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BUSINESS RESTRUCTURING REVIEW

# TENANT'S ELECTION TO RETAIN POSSESSION OF REJECTED LEASE PREMISES PRESERVES OBLIGATIONS UNDER RELATED AGREEMENTS

**Daniel J. Merrett ■ Mark G. Douglas**

Section 365(h) of the Bankruptcy Code provides special protection for tenants if a trustee or chapter 11 debtor-in-possession ("DIP") rejects an unexpired lease under which the debtor was the lessor by giving the tenant the option of retaining possession of the leased premises. Although the provision clearly describes what rights a tenant has if it makes such an election, it does not unequivocally address the extent of the electing tenant's obligations under the rejected lease or any related agreements. The U.S. Court of Appeals for the Sixth Circuit recently examined this question in *EPLET, LLC v. DTE Pontiac N., LLC*, 984 F.3d 493 (6th Cir. 2021). The court reversed a district court's dismissal of environmental remediation claims asserted by a chapter 11 litigation trust against the guarantor of a tenant's obligations under a services agreement that, together with a rejected lease, was part of an integrated transaction. According to the Sixth Circuit, by electing to retain possession of the leased premises under section 365(h), the guaranty was "likewise joined to [the tenant's] § 365(h) election."

## REJECTION IN BANKRUPTCY OF UNEXPIRED LEASES UNDER WHICH THE DEBTOR IS THE LESSOR

Section 365(a) of the Bankruptcy Code provides that, subject to bankruptcy court approval, a bankruptcy trustee or DIP (pursuant to section 1107(a)) "may assume or reject any executory contract or unexpired lease of the debtor." Rejection of a contract or lease that has not been previously assumed by the trustee constitutes a breach of the agreement as of immediately preceding the bankruptcy petition date. *See* 11 U.S.C. § 365(g).

Section 365(h)(1) provides that, if the trustee or DIP rejects an unexpired real property lease under which the debtor is the lessor, the nondebtor lessee (and any permitted successor or assign, pursuant to subsection (h)(1)(D)) has the option of either treating the lease as terminated or retaining its rights under the lease for the balance of the lease term. In particular, section 365(h)(1)(A) provides as follows:

> If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and—
>
> (i) if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy

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law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or

(ii) if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.

11 U.S.C. § 365(h)(1)(A). Pursuant to section 365(h)(1)(B), a tenant electing to retain its rights under a rejected lease may offset future rent against any damages caused by the debtor-lessor's nonperformance after the rejection date, but cannot assert a claim against the estate.


In enacting section 365(h)(1), lawmakers sought to "codify a delicate balance between the rights of a debtor-lessor and the rights of its tenants" by preserving the parties' expectations in a real estate transaction. *In re Lee Road Partners, Ltd.*, 155 B.R. 55, 60 (Bankr. E.D.N.Y. 1993). The provision's legislative history indicates that lawmakers intended that rejection of a lease by a debtor-lessor should not deprive the tenant of its estate for the term for which it bargained. *See* H.R. Rep. No. 95-595, 349–50 (1977); S. Rep. No. 95-989, 60 (1978).

Rejection of a lease or contract does not relieve any guarantor of the lease or contract from liability, although any claim of a lessor against both the debtor-tenant and any debtor-guarantor of a lease arising from *termination* of the lease may be capped under section 502(b)(6). *See In re Concepts Am., Inc.*, 621 B.R. 848, 861 (Bankr. N.D. Ill. 2020); *See In re Emple Knitting Mills, Inc.*, 123 B.R. 688, 691 (Bankr. D. Me. 1991).

## *EPLET*

In 2007, a manufacturer sold a Michigan power plant to energy company DTE Energy Pontiac North, LLC ("Pontiac") and leased the land under the plant to Pontiac for 10 years. In addition to the land lease agreement ("Lease") and the asset purchase agreement ("APA"), the manufacturer and Pontiac entered into a utility services agreement ("UA") whereby Pontiac agreed to provide steam, compressed air and electricity to an adjacent factory owned by the manufacturer and covenanted to adhere to certain maintenance and environmental obligations. Pontiac's corporate parent DTE Energy Services, Inc. ("DTE") executed a guaranty ("Guaranty") of Pontiac's obligations under the UA and granted an indemnity to the manufacturer for any environmental liabilities arising from the operation of the power plant ("Indemnity"). The APA, the Lease and the UA ("Associated Agreements") each contained a provision confirming that all of the agreements documenting the transaction were executed as part of a single "integrated" transaction.

The manufacturer filed for chapter 11 in 2009. Because it no longer required utility services provided from the plant, the manufacturer sought court authority to reject the UA. Pontiac opposed rejection, arguing that the UA could not be rejected alone because the Associated Agreements were part of an integrated transaction. In 2011, after the parties settled the dispute, the court authorized the manufacturer to reject each of the Associated Agreements. Pontiac then filed an unsecured proof of claim for damages arising from the manufacturer's breach of the contracts. However, it later elected to retain possession of the leased premises under section 365(h).

The bankruptcy court confirmed the manufacturer's chapter 11 plan in 2011. The plan created a trust ("Trust") to remediate the manufacturer's environmental liabilities and assume ownership of certain properties owned by the manufacturer, including the land on which the Michigan power plant was located.

Following rejection of the Lease and the other Associated Agreements, Pontiac retained possession of the leased premises until 2017, after which the Trust discovered that the property had not been maintained and required substantial environmental remediation. The Trust accordingly sued Pontiac and DTE (both under a veil-piercing theory and as guarantor) in federal district court for, among other things, breach of the Associated Agreements, breach of the Guaranty and violation of environmental laws.

The district court dismissed the direct claims against DTE, ruling that the Trust failed to plead a valid veil-piercing theory of liability. The court also dismissed the breach of contract and breach of guaranty claims against both Pontiac and DTE, concluding that the Associated Agreements (and, by extension, the Guaranty) had terminated after the manufacturer rejected them in bankruptcy and the limitations period for bringing suit to collect under the documents had expired. The Trust appealed to the Sixth Circuit.

## THE SIXTH CIRCUIT'S RULING

A three-judge panel of the Sixth Circuit considered two issues on appeal: (i) whether the Trust's veil-piercing claims against DTE were adequately pleaded; and (ii) whether Pontiac's section 365(h) election "preserved its obligations under the [UA] and, by extension, [DTE's] obligations under the [Guaranty]."

Writing for the panel, Circuit Judge Richard A. Griffin faulted the district court's dismissal of the Trust's veil-piercing claim against DTE. He determined that the Trust had sufficiently pleaded facts that supported piercing the corporate veil under Michigan law.

Next, Judge Griffin examined whether the Guaranty survived rejection of the Associated Agreements in the manufacturer's bankruptcy. The Trust argued that, when Pontiac elected to continue to occupy the premises under the Lease, "it also preserved its obligations under the [UA], which in turn preserved [DTE's] responsibilities under the [Guaranty]." Pontiac and DTE countered that the Guaranty expired when the UA terminated after being rejected, leaving only the unguaranteed Lease.

