

For the Resi Crowd: Loosening FIRREA's Reins on Appraisal Requirements

On December 7, the Comptroller of the Currency, Federal Reserve System, and Federal Deposit Insurance Corporation (the "agencies") published in the *Federal Register* a proposed rule that would make four principal changes to the existing Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requirements for appraisals in connection with residential real-estate-related transactions. Comments on the proposal were due by February 5, 2019.

First, the agencies propose to increase the threshold at or below which a lender is not required to obtain an appraisal of the property to support its decision to enter into a residential real-estate-related transaction. Currently, an appraisal is required for residential transactions with a value of $250,000 or more, and this threshold has not changed since 1994. The proposal would increase the threshold to $400,000, expanding the number of residential transactions eligible for the exemption. FIRREA-compliant evaluations would continue to be required for all transactions below this increased threshold amount. The Consumer Financial Protection Bureau (CFPB) must concur with the increase in the threshold to ensure that the adjusted level "provides reasonable protection for consumers who purchase 1-to-4 unit single-family residences." Some of the large trade groups, such as the Mortgage Bankers Association, support the proposed increase of the appraisal threshold.

Second, to provide clarification on the scope of transactions subject to the requirement to obtain an appraisal, the agencies propose to define "residential real estate transaction" to be consistent with the manner in which the term is defined in FIRREA—meaning a real estate transaction secured by a one- to four-family residential property.

Third, the agencies propose to require regulated lending institutions to obtain evaluations, in lieu of appraisals, for certain transactions secured by residential property in rural areas (as defined in 12 C.F.R. § 1026.35(b)(2)(iv)(A)). New Section 1127 to FIRREA would exempt a transaction if: (1) the mortgage originator or its agent has contacted at least three local appraisers and documents that no such individual was available to provide an appraisal "within five business days beyond customary and reasonable fee and timeliness standards for comparable appraisal assignments"; (2) the transaction value is less than $400,000; and (3) the mortgage originator is subject to federal oversight. This exemption would be unavailable if the relevant federal financial regulatory agency would otherwise require an appraisal (under 12 C.F.R. §§ 34.43(c), 225.63(c), 323.3(c), or 722.3(e), as applicable) or if the transaction is a high-cost mortgage as defined in Section 103 of the Truth in Lending Act (TILA).

Fourth, the agencies included in the proposed rule provisions relating to appraisal review. FIRREA (as amended by Dodd–Frank) currently requires the federal appraisal regulations to ensure that all appraisals performed in connection with federally related transactions are "subject to appropriate review for compliance with the Uniform Standards of Professional Appraisal Practice." As regulated lending institutions are already providing such reviews under FIRREA, the effect of the agencies' proposal would be to further implement this requirement.

As with the agencies' existing regulations, the proposed rule would apply to the agencies and institutions regulated by the agencies that are depository institutions, bank holding companies, or subsidiaries of depository institutions or bank holding companies entering into real-estate-related transactions. The proposed rule would also apply to nonbanks to the extent that they sell loans to, or enter into transactions (e.g., mortgage-backed securities or warehouse lending) with, regulated lending institutions. The proposed rule would not impact other appraisal requirements that may be applicable to a transaction—for instance, those arising under FHA and VA guidelines, or those arising under TILA relating to higher-priced mortgage loans or to appraisal independence. ■

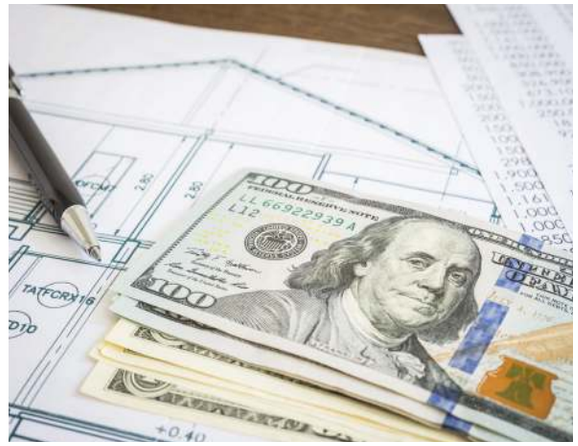
Now with More Disclosures: California Commercial Lending Subject to TILA-ish Regulations

Entities engaging in "commercial financing" in California need to be aware of important amendments to the California Financing Law (CFL), which were enacted on September 30, 2018, to create the first state-enacted small business truth-in-lending law.