Judge Griffin explained that, under section 365(g), rejection of a contract does not terminate it, but instead constitutes a breach. Under section 365(h)(1), he noted, the tenant under a lease rejected by the trustee then has the option to treat the lease as terminated in accordance with its terms or applicable non-bankruptcy law, or to remain in possession for the remaining term of the lease. "In effect," Judge Griffin wrote, "a tenant who elects to continue a lease under § 365(h)(1)(A)(ii) waives the debtor's breach and instead opts to continue under the lease's existing terms and obligations, albeit with a more limited right of recovery against its landlord for breaches."

According to Judge Griffin, a contract or lease must be assumed or rejected in its entirety unless an agreement is "severable" from the remainder of the contract or lease, in which case that agreement may be assumed or rejected without assuming or rejecting the rest of the contract or lease. In addition, he noted, when two or more agreements are part of an "integrated transaction," a trustee may not assume one agreement without also assuming all other integrated agreements. These principles, he explained, are relevant to the analysis under section 365(h):

> Typically, the question is whether contracts assumed by the trustee or debtor-in-possession are severable. But we see no reason why the analysis would be any different when evaluating whether a tenant's obligations are severable after a § 365(h) election. If the obligations are part of one contract as a matter of law, and the tenant elects to retain the benefits of that contract through § 365(h), it must also assume the contract's obligations. Defendants offer no reason why § 365 would allow a tenant, but not a debtor, to assume the benefits of a contract while rejecting its burdens or assume integrated contracts on a piecemeal basis.

*EPLET*, 2021 WL 37496, at *9 n.4 (citing *City of Covington v. Convington Landing Ltd. P'ship*, 71 F.3d 1221, 1226 (6th Cir. 1995); *In re Spanish Peaks Holdings, II, LLC*, 872 F.3d 892, 900 (9th Cir. 2017) (section 365(h) evinces "a clear intent to protect lessees' rights outside of bankruptcy, not an intent to enhance them")).

Under Michigan law, Judge Griffin concluded, the UA and the Lease were not severable, but interdependent, based on the parties' intent, the agreements' common subject matter and Pontiac's representations to that effect in the manufacturer's chapter 11 case. The Sixth Circuit accordingly ruled that: (i) the district court erred in finding that the Lease and the UA were severable as a matter of law at the motion to dismiss stage; (ii) Pontiac "could not elect to continue the [L]ease under 11 U.S.C. § 365(h) without its related obligations under the [UA]"; and (iii) because DTE guaranteed Pontiac's obligations under the UA, including environmental remediation obligations, the Guaranty "is likewise joined to Pontiac's § 365(h) election."

In so ruling, the Sixth Circuit rejected the argument that a non-severability finding would lead to an absurd result because, once the manufacturer shut down the factory to which Pontiac was supplying utilities services under the UA, no utilities could be bought or sold under the agreement. According to the court, the UA contemplated not only the provision of utilities, but also environmental and maintenance obligations, the breach of which was the crux of the Trust's lawsuit.

Finally, the Sixth Circuit rejected the argument that Pontiac's assertion of a rejection claim and subsequent nonperformance under the Lease terminated the UA. It also invalidated the district court's statute of limitations ruling, holding that the obligations of Pontiac and DTE under the Associated Agreements and the Guaranty survived until Pontiac vacated the premises in 2017, which was "well within the six-year statute of limitations" for bringing suit.

The Sixth Circuit remanded the case below in light of its ruling.

## OUTLOOK

The Sixth Circuit's decision in *EPLET* is notable for several reasons. First, given the court's conclusions that the Associated Agreements (and, by extension, the Guaranty) were not terminated after the manufacturer rejected them and that the statute of limitations had not expired, it is unclear why the Sixth Circuit proceeded to find that the obligations of the parties under the UA and the Guaranty were preserved when Pontiac elected to retain possession of the leased premises under section 365(h). If DTE's guaranty of Pontiac's obligations under the UA (including the environmental and maintenance covenants) was still enforceable, the Sixth Circuit's section 365(h) ruling was unnecessary. Why the Trust did not succeed to the manufacturer's rights against DTE under the Indemnity as an independent path to recovery is also unclear.

Second, section 365(h)(1) says nothing about the rights or obligations of parties other than the electing tenant or the debtor. It also does not address what impact the tenant's election has on related agreements (whether severable or not) involving other parties. Thus, the Sixth Circuit's ruling appears to have imposed requirements going beyond the express terms of section 365(h).

# WASHINGTON BANKRUPTCY COURT APPROVES CHAPTER 11 PLAN EXCULPATION AND RELEASE PROVISIONS

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There is longstanding controversy concerning the validity of release and exculpation provisions in non-asbestos trust chapter 11 plans that limit the potential exposure of various parties involved in the process of negotiating, implementing and funding the plan. The U.S. Bankruptcy Court for the Eastern District of Washington recently contributed to the extensive body of case law addressing these issues in *In re Astria Health*, 623 B.R. 793 (Bankr. E.D. Wash. 2021). The court ruled that the Bankruptcy Code did not prohibit and, instead, authorized a chapter 11 plan to include a plan exculpation clause and voluntary nondebtor releases. Its reasoning could signal that courts in the Ninth Circuit may be less hostile to such provisions than in the past.

## RELEASES V. EXCULPATION CLAUSES

Releases can provide for the relinquishment of both prepetition and postpetition claims belonging to the debtor or nondebtor third parties (e.g., creditors) against various nondebtors. Exculpation clauses, by contrast, specify the scope of, or the standard of care governing, an exculpated party's liability (e.g., ordinary negligence, gross negligence or willful misconduct) for conduct during the course of the bankruptcy case. *See In re Murray Metallurgical Coal Holdings, LLC,* 2021 WL 105622, *40 (Bankr. S.D. Ohio Jan. 11, 2021); *In re Friedman's, Inc.*, 356 B.R. 758, 764 (Bankr. S.D. Ga. 2005); *see also Blixseth v. Credit Suisse*, 961 F.3d 1074, 1084 (9th Cir. 2020) (distinguishing releases and exculpation clauses). Both releases and exculpation clauses have become common features of chapter 11 plans, but nondebtor releases are more controversial.

## VALIDITY OF CHAPTER 11 PLAN RELEASES AND EXCULPATION CLAUSES

It is generally accepted that a chapter 11 plan can release nondebtors from claims of other nondebtor third parties if the release is consensual. *See generally* COLLIER ON BANKRUPTCY ¶ 524.05 (16th ed. 2020) (citing cases). Such consensual releases are commonly agreed upon by creditors in connection with their vote to accept the plan. In addition, a plan that establishes a trust under section 524(g) of the Bankruptcy Code to fund payments to asbestos claimants can enjoin litigation against certain third parties (e.g., entities related to the debtor or its insurers) alleged to be liable for the debtor's conduct. *See* 11 U.S.C. § 524(g)(4).

The circuit courts of appeals are split as to whether a bankruptcy court has the authority to approve chapter 11 plan provisions that, over the objection of creditors or other stakeholders, release specified nondebtors from liability or enjoin dissenting stakeholders from asserting claims against such nondebtors. The minority view, held by the Fifth and Tenth Circuits—and until 2020, arguably the Ninth Circuit (see below)—bans such nonconsensual releases on the basis that they are prohibited by section 524(e) of the Bankruptcy Code, which provides generally that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." *See Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009); *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394 (9th Cir. 1995); *In re W. Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990); *see also Blixseth*, 961 F.3d at 1083-84 (suggesting, contrary to *Lowenschuss* and other previous rulings, that section 524(e) does not preclude certain nondebtor plan releases of claims that are not based on the debt discharged by the plan).

On the other hand, the majority of the circuits that have considered the issue have found such releases and injunctions permissible under certain circumstances. *See SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, 780 F.3d 1070 (11th Cir. 2015); *In re Airadigm Commc'ns, Inc.*, 519 F.3d 640 (7th Cir. 2008); *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002); *In re Drexel Burnham Lambert Grp., Inc.*, 960 F.2d 285 (2d Cir. 1992); *In re A.H. Robins Co., Inc.*, 880 F.2d 694 (4th Cir. 1989). For authority, these courts generally rely on section 105(a) of the Bankruptcy Code, which authorizes courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." Moreover, as the Seventh Circuit held in *Airadigm*, the majority view is that section 524(e) does not limit a bankruptcy court's authority to grant such releases. *Airadigm*, 519 F.3d at 656 ("If Congress meant to include such a limit, it would have used the mandatory terms 'shall' or 'will' rather than the definitional term 'does.' And it would have omitted the prepositional phrase 'on, or . . . for, such debt,' ensuring that the 'discharge of a debt of the debtor shall not affect the liability of another entity'—whether related to a debt or not.").

Some courts have also relied on section 1123(b)(6) of the Bankruptcy Code, which provides that a chapter 11 plan may "include any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]," as authority for involuntary releases. *See Airadigm*, 519 F.3d at 657; *In re Scrub Island Dev. Grp. Ltd.*, 523 B.R. 862, 875 (Bankr. M.D. Fla. 2015).

The First and D.C. Circuits have suggested that they agree with the "pro-release" majority that finds such provision permissible under certain circumstances. *See In re Monarch Life Ins. Co.*, 65 F.3d 973 (1st Cir. 1995) (a debtor's subsidiary was collaterally estopped by a plan confirmation order from belatedly challenging the jurisdiction of the bankruptcy court to permanently enjoin lawsuits against the debtor's attorneys and other nondebtors not contributing to the debtor's reorganization); *In re AOV Indus.*, 792 F.2d 1140 (D.C. Cir. 1986) (a plan provision releasing liabilities of nondebtors was unfair because the plan did not provide additional compensation to a creditor whose claim against


the nondebtor was being released; adequate consideration must be provided to a creditor forced to release claims against nondebtors).

In *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019), the Third Circuit refrained from "broadly sanctioning the permissibility of nonconsensual third-party releases in bankruptcy reorganization plans," but, based on the "specific, exceptional facts" of the case, upheld a lower court decision confirming a chapter 11 plan containing nonconsensual third-party releases, finding that the order confirming the plan did not violate Article III of the U.S. Constitution.

Even courts in the majority camp acknowledge that nonconsensual plan releases should be approved only in rare or usual cases. *See Seaside*, 780 F.3d at 1078; *Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 347-50 (4th Cir. 2014); *Behrmann v. Nat'l Heritage Found.*, 663 F.3d 704, 712 (4th Cir. 2011); *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141-43 (2d Cir. 2005).

Majority-view courts employ various tests to determine whether such releases are appropriate. Factors generally considered by courts evaluating third-party plan releases or injunctions include whether they are essential to the reorganization, whether the parties being released have made or are making a substantial financial contribution to the reorganization, and whether affected creditors overwhelmingly support the plan. *See Dow Corning*, 280 F.3d at 658 (listing factors).

Exculpation provisions have generally been approved provided the scope of the provisions is not overbroad. *See, e.g., Murray Metallurgical*, 2021 WL 105622, at *42 (approving an exculpation provision that extended protection to non-estate fiduciaries for claims that might be asserted against them based on the restructuring and also provided a carve-out for gross negligence, intentional fraud and willful misconduct; extension of the provision to acts and omissions occurring prepetition was not overly broad); *In re Aegean Marine Petroleum Network Inc.*, 599 B.R. 717, 721 (Bankr. S.D.N.Y. 2019) (noting that "an appropriate exculpation provision should say that it bars claims against the exculpated parties based on the negotiation, execution, and implementation of agreements and transactions that were approved by the Court").

In *Blixseth*, the Ninth Circuit held that nothing in the Bankruptcy Code—including section 524(e)—precludes plan exculpation clauses, and that such clauses may be approved under sections 105(a) and 1123(b)(6). In so ruling, the court wrote:

> Section 524(e) establishes that "discharge of a *debt* of the debtor does not affect the liability of any other entity on . . . *such debt*." . . . In other words, "the discharge in no way affects the liability of any other entity . . . for the *discharged* debt.". . . By its terms, § 524(e) prevents a bankruptcy court from extinguishing claims of creditors against non-debtors over the very debt discharged through the bankruptcy proceedings.
>
> A bankruptcy discharge thus protects the debtor from efforts to collect the debtor's discharged debt indirectly and outside of the bankruptcy proceedings; it does not, however, absolve a non-debtor's liabilities for that same "such" debt.

*Blixseth*, 961 F.3d at 1082–83 (citations omitted); *accord In re PWS Holding Corp.*, 228 F.3d 224, 245–46 (3d Cir. 2000). The Ninth Circuit also distinguished its previous rulings regarding section 524(e)'s preclusion of third-party plan releases. All of those cases, the court wrote, "involved sweeping nondebtor releases from creditors' claims on the debts discharged in the bankruptcy, not releases of participants in the plan development and approval process for actions taken during those processes." *Blixseth*, 961 F.3d at 1083–84.

Although *Blixseth* involved an exculpation clause, the Ninth Circuit's reasoning arguably indicates that section 524(e) does not preclude nondebtor chapter 11 plan releases, provided the claims released are not based on the "debt" discharged under the plan, such as claims against co-obligors or guarantors). Thus, with this caveat, the Ninth Circuit arguably joined the majority camp on the validity of certain kinds of nondebtor releases.

### *ASTRIA HEALTH*

Astria Health ("Astria") owned and operated hospitals and health care clinics in Washington. It filed for chapter 11 protection in May 2019 in the Eastern District of Washington. Astria clashed with its main secured creditor and postpetition lender, Lapis Advisers LP ("Lapis"), and Astria's unsecured creditors' committee ("committee") on many aspects of the case during the next year. However, the combatants ultimately reached a global settlement incorporated into a plan of reorganization that all voting classes accepted by significant margins.

The chapter 11 plan included the following release and exculpation provisions as part of the settlement:

> Key case participants, including Astria, Lapis, the committee, directors and certain other parties would be exculpated from liability arising from their postpetition conduct in connection with, among other things, the chapter 11 case or formulating, confirming or implementing the plan or any related agreements, except for liability stemming from any act or omission determined to be gross negligence or willful misconduct.
>
> Astria and its estate would release substantially the same entities from all causes of action arising from or related in any way to, among other things, Astria, its assets, management of Astria, the chapter 11 case or any restructuring of claims or interests undertaken prior to the plan's effective date.
>
> Various non-debtors, including creditors that voted to accept the plan and did not affirmatively opt out of the third-party release on their plan ballots, would release substantially the same parties for similar claims.