SB 1235 adds Sections 22780.1 and 22800–22805 to the existing CFL, requiring a "provider" to deliver certain specified disclosures whenever it extends a specific offer of "commercial financing" to a "recipient." For the purposes of the revised CFL, a "provider" is a person who extends an offer of commercial financing; "commercial financing" refers to an accounts receivable purchase transaction, which includes factoring, asset-based lending, commercial loans, commercial open-end credit plans, or lease financing transactions "intended by the recipient for use primarily for other than personal, family, or household purposes"; and a "recipient" is a person who is presented a commercial financing offer by a provider that is equal to or less than $500,000.

Under these provisions, providers must disclose the following information to recipients at the time of extending a commercial financing offer and obtain the recipient's signature before consummating the transaction: (1) the total amount of funds provided; (2) the total dollar cost of the financing; (3) the term or estimated term; (4) the method, frequency, and amount of payments; and (5) a description of prepayment policies.

Compliance is not required until the commissioner of the Department of Business Oversight's (DBO) final regulations take effect. First, the commissioner must adopt final regulations addressing these requirements, including (1) additional definitions, contents, and methods of calculations for each of the disclosures; (2) requirements concerning the time, manner, and format of the disclosures; (3) the appropriate method to express the annualized rate disclosure and types of fees and charges to be included in the calculation; (4) when providers can disclose



an estimated annual rate and the method for calculating such an estimate; and (5) the accuracy requirements and tolerance allowances for the calculation. The DBO closed its official commentary period for proposed rulemaking on commercial financing disclosures on January 22, 2019.

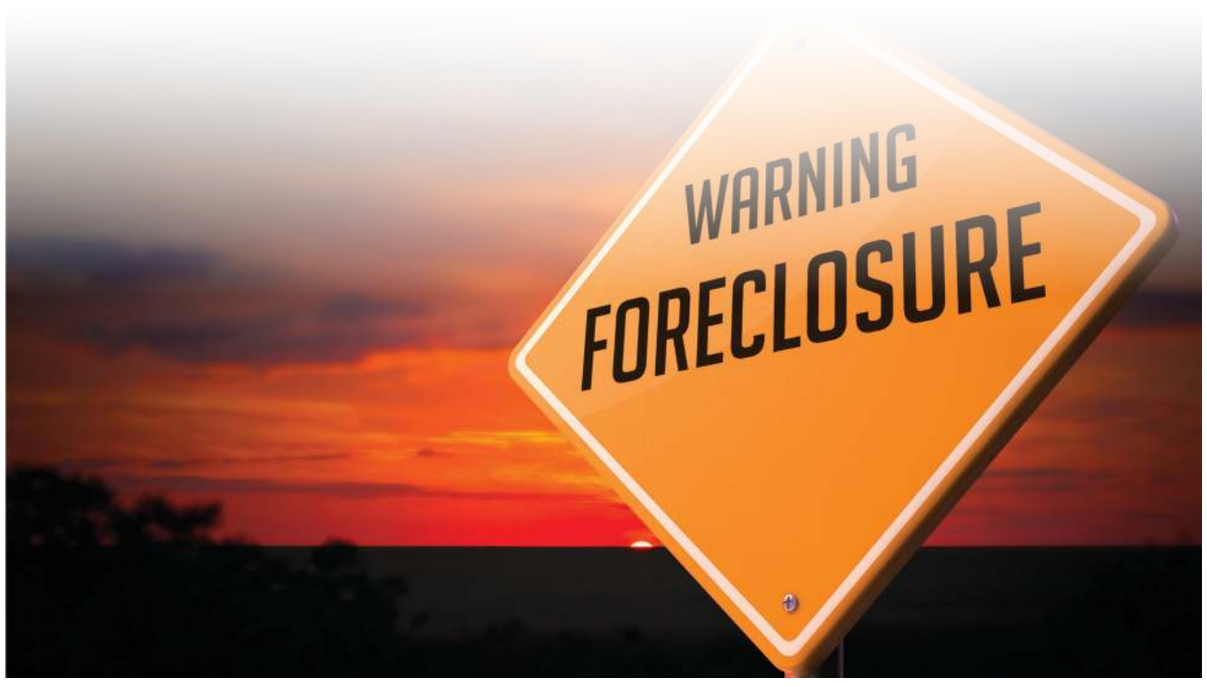
Notably, this disclosure requirement appears to apply to all providers engaging in commercial financing transactions, subject to the specific exemptions in new Section 22801 and irrespective of whether they are required to be licensed under the CFL because they engage in business as finance lenders or brokers. Such terms are defined broadly in the CFL to include entities engaging in the origination, brokering, or servicing of a multitude of consumer and commercial loan products. Notwithstanding the application of this requirement to all such providers, only providers licensed under the CFL will be subject to examination and enforcement by the commissioner upon the effective date of the commissioner's final regulations. Further, to the extent this disclosure requirement applies to a provider that is a passive secondary market investor in loans made under the CFL, it does not appear from the plain language of the revised CFL that there is any additional assignee liability under the revised CFL for such an investor. ■

Servicers Foreclosing on Massachusetts Mortgage Loans – Read This!