Therefore, under the plan, an individual creditor would not release any nondebtor unless the creditor voted to accept the plan and did not opt out of the releases on its ballot. The plan did not treat creditors that elected not to opt out differently from those that made the opt-out election.

The Office of the U.S. Trustee ("UST") objected to confirmation of the plan, arguing that the plan's release and exculpation provisions were overbroad and inconsistent with Ninth Circuit precedent.

### THE BANKRUPTCY COURT'S RULING

The bankruptcy court overruled the UST's objections and confirmed Astria's chapter 11 plan.

Initially, Bankruptcy Judge Whitman L. Holt explained that lawmakers "recognized the futility of any exercise to anticipate the boundless issues requiring treatment in a given chapter 11 plan." For this reason, Congress included section 1123(b)(6) in the Bankruptcy Code, which "invites creativity in drafting a plan" and permits plan proponents to tailor a plan to the particular requirements of any given case, provided the terms of the plan are not inconsistent with other provisions of the Bankruptcy Code.

Because nothing in the Bankruptcy Code prohibits (or even addresses) exculpation provisions in a plan, Judge Holt reasoned, section 1123(b)(6) permits such plan provisions—a conclusion that the Ninth Circuit validated in *Blixseth*. He rejected the UST's argument that the exculpation clause was improperly broad because it: (i) covered conduct during the entire postpetition period; (ii) included parties with no role in the reorganization or who were not bankruptcy estate fiduciaries; and (iii) excused culpable conduct.

According to Judge Holt, "[a]n exculpation provision may sweep broadly and cover the entire period after the filing of a bankruptcy petition" because establishing a standard of care in the bankruptcy case that shields parties from liability under state law is clearly within a bankruptcy court's power and exclusive jurisdiction. He further explained that all of the parties covered by the clause played a significant role during the chapter 11 case and "engaged in conduct potentially subject to second guessing or hindsight-driven criticism."

Judge Holt noted that, although some courts in other jurisdictions limit exculpation to estate fiduciaries, the Ninth Circuit considered the question and expressly declined to do so in *Blixseth*. He further reasoned that such a limitation would be inconsistent with section 1125(e), which protects parties, including creditors who are not estate fiduciaries, from liability for good-faith acts related to soliciting votes for a plan. The judge explained that, if the Bankruptcy Code provides such protection for a creditor who is a plan proponent, "then logic and fairness would not be served by excluding the same creditor from participating in plan-based exculpation," particularly if the party actively participated in and contributed to the progress of the bankruptcy case.

Finally, the judge concluded that the exculpation provision was not overly broad because it expressly carved out gross negligence or willful misconduct, consistent with requirements several other courts have "imposed to prevent exculpation clauses from transforming into overbroad releases."

Next, Judge Holt ruled that the plan's release of claims belonging to the estate was appropriate. However, instead of relying on section 1123(b)(6), he invoked section 1123(b)(3)(A), which provides that a plan may provide for "the settlement or adjustment of any claim or interest belonging to the debtor or to the estate." According to Judge Holt, the proposed estate releases satisfied Ninth Circuit precedent governing the approval of settlements, even applying heightened scrutiny to compromises or releases benefiting insiders. Among other things, he wrote, "the plan's global settlement, including the releases of estate claims, is in the paramount interests of creditors as evidenced by key stakeholder support for confirmation and the overwhelming acceptance of the plan by voting classes."

Finally, Judge Holt held that the plan's release of claims of nondebtors against other nondebtors did not violate section 524(e) and was appropriate under section 1123(b)(6).

In *Blixseth*, he explained, the Ninth Circuit "clarified and corrected [the] misguided conventional wisdom" regarding section 524(e). According to Judge Holt, *Blixseth* clarified that the limitation in section 524(e) applies only to a "debt" owed by the debtor, thereby precluding a court from "'extinguishing claims of creditors against nondebtors over the very debt discharged through the bankruptcy proceedings'" (quoting *Blixseth*, 961 F.3d at 1082).

"Based on this crucial distinction," Judge Holt wrote, "section 524(e) prevents a chapter 11 plan from releasing a nondebtor co-obligor of the debtor from liability on a common claim, but is inapplicable to the release of other claims against the nondebtor." Therefore, he ruled, "a release of these other claims is . . . permissible using the bankruptcy court's residual reorganizational powers under the circumstances." Because the nondebtor releases in Astria's plan did not relate to any liability common to Astria and any released party, Judge Holt concluded that "section 524(e) has no relevance to the court's evaluation."

In addition, Judge Holt explained that the nondebtor releases were "entirely consensual under any framework" because: (i) individual creditors would not release any nondebtors unless the creditors affirmatively voted to accept the plan *and* separately elected not to opt out; and (ii) any creditor who declined to provide a release would not be penalized.

Based on all of the foregoing, Judge Holt held that the nondebtor releases "are a feature permissibly included in a plan pursuant to Bankruptcy Code section 1123(b)(6)."

### OUTLOOK

In *Astria Health*, the bankruptcy court concluded that the rationale applied by the Ninth Circuit in *Blixseth* to plan exculpation clauses applied to the consensual, nondebtor releases included in the debtor's chapter 11 plan. Even so, it would be premature to declare that the Ninth Circuit rests firmly in the majority camp on the validity of nondebtor releases. The Ninth Circuit did not consider the validity of a nondebtor release in a chapter 11 plan in *Blixseth*, but the court's analysis of the scope of section 524(e) suggests that such releases should not be barred by the Bankruptcy Code.

It bears adding that neither *Astria Health* nor *Blixseth* involved involuntary nondebtor releases. Thus, these rulings do not clarify the Ninth Circuit's approach to this controversial issue.

## LEGISLATIVE UPDATE: NEW AUSTRALIAN INSOLVENCY LAW REFORMS ENACTED FOR SMALL BUSINESSES

**Roger Dobson ■ Katie Higgins ■ Kane Kersaitis**
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In response to the emergence of the COVID-19 pandemic in Australia in 2020, the federal government injected an unprecedented level of stimulus into the Australian economy and introduced temporary law reforms aimed at protecting against an anticipated "tidal wave" of insolvencies. These temporary law reforms included a moratorium on civil liability for insolvent trading for directors and increased thresholds and time frames for responding to statutory demands.

The majority of these temporary relief measures came to an end on December 31, 2020, and in an attempt to address the expected resulting rise in insolvencies, the federal government has implemented a number of permanent insolvency law reforms intended to assist small businesses restructure their debts in 2021 and beyond. These reforms, which were analyzed as draft legislation in a Jones Day *White Paper* in October 2020, have been passed by the government and have come into effect from January 1, 2021. The reforms introduce a new reorganization process, a simplified liquidation process, and some changes to the licensing of liquidators.

The reforms apply to "small businesses," which are companies in Australia with liabilities of less than A$1 million. The federal government has suggested this will capture around 76% of businesses subject to insolvencies today.

### THE "DEBTOR IN POSSESSION" REORGANIZATION PROCESS FOR SMALL BUSINESSES

The centerpiece of the reforms is a new reorganization process, which the federal government has emphasized is similar to a Chapter 11 process under the Bankruptcy Code in the United States, in that it is a "debtor in possession" model. However, unlike a Chapter 11 reorganization, the new reorganization process is an out-of-court process and generally does not allow for secured claims to be compromised.

The new reorganization process is in fact more like a hybrid of a safe harbor for insolvent trading and a streamlined voluntary administration process (which already exists under Part 5.3A of the Corporations Act 2001). It aims to provide small businesses with a quicker and simpler way to restructure their existing debts and maximize their chances of continuing as a business.

The new reorganization process for small businesses involves the following general steps:

1. The small business announces its intention to access the restructuring process. The directors have discretion on

whether or not to commence this process, but they must be satisfied that in their opinion the company is insolvent, or is likely to become insolvent at some future time. The company must also have total liabilities of less than A$1 million on the day that the restructuring begins.

2. The directors of the business appoint a small business restructuring practitioner (or "SBRP") who helps the business develop a restructuring plan. A moratorium on enforcement action by certain creditors against the company commences upon appointment of the SBRP. The directors continue to control the business and trade in the ordinary course, while they work alongside the SBRP to develop a restructuring plan over 20 business days. The directors have a safe harbor for civil liability for insolvent trading during the restructuring of the company.
3. After this 20-business-day period, the business sends the plan and supporting documents to creditors, and the SBRP declares that, if the restructuring plan is made, the company is likely to be able to discharge the obligations created by the plan. The company must have lodged any outstanding tax returns and paid any outstanding employee entitlements before the plan is put to creditors.
4. Creditors vote on the proposed plan. If a majority of creditors voting by value approve the plan, the plan is then binding on all unsecured creditors (and secured creditors to the extent that any part of their debt exceeds the value of their security interest).
5. If the plan is approved, the SBRP administers the plan and makes distributions to creditors while the business continues to be run as normal by the directors. If the plan is not approved, the directors may place the company into voluntary administration or liquidation.


## TEMPORARY RELIEF

The new laws also introduce a temporary relief period between January 1, 2021, and March 31, 2021, for businesses that wish to engage an SBRP and enter into a restructuring process, but have been unable to find a practitioner or otherwise enter into the process. This is because there may not be enough SBRPs in the early stages of 2021 to service those companies that wish to restructure.

In order to avail themselves of this temporary relief period, the directors of the business must make a declaration in writing that sets out that there are reasonable grounds to believe the that: (i) company is insolvent and otherwise eligible for a small business restructuring; (ii) the board has resolved that a restructuring practitioner should be appointed; and (iii) there is no SBRP or administrator for the company. This declaration must be provided to the Australian corporate regulator, ASIC, within five business days of being made.

The temporary relief provides eligible businesses with a safe harbor from insolvent trading and protection against statutory demands—statutory demands may be issued against the company only for debts above A$20,000 (instead of the threshold of A$2,000 applicable to all other companies) and the company has six months to respond to a demand (instead of the deadline of 21 days applicable to all other companies).

**The Simplified Liquidation Process**

From January 1, 2021, small businesses with liabilities of less than A$1 million will also be able to access a new simplified liquidation process. This process will retain the basic structure of existing liquidations in Australia, but with time and cost savings through reduced investigative and reporting requirements, and without the requirement for holding meetings of creditors.

The key features of the simplified liquidation process are:

1. Liquidators have narrower obligations to report on potential misconduct by officers or employees of the company in liquidation (as is typically required by Section 533 of the Corporations Act 2001).
2. Liquidators have reduced requirements to convene meetings of creditors.
3. There are reduced circumstances in which unfair preference payments made by a company are voidable, including if such payments occurred more than three months prior to commencement of a liquidation or the payments involve amounts of less than A$30,000.
4. There are relaxed requirements regarding creditors' proofs of debt and the processes for liquidators to pay out dividends to creditors.

## RELAXED LICENSING REQUIREMENTS

The suite of reforms also includes changes to the Insolvency Practice Rules (Corporations) 2016 to allow for relaxed requirements for the licensing of liquidators if they intend to practice only as SBRPs. In short, the relatively onerous requirements for the licensing of liquidators are relaxed for those who intend to practice only as SBRPs. For example, accountants may be appointed as SBRPs and need not have extensive specialist insolvency or liquidation training.

## KEY ISSUES AND TAKEAWAYS

The small business insolvency law reforms have been met with mixed responses in Australia. Some insolvency practitioners and lawyers have criticized the minimal qualifications, experience, and licensing requirements for the new subcategory of liquidators licensed only to act as SBRPs. Their concern is that those who will qualify for licensing will not have sufficient understanding of Australia's insolvency regime to competently fulfil their duties.

In addition, there are other key issues arising from the reforms, including:

1. Debts incurred after the appointment of the SBRP do not have priority over unsecured debts incurred before the restructuring. This means it may be difficult for small businesses to retain staff and maintain relationships with key suppliers during the restructuring process, as employees and suppliers will have no comfort that their debts will be paid ahead of existing unsecured creditors.
2. The duties and liabilities of SBRPs are not commensurate with the scope of their role, powers, and remuneration. SBRPs are treated as "officers" of the company once appointed, exposing them to directors' duties under the Corporations Act 2001, as well as potentially significant liabilities under workplace or occupational health and safety and environmental laws. In contrast, SBRPs have limited control over the business, which remains in the hands of the directors in a "debtor in possession" style process. This means that SBRPs may be exposed to potential liabilities that are not commensurate with their comparatively limited responsibilities, notwithstanding the introduction of Regulation 5.3B.42 to the Corporations Regulations 2001, which aims to protect SBRPs from liability for conduct "in good faith and without negligence."
3. The restructuring period is defined in Section 453A of the Corporations Act 2001 and Regulation 5.3B.02 of the Corporations Regulations 2001 as being (typically) the period beginning when an SBRP is appointed and ending when the company makes a restructuring plan that is approved by creditors. Notably, it does not include the period in which the restructuring plan is actually implemented. It remains to be seen how effective this will be in ensuring that restructuring plans approved by creditors are implemented properly and efficiently.

It is still not clear whether the anticipated "tidal wave" of insolvencies in Australia will result in the wide-scale adoption of the federal government's new restructuring processes for small businesses. As of January 25, 2021, no businesses have made use of the new reorganization process, and only five businesses have announced their intention to access the temporary restructuring relief period between January 1, 2021, and March 31, 2021.

Financiers, banks, and unsecured creditors should be aware of these new kinds of restructuring and insolvency processes in Australia. The lack of creditor oversight and compressed time frames mean that creditors should be prepared to be proactive if debtors begin to engage in a new reorganization process or simplified liquidation.

## THIRD CIRCUIT INVOKES EQUITABLE MOOTNESS TO BAR APPEAL OF GIFTING CHAPTER 11 PLAN

**Timothy W. Hoffmann ■ Mark G. Douglas**

In *In re Nuverra Environmental Solutions, Inc.*, 834 Fed. App'x 729 (3d Cir. 2021), the U.S. Court of Appeals for the Third Circuit handed down a long-awaited ruling that could have addressed, 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.*, ___ U.S. ___, 137 S. Ct. 973 (2017). In that case, the Supreme Court 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.