On February 8, the First Circuit Court of Appeals issued a noteworthy and troubling decision for servicers of defaulted loans in Massachusetts and potentially other jurisdictions within the First Circuit (i.e., Maine, New Hampshire, Rhode Island, and Puerto Rico). In *Thompson v. JPMorgan Chase Bank*, the court held that it is "potentially deceptive" to advise a borrower of its right to reinstate the mortgage loan after acceleration (in accordance with Paragraph 22 of the Fannie Mae/Freddie Mac form of mortgage) without also letting the borrower know that such right terminates five days before the foreclosure sale (as noted in Paragraph 19).

In this case, the borrowers argued that the servicer's default letter failed to strictly comply with the mortgage because the letter did not advise of the conditions and time limits associated with their post-acceleration reinstatement rights as described in Paragraph 19 of their mortgage—namely, that they would need to tender payment five days before sale in order to reinstate. While the court recognized that Paragraph 19 of the mortgage does not specifically impose any notice obligations, it held that the Paragraph 22 notice given to the mortgagor must still be accurate and not deceptive. The court further determined that the notice's language, which stated that the borrower could avoid foreclosure by paying the total past-due amount before a foreclosure sale takes place, could mislead the borrowers into thinking that they could wait until a few days before the sale to tender the required payment. The court was not swayed by the fact that the borrowers did not attempt to repay and reinstate and that the notice letter in question exactly replicated the notice set forth in 209 CMR 56.04.

The bottom line is that a foreclosure/reinstatement notice to a mortgagor must include the requisite timeline to reinstate in order to not be deemed deceptive under Massachusetts law and to comply with the express terms of the mortgage contract. To do otherwise risks voiding the impending foreclosure. ■



MPL Battle Over "True Lender" Continues to Drag On in Colorado

Strictly speaking, the *Marlette Funding* case was limited in scope to Colorado Internet-based consumer loans that exceed the state usury limit. However, the import of this case is such that we worry it could have wide-reaching implications throughout the marketplace lending (MPL) industry as a whole and its future viability.

Just to refresh, in bringing this lawsuit, the Colorado attorney general challenged the bank origination model, alleging that (1) the relationship between Marlette and Avant, the marketplace lenders, and the originating bank (in Marlette's case, Cross River Bank, and in Avant's case, WebBank) "is essentially a sham, a 'rent-a-bank arrangement'" in which each nonbank is using the bank's right of federal preemption to charge interest rates that circumvent Colorado's usury laws and Uniform Consumer Credit Code (UCCC); and (2) federal preemption is not applicable because Marlette and Avant are the "true lenders" based on their predominant economic interest in the loans made to Colorado consumers.

After some procedural to-ing and fro-ing, the Colorado court denied the defendants' motion to dismiss this past August, but granted motions of Cross River Bank and WebBank to intervene. As a result, the case will continue probing the true-lender issue. The thesis of this issue seems to coalesce around who bears the economic risks. Here, Marlette and Avant pay all costs, perform all marketing and underwriting, raise capital for funding the loans, bear the risk of loan default, and enjoy most of the profits from the loans. We think settlement of the case with the Colorado attorney general is unlikely at this point, and it appears that the case could continue to drag on for a lengthy period of time.

If the court ultimately determines that Marlette and Avant were the true lenders and therefore liable for usury and choice-of-law violations of the UCCC, we can surely expect a spate of similar challenges to be brought in other states where the interest rate charged exceeds the local usury limitation. Further, if MPL platforms are found to violate applicable state licensing laws, this could result in the voiding of its consumer loans under state law. Lastly, if the origination of the consumer loans by an MPL platform are found to have violated usury, choice of law, or licensing laws of an individual state, those loans sold to investors or securitized could expose the platform to substantial put-back claims based on a breach of loan level representations and warranties.

These stakes are high for the industry, and so we wait. ■

BANKRUPTCY Beat

Feeling Entitled to Make-Whole Premiums and Post-Petition Default Interest? Might Want to Avoid the Fifth Circuit

On January 17, 2019, the Fifth Circuit Court of Appeals issued another significant opinion concerning the viability/enforceability of a contractual "make-whole" provision as well as post-petition interest in bankruptcy. In the underlying *Ultra Petroleum Corp*. bankruptcy case, the debtors proposed a plan treating certain noteholder claimants as "unimpaired" by providing for the payment of the outstanding principal amount on their notes plus pre-petition interest at a rate of 0.1% and post-petition interest at the federal judgment rate. The noteholders objected, claiming impairment because the plan did not provide for payment of a contractual make-whole premium (totaling $201 million) and post-petition interest at the contractual default rate (totaling $186 million). Importantly, under the debtors' plan, they were solvent. The bankruptcy court agreed with the noteholders, holding that they were entitled to recover the make-whole amount and that the Bankruptcy Code did not limit their contractual right to receive post-petition interest at the default rate. The debtors appealed the bankruptcy court's ruling directly to the Fifth Circuit.

The Fifth Circuit vacated the bankruptcy court's decision and remanded with "guidance" on how it believes the bankruptcy court should address the issues. The court examined what constitutes impairment under a Chapter 11 plan, holding that, per the plain text of and existing authority on Section 1124(1) of the Bankruptcy Code, a creditor is impaired only if *the plan itself* alters a claimant's legal, equitable, or contractual rights. Because the bankruptcy court did not consider whether the Bankruptcy Code disallows payment of the make-whole amount or post-petition interest at the contractual default rate, the Fifth Circuit remanded on those specific issues. Although remanding, the court weighed in with its views.

Make-Whole Amount. The Fifth Circuit indicated that payment of a make-whole amount could be disallowed under Section 502(b)(2) of the Bankruptcy Code as a claim for "unmatured interest," on the grounds that (1) by definition, a make-whole amount is the economic equivalent of interest, because it is intended to compensate the lender for lost interest; and (2) the make-whole amount here was unmatured when the debtors filed their Chapter 11 petitions because the amount would only be triggered pursuant to an unenforceable acceleration upon bankruptcy (i.e., an ipso facto clause). Further, the court explicitly disagreed with other cases holding that make-whole amounts do not constitute unmatured interest.

Post-Petition Interest. While the Fifth Circuit acknowledged that the noteholders may be entitled to some post-petition interest because the debtors here were solvent, it did not determine the measure of the interest. It instead suggested two paths for determining the rate of post-petition interest: (1) 28 U.S.C. Section 1961(a), the general federal post-judgment interest statute, which allows interest "on any money judgment in a civil case recovered in a district court" and sets a rate referencing certain Treasury yields; and (2) a bankruptcy court's power to set an "equitable" rate of interest, which could potentially include the contractual default interest rate. The bankruptcy court will need to choose the path for such determination on remand. Unfortunately for noteholders, the Fifth Circuit determined that noteholders are not legally or contractually entitled to receive post-petition interest on a bankruptcy claim at the default rate.

A more detailed review of this case may be found in our advisory, "Fifth Circuit Rules on Payment of a Make-Whole Premium and Post-Petition Default Interest." ■

Another Cautionary Tale: Involuntary Petition Against Taberna CDO Dismissed

Market participants in the CDO, CLO, and securitization space should take note. An important decision regarding the filing of involuntary petitions by activist investors against a CDO known as Taberna IV was handed down in Q4 of last year in the Bankruptcy Court for the Southern District of New York. The overall takeaway is that activist investors in nonrecourse structures will face scrutiny when filing involuntary petitions to circumvent bargained-for liquidation provisions in credit documents.

In 2005, Taberna IV issued 11 classes of notes in the aggregate principal amount of $630,175,000 that descend in priority and have a stated maturity date of May 5, 2036. The note proceeds were used to purchase various types of securities securing the notes, which were intended to generate sufficient cash flow to repay the notes. Following an event of default under the indenture, the petitioning creditors purchased 100% of the A-1 notes and approximately 34% of the A-2 notes, and first attempted to liquidate the collateral. The liquidation efforts failed, and the petitioning creditors then filed an involuntary petition against Taberna IV, which was opposed by the collateral manager and several junior noteholders.