### EQUITABLE MOOTNESS

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. *See, e.g., In re LCI Holding Company, Inc.*, 802 F.3d 547, 554 (3d Cir. 2015) (stating that the doctrine "comes into play in bankruptcy (so far as we know, its only playground) after a plan of reorganization is approved" and ruling that equitable mootness would not cut off the authority to hear an appeal outside the plan context).

The doctrine of equitable mootness is sometimes criticized as an abrogation of federal courts' "virtually unflagging obligation" to hear appeals within their jurisdiction. *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). According to this view, dismissing an appeal on equitable mootness grounds "should be the rare exception." *In re Tribune Media Co.*, 799 F.3d 272, 288 (3d Cir. 2015).

Substantially similar tests have been applied by most circuit courts of appeals in assessing whether an appeal of a chapter 11 confirmation order should be dismissed under the doctrine. Those tests generally focus on whether the appellate court can fashion effective and equitable relief. *See, e.g., PPUC Pa. Pub. Util. Comm'n v. Gangi,* 874 F.3d 33, 37 (1st Cir. 2017) (considering whether: (i) the appellant diligently pursued all available remedies to obtain a stay of the confirmation order; (ii) the challenged chapter 11 plan had progressed "to a point well beyond any practicable appellate annulment"; and (iii) providing relief would harm innocent third parties); *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.)*, 801 F.3d 1161, 1167–68 (9th Cir. 2015) (applying a four-factor test, including whether the court "can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court"); *Tribune*, 799 F.3d at 278 (considering "(1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation"); *Search Market Direct, Inc. v. Jubber (In re Paige)*, 584 F.3d 1327, 1339 (10th Cir. 2009) (applying a six-factor test, including the likely impact upon a successful reorganization of the debtor if the appellant's challenge is successful); *In re United Producers, Inc.*, 526 F.3d 942, 947–48 (6th Cir. 2008) (three-factor test); *TNB Fin., Inc. v. James F. Parker Interests (In re Grimland, Inc.)*, 243 F.3d 228, 231 (5th Cir. 2001) (three-factor test); *see also In re Fin. Oversight & Mgmt. Bd. for Puerto Rico*, 2021 WL 438891, **6-7 (1st Cir. Feb. 8, 2021) (holding that the doctrine of equitable mootness was not abrogated by the U.S. Supreme Court's ruling in *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (2019), and that the doctrine applied to dismiss an appeal of an order approving a plan in a proceeding under the Puerto Rico Oversight, Management, and Economic Stability Act).


A common element of almost all of these tests is whether the chapter 11 plan has been substantially consummated. Section 1101(2) of the Bankruptcy Code provides that "substantial consummation" of a chapter 11 plan occurs when substantially all property transfers proposed by the plan have been completed, the debtor or its successor has assumed control of the debtor's business and property, and plan distributions have commenced.

### *NUVERRA*

Nuverra Environmental Solutions, Inc. ("NES") filed a prepackaged chapter 11 case in May 2017 with $500 million in secured debt and a value of approximately $300 million. NES proposed a chapter 11 plan under which: (i) secured noteholders received new stock, representing an estimated 55% recovery, but forfeited $190 million in deficiency claims; (ii) unsecured noteholders received a combination of new stock and cash amounting to a 4–6% recovery; and (iii) trade and certain other business-related unsecured claims (collectively, "trade claims") were paid in full. Secured noteholders agreed to fund payments to holders of unsecured noteholder and trade claims, which otherwise would have received nothing under the plan.

The unsecured noteholder class voted to reject the plan. One unsecured noteholder ("Hargreaves") objected to confirmation, arguing that: (i) the plan's proposed treatment of the dissenting unsecured noteholder class was not "fair and equitable," a requirement for cram-down confirmation under section 1129(b)(1) of the Bankruptcy Code, because the plan distributed less value to that class than to the trade claim class; and (ii) the plan's classification scheme was improper because unsecured noteholder claims and trade claims should not have been separately classified because they were "substantially similar" within the meaning of section 1122(a) of the Bankruptcy Code.

The bankruptcy court overruled the objection and confirmed the plan. The court determined that separate classification of the unsecured noteholder claims and the trade claims was reasonable because trade creditors were critical to the success of reorganized NES.

The bankruptcy court also considered whether the plan satisfied section 1129(b)(1)'s mandate that a chapter 11 plan cannot "discriminate unfairly" with respect to rejecting classes of creditors and shareholders. Applying a test (the Markell test) used by many courts in determining whether a plan "discriminates unfairly," the court found that the disparate treatment of the unsecured noteholder and trade creditor classes gave rise to a rebuttable presumption of unfair discrimination. However, it determined that the presumption had been rebutted because the unsecured noteholder class was "indisputably out of the money and not, otherwise, entitled to any distribution under the [B]ankruptcy [C]ode's priority scheme[,] and . . . the proposed classification and treatment of the unsecured creditors fosters a reorganization of these debtors."

The court also held that, because the plan distributions to unsecured creditors were "gifted" by the secured creditors from property to which they otherwise would have been entitled, rather than property of the estate—sometimes referred to as "horizontal gifting"—the plan satisfied the "absolute priority rule," which, broadly stated, precludes any distribution to junior creditors unless more senior creditors are paid in full or agree otherwise.

Hargreaves appealed the confirmation order to the district court. The district court denied his emergency request to stay the confirmation order beyond the 10-day period specified in the order.

The district court affirmed. As an initial matter, the court ruled that the appeal was equitably moot. In particular, the district court concluded that NES had "substantially consummated" its chapter 11 plan and that the relief sought by Hargreaves—equal distributions to unsecured noteholders and trade creditors—would "require undoing the [p]lan" and necessarily result in harm to third parties. Specifically, the court noted, "disgorgement would require the clawback, not only of cash payments made to hundreds of individual creditors, but also the clawback of stock that is trading on the national stock exchange, and may now be held by third parties who purchased these securities in the ordinary course."

Nevertheless, the district court addressed the merits of the appeal. It found no fault with the bankruptcy court's conclusions. Among other things, the district court explained that, although "vertical gifting"—gifting in a manner that skips over an intermediate junior class of dissenting creditors—violates the absolute priority rule under Third Circuit precedent, horizontal gifting does not. We provide a more detailed discussion of the bankruptcy and district court rulings and the legal concepts involved.

Hargreaves appealed the ruling to the Third Circuit.

## THE THIRD CIRCUIT'S RULING

A divided three-judge panel of the Third Circuit affirmed, but skirted the merits. Instead, the majority ruled that the district court correctly held that the appeal was equitably moot.

Initially, the court explained that Hargreaves, who was the only creditor in the unsecured noteholder class to appeal the confirmation order, sought as a remedy for the alleged unfair discrimination an individual payout of $450,000, equal to a 100% recovery on his claim, but only 0.45% of NES's $173 million enterprise value.