The court first ruled that the petitioning creditors lacked the requisite unsecured claims against Taberna IV and were therefore ineligible to file an involuntary petition because their notes were nonrecourse under the plain language of the indenture. Second, the court dismissed the case for "cause" under Section 1112(b) of the Bankruptcy Code. The court noted that a bankruptcy petition "must seek to create or preserve some value that would otherwise be lost—*not merely distributed to different a stakeholder*—outside of bankruptcy." The court also noted that there are facts present that could support a finding that the involuntary petition was brought in bad faith, but did not rule on that issue. Instead, the court reasoned that cause to dismiss existed because no bankruptcy purpose is served by the filing. Since the true legislative purpose of Chapter 11 is to facilitate the speedy rehabilitation of financially troubled businesses, and because Taberna IV was not an operating business, no rehabilitative objective can be served by allowing a bankruptcy case to proceed. Moreover, because the petitioning creditors sought out and contracted for Taberna's liquidation scheme—the process was set forth in the indenture—they would not suffer any prejudice if the case is dismissed. The court frowned upon the idea of essentially rewriting the terms of the indenture to force an accelerated liquidation, not a reorganization.

The court dismissed the involuntary petition, concluding that the petitioning creditors did not meet the requirements of Section 303(b) of the Bankruptcy Code and, therefore, were ineligible to commence an involuntary case against Taberna IV. The court also held that because the involuntary case served no legitimate bankruptcy purpose, petitioning creditors would not be prejudiced by dismissal and that dismissal was in the best interest of the creditors and the estate.

It is noteworthy that the Structured Finance Industry Group (SFIG) filed an amicus brief in the case, contending that the involuntary petition against Taberna IV is an attack on a core precept of the securitization industry—that is, nonrecourse securitization vehicles should be liquidated in accordance with the bargained-for waterfalls in the indenture. ■

ALSTON & BIRD ANNOTATIONS

Asset-Backed Alert recently ranked Alston & Bird among the top counsel for both issuers and underwriters of asset-backed and mortgage-backed securities. Alston & Bird was ranked #10 as counsel to issuers in 13 deals—more than double the number for 2017. We were ranked #20 among counsel to deal underwriters.

Please join us for our SFIG Kick-off Reception on Sunday, February 24, 8-10pm, at Aria's Lift Bar

Please join us for our NYC event "Journey to the Top: Women Leaders Reflect on Challenges, Opportunities, and Lessons Learned" on Thursday, March 7 at 6pm. Contact lindsey.fisher@alston.com to register

Save the Date for our NYC Finance Forum Wednesday, May 1

CONTRIBUTING AUTHORS

Aimee Cummo
Partner, Finance
Editor

Tara Castillo
Partner, Finance

Jonathan Edwards
Partner, Financial Restructuring & Reorganization

Clay Littlefield
Partner, Tax

Peter McKee
Partner, Finane

Steve Ornstein
Partner, Financal Services & Products

Richard Simonds
Partner, Finance

Michael Thimmig
Partner, Finance

Jim Vincequerra
Partner, Financial Restructuring & Reorganization

Nanci Weissgold
Partner, Financial Services & Products

William Hao
Counsel, Financial Restructuring & Reorganization

Lisa Lanham
Senior Associate, Financial Services & Products

Morey Barnes Yost
Senior Associate, Financial Services & Products

Kristen Truver
Senior Associate, Financial Services & Products

Finance

Michael Calandra
Partner, Finance
michael.calandra@alston.com
212-210-9426

Tara Castillo
Partner, Finance
tara.castillo@alston.com
202-239-3351

Shanell Cramer
Partner, Finance
shanell.cramer@alston.com
212-210-9580

Aimee Cummo
Partner, Finance
aimee.cummo@alston.com
212-210-9428

Karen Gelernt
Partner, Finance
karen.gelernt@alston.com
212-210-9535

Mark Harris
Partner, Finance
mark.harris@alston.com
214-922-3504

Mike Jewesson
Partner, Finance
mike.jewesson@alston.com
214-922-3511

Peter McKee
Partner, Finance
peter.mckee@alston.com
214-922-3501

Jeff O'Neale
Partner, Finance
jeffrey.oneale@alston.com
704-444-1044

Pat Sargent
Partner, Finance
patrick.sargent@alston.com
214-922-3502

Richard Simonds
Partner, Finance
richard.simonds@alston.com
212-210-9431

Michael Thimmig
Partner, Finance
michael.thimmig@alston.com
214-922-3421

Karen Wade
Partner, Finance
karen.wade@alston.com
214-922-3510

Charlie Marshall
Senior Counsel, Finance
charlie.marshall@alston.com
214.922.3503