Applying the *Tribune* test for equitable mootness, the Third Circuit concluded that NES's chapter 11 plan had been substantially consummated, but acknowledged that the relief sought, "an individual payout of a relatively small sum," might not "fatally scramble the plan." However, the court held that such relief "is not permitted by the Bankruptcy Code" because it would: (i) violate section 1123(a)(4), which states that a chapter 11 plan must "provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment"; and (ii) contravene the purpose of the prohibition of unfair discrimination, which "applies only to classes of creditors *(not the individual creditors that comprise them)*, and then only to classes that dissent" (citations and internal quotation marks omitted).

According to the Third Circuit, Hargreaves could not "properly . . . propose that the appropriate remedy is to pay him only and no one else in his class." It also explained that, if every creditor in the unsecured noteholder class were to be paid in full, the $40 million payment would drain 23.3% of the value of reorganized NES—thus scrambling the plan. The Third Circuit accordingly ruled that Hargreaves's appeal was equitably moot.

In a concurring opinion, Circuit Judge Cheryl Ann Krause sided with NES, but not for the reason cited by the majority. She criticized the majority for "abdicating our jurisdiction" on the basis of equitable mootness—a "narrow" doctrine she has previously decried as "legally ungrounded and practically unadministrable."

According to Judge Krause, because the relief requested by Hargreaves did not threaten to fatally scramble the chapter 11 plan or significantly harm the interest of reliant third parties, the appeal was not equitably moot, and the court should have considered the merits of the appeal. Important issues that should have been addressed, she explained, include: (i) whether "individualized relief" is permitted by section 1123(a)(4) when one member of a class objects to a less-favorable treatment under a plan, but others do not; (ii) whether the Supreme Court's ruling in *Jevic* "foreclose[s] preferential treatment of a sub-class through horizontal gifting"; (iii) whether the unfair discrimination test "focus[es] on the plan's results or the process" that produced them; and (iv) the limits of chapter 11 plan classification schemes. Judge Krause then summarily stated that she would have upheld confirmation of NES's plan on the merits.

## OUTLOOK

Senior-class gifting is an important tool for building consensus on the terms of a confirmable chapter 11 plan. The district court's ruling in *Nuverra* dispelled speculation that *Jevic* might presage an end to all kinds of gifting chapter 11 plans, but many anticipated that the Third Circuit would provide additional circuit-level guidance on the issue. It elected not to do so. Thus, courts in that circuit will continue to grapple with an issue that is increasingly a common feature of many chapter 11 plans.

# U.S. SUPREME COURT: MERE RETENTION OF PROPERTY DOES NOT VIOLATE THE AUTOMATIC STAY

**Bruce Bennett ■ Christopher DiPompeo**
**Heather Lennox ■ Dan T. Moss ■ Kevyn D. Orr**

On January 14, 2021, the U.S. Supreme Court held in *City of Chicago v. Fulton*, 592 U.S. ___ (2021), that a creditor in possession of a debtor's property does not violate the automatic stay, specifically section 362(a)(3) of the Bankruptcy Code, by retaining the property after the filing of a bankruptcy petition. The Court's decision provides important guidance to bankruptcy courts, practitioners, and parties on the scope of the automatic stay's requirements.

*Fulton* arose from four separate bankruptcy cases. In each case, the City of Chicago ("City") had impounded the debtor's vehicle due to the debtor's failure to pay fines for motor vehicle infractions. Each debtor filed a chapter 13 bankruptcy petition and requested that the vehicle be returned. When the City refused, the bankruptcy court sanctioned the City for violating the automatic stay. In a consolidated appeal of the four cases, the Seventh Circuit affirmed, reasoning that the City had acted "to exercise control over property of the estate," 11 U.S.C. § 362(a)(3), especially in light of the Bankruptcy Code's turnover obligation under 11 U.S.C. § 542(a), which mandates that an entity in possession of estate property "shall deliver" the property to the trustee. A majority of circuits to address this question reached the same conclusion.

Justice Alito delivered the opinion for a unanimous court, reversing the Seventh Circuit. The Court reasoned that the language used in section 362(a)(3)—"stay," "act," and "exercise"—suggested that the automatic stay prohibits only "affirmative acts that would alter the status quo," which would not include mere retention of property. The Court embraced that interpretation because an opposite reading of section 362(a)(3) would render superfluous the "central command" of section 542(a) that estate property be delivered to the trustee. In reaching this conclusion, the Court implicitly rejected the debtors' argument that the two provisions work in tandem to create an automatic obligation to turn over estate property. The Court explicitly declined to comment on the operation of the turnover obligation under section 542 and on other subsections of section 362(a).

In a concurring opinion, Justice Sotomayor recognized that it is often essential that chapter 13 debtors recover their vehicles in order to maintain employment and pay their creditors, but also that adversary proceedings under section 542 can last for months. While Justice Sotomayor agreed that section 362(a)(3) could not provide a solution, she emphasized that the Court's opinion did not preclude other potential approaches, such as invoking subsections 362(a)(4) and (6) or proceeding under section 542 by motion instead of by adversary proceeding.

The Court's decision puts an end to the governing approach in the Second, Seventh, Eighth, Ninth, and Eleventh Circuits. Courts in these jurisdictions have invoked section 362(a)(3) against both private and public creditors, in cases involving the return of vehicles, commercial equipment, disputed taxes, and the approval of sales of liquor licenses.

The Court's decision is more favorable to creditors holding estate property than to debtors or their other creditors. If section 362(a)(3) itself required turnover of estate property, creditors who did not immediately turn over such property could have faced damages or sanctions for violating the automatic stay. Debtors must pursue relief under section 542, by contrast, likely in an adversary proceeding that will give the creditor the ability to raise defenses with the procedural protections of civil litigation. In the meantime, to the extent that the property is important to the debtor's income, such as property used in the operation of a business, the creditor holding the property will likely have additional leverage over the debtor and other creditors of the estate.

On the other hand, the Court's decision is ultimately a narrow one. The Court repeatedly states that it is examining only the "mere retention of property" in the context of section 362(a)(3). The decision leaves open the possibility that retention of estate property could violate other aspects of the automatic stay, such as where the refusal to turn over estate property amounts to an effort to collect a prepetition debt. Moreover, the Court's opinion applies only to passive retention of estate property. If a creditor holding estate property seeks to use or sell the property, it may face a claim that it has willfully violated the automatic stay, for which the creditor could be subject to punitive damages under section 362(k). Creditors holding estate property should therefore remain wary.

*Brett J. Wierenga, an associate in Jones Day's Washington Office, assisted in the preparation of this article.*

# LEGISLATIVE UPDATE: THE DUTCH SCHEME HAS ARRIVED

Jasper Berkenbosch ■ Sid Pepels ■ Erik Schuurs

After more than six years of development, the legislative process concerning new Dutch restructuring legislation (*Wet Homologatie Onderhands Akkoord*, or "WHOA") that introduces a Dutch debt-or-in-possession proceeding ("Dutch Scheme"), combining features of chapter 11 of the U.S. Bankruptcy Code and the English Scheme of Arrangement, was finalized at the end of 2020. The WHOA entered into force January 1, 2021, and is now available to companies.

Since our discussion of the Dutch Scheme (February 2020), the WHOA has been amended in several relevant aspects. Here, we briefly discuss the most notable of these amendments and include a restated version of the original white paper on the Dutch Scheme.