Robin Boucard
Counsel, Finance
robin.boucard@alston.com
212-210-9454

John Caverlee
Counsel, Finance
john.caverlee@alston.com
214-922-3455

Ron Klein
Counsel, Finance
ronald.klein@alston.com
212-210-9588

Andrea Nixon
Senior Associate, Finance
andrea.nixon@alston.com
212-210-9442

STRUCTURED & WAREHOUSE FINANCE TEAM

Bradford Patterson
Senior Associate, Finance
bradford.patterson@alston.com
214-922-3513

Emily Redmerski
Senior Associate, Finance
emily.redmerski@alston.com
212-210-9589

Jon Ruiss
Senior Associate, Finance
jon.ruiss@alston.com
202-210-9508

Kristin Burnett
Associate, Finance
kristin.burnett@alston.com
214-922-3457

Lindsey Klein
Associate, Finance
lindsay.klein@alston.com
212.210.9513

J. Nicole Knox
Associate, Finance
nicole.knox@alston.com
212-210-9448

Robert O'Connor
Associate, Finance
robert.oconnor@alston.com
212-210-9555

Elizabeth Osborne
Associate, Finance
elizabeth.osborne@alston.com
212-210-9504

Jacob Walpert
Associate, Finance
jacob.walpert@alston.com
212-210-9489

Natalie Witter
Associate, Finance
natalie.witter@alston.com
212-210-9491

Financial Restructuring & Reorganization

Gerard Catalanello
Partner, Financial Restructuring & Reorganization
gerard.catalanello@alston.com
212-210-9509

Jonathan Edwards
Partner, Financial Restructuring & Reorganization
jonathan.edwards@alston.com
404-881-4985

Will Sugden
Partner, Financial Restructuring & Reorganization
will.sugden@alston.com
404-881-4778

James Vincequerra
Partner, Financial Restructuring & Reorganization
james.vincequerra@alston.com
212-210-9503

Tax

Clay Littlefield
Partner, Tax
clay.littlefield@alston.com
704-444-1440

Trust

Peter Barwick
Partner, Finance
peter.barwick@alston.com
704-444-1415

Patrick Hayden
Partner, Finance
patrick.hayden@alston.com
704-444-1453

Brad Johnson
Partner, Finance
brad.johnson@alston.com
704-444-1460

Antone Little
Senior Associate, Finance
antone.little@alston.com
704-444-1152

Bill Macurda
Partner, Finance
bill.macurda@alston.com
704-444-1335

Drew Peterson
Partner, Finance
drew.peterson@alston.com
704-444-1369

Adam Smith
Partner, Finance
adam.smith@alston.com
704-444-1127

Jason Solomon
Partner, Finance
jason.solomon@alston.com
704-444-1295

ERISA

Blake MacKay
Partner, Employee Benefits
blake.mackay@alston.com
404-881-4982

‘40 Act

David Baum
Partner, Financial Services
david.baum@alston.com
202-239-3346

UCC

Noël Para
Partner, Financial Services
noel.para@alston.com
212-210-9556

Servicing

Jamie Daniel
Partner, Finance
jamie.daniel@alston.com
704-444-1436

Bob Sullivan
Partner, Finance
robert.sullivan@alston.com
704-444-1293

STRUCTURED & WAREHOUSE FINANCE TEAM

Regulatory

Steve Ornstein
Partner, Financial Services & Products
stephen.ornstein@alston.com
202-239-3844

Cliff Stanford
Partner, Financial Services & Products
cliff.stanford@alston.com
404-881-7833

Nanci Weissgold
Partner, Financial Services & Products
nanci.weissgold@alston.com
202-239-3189

Real Estate

Meryl Diamond
Partner, Real Estate Finance
meryl.diamond@alston.com
212-210-9579

Ellen Goodwin
Partner, Real Estate Finance
ellen.goodwin@alston.com
212-210-9447

Gerard Keegan
Partner, Real Estate Finance
gerard.keegan@alston.com
212-210-9558

Steve Collier
Counsel, Real Estate Finance
steve.collier@alston.com
404-881-7638

Litigation

John Doherty
Partner, Litigation
john.doherty@alston.com
212-210-1282

ALSTON & BIRD | Finance

Atlanta | Beijing | Brussels | Charlotte | Dallas | Los Angeles | New York | Raleigh | San Francisco | Silicon Valley | Washington, D.C.