## AMENDMENTS TO THE WHOA

**Small Enterprise Trade Creditors' Exception.** The WHOA now includes additional protection for trade creditors who qualify as a small enterprise (defined as enterprises with a maximum of 50 employees, or less than €6 million in assets and €12 million in net annual revenue). Subject to certain criteria, dissenting small enterprise trade creditors can prevent the adoption of a restructuring plan if they do not receive a distribution under the plan equal to at least 20% of their claims.

**Secured Creditors' Position.** The position of secured creditors under the WHOA has been further clarified in two amendments. First, the WHOA now specifically provides that a secured creditor's claim will be bifurcated into a secured claim, to the extent of the value of any collateral, and an unsecured claim for the deficiency, and that the secured and unsecured claims must be classified separately for plan voting purposes. The extent to which a claim is secured will be calculated based on the value that the secured creditor would be expected to receive in a bankruptcy liquidation (as distinguished from a Dutch Scheme) by virtue of its security rights.

Second, secured financial creditors have been excepted from the obligation to offer dissenting creditors that are part of a dissenting class a cash distribution under the plan that is equal to the amount that they would have received in a bankruptcy liquidation. Instead, for the plan to be eligible for confirmation, it is sufficient to offer such a dissenting secured financial creditor, who is part of a dissenting class of creditors, any distribution other than (certificates of) shares for the plan to be eligible for confirmation.

## RESTATED WHITE PAPER

Previously, Dutch law did not provide a mechanism for imposing a restructuring plan on dissenting creditors outside of formal insolvency proceedings. As a result, a restructuring plan required the consent of all creditors and shareholders whose rights are affected by the plan. This made restructurings outside of a formal insolvency proceeding very difficult and provided stakeholders with ample opportunity to monetize on nuisance value. With the Dutch Scheme, the Dutch legislature is aiming to effectively allow debtors to propose restructuring plans to their creditors and shareholders outside of formal insolvency proceedings, with the prospect of the debtor being preserved on a going-concern basis.

The Dutch Scheme is, to a large extent, in line with the EU-wide initiative to promote "debtor-in-possession" restructuring, as recently formalized in the EU Harmonisation Directive (EU 2019/1023). The bill was adopted by the Dutch legislature in October 2020 and has taken effect as of January 1, 2021, allowing companies in distress to apply the Dutch Scheme after the effective date.

**Key Features.** The key features of the Dutch Scheme include:

- **Restructuring Plan**: Debtors or a court-appointed restructuring expert will be permitted to propose a restructuring plan for approval by creditors (secured, preferential, and unsecured) and shareholders.
- **Voting Threshold**: Stakeholders may be split into voting classes divided on the basis of the similarity of their rights vis-à-vis the debtor. The restructuring plan has to be approved by a two-thirds majority of each voting class, with the possibility of requesting a cross-class cram-down in certain circumstances.
- **Debtor-in-Possession Proceeding**: The debtor remains in control of the company's affairs throughout the Dutch Scheme proceeding.
- **Stay of Individual Enforcement Actions**: Debtors will be permitted to apply for a stay of individual enforcement actions and bankruptcy requests for a period of four months (extendable to a total of eight months in certain circumstances).
- **Broad Basis for Jurisdiction and Group Restructurings**: Subject to certain qualifying criteria, the Dutch courts will have jurisdiction to confirm restructuring plans for both Dutch and non-Dutch companies, allowing for cross-border group restructurings to be centralized in the Netherlands.

**Early Access to the Dutch Scheme.** The WHOA is aimed at granting viable enterprises in financial distress early access to a restructuring tool that will enable the debtor to restructure its liabilities and to survive on a going-concern basis. To be eligible to use the Dutch Scheme, it must be "reasonably likely that the debtor cannot continue to pay its debts." This will be the case if the debtor is still able to pay its due and payable debts, while at the same time there is no realistic prospect of avoiding future insolvency if its debts are not restructured (looking as much as

a year ahead). Unlike a UK scheme of arrangement, there will not necessarily be a court hearing prior to the meeting of the debtor's creditors and shareholders to vote on the restructuring plan. Whether the debtor complies with the eligibility criteria for the plan and has properly constituted creditor classes for voting on the plan will in principle be tested only at the confirmation hearing. In principle, a debtor need not obtain shareholder consent to initiate the process and propose a restructuring plan.

Individual creditors, shareholders, and employee representative bodies are also permitted to commence restructuring proceedings by requesting the court to appoint a restructuring expert, who is tasked with independently developing and proposing a restructuring plan on behalf of the debtor. This request will be granted if it is reasonably likely that the debtor cannot continue to pay its debts, unless the stakeholders as a whole will be disadvantaged by the appointment of an independent restructuring expert. Since the Dutch Scheme is a debtor-in-possession procedure, the restructuring expert is not authorized to take control of the debtor's business. However, the debtor itself is not permitted to propose a restructuring plan during the duration of the expert's appointment either. In the case of a debtor with a small or medium-size enterprise, the restructuring expert will, under certain circumstances, require shareholder consent to offer the restructuring plan to the creditors.

**A Broad Basis for International Jurisdiction and Recognition.** One of the Dutch Scheme's most important benefits is that it will be available both to Dutch companies that have a center of main interest ("COMI") in the Netherlands and foreign companies. If a debtor's COMI is located in the Netherlands, a "public" Dutch Scheme proceeding may be opened, which will be publicized by registration in the insolvency register and in which court decisions are public. Dutch "public" proceedings will benefit from automatic recognition throughout the European Union pursuant to the EU Regulation on Insolvency Proceedings, as the Dutch government announced that it will arrange to have the public Dutch Scheme be admitted to the list of "insolvency proceedings" recognized as such under the EU Regulation on Insolvency Proceedings, the so-called Annex A.

In the alternative, or if opted for voluntarily, debtors may also apply for "nonpublic" Dutch Scheme proceedings, which will not be registered in the insolvency register and in which court proceedings will take place in judges' chambers (i.e., anonymized decisions). This type of proceeding will fall outside the scope of the EU Regulation on Insolvency Proceedings and thus is not limited to debtors with either a COMI or an "establishment" in the Netherlands. Access to this nonpublic proceeding is open to any debtor with a "sufficient connection" to the Netherlands, which, for example, may be established or otherwise evidenced if a (substantial) part of: (i) the debtor's assets or group companies are located in the Netherlands; and/or (ii) the relevant finance documents are governed by Dutch law or include a forum choice for the Dutch courts.

A court-confirmed restructuring plan in a nonpublic proceeding, however, will not be automatically recognized in the European Union on the basis of the European Insolvency Regulation. Recognition under UNCITRAL Model Law implementations, the EU Brussels I Regulation, or domestic laws may potentially be available, however.

**Flexible Content of the Restructuring Plan.** The plan may alter rights of all or some of the debtor's creditors, whether secured, preferred, or unsecured, and of existing shareholders. As the WHOA takes a flexible approach to the underlying terms of the restructuring plan, its content may be tailored to the circumstances at hand. The restructuring plan may, for example, entail a debt-for-equity swap, a (partial) write-off or extension of debt, a sale of all (or part) of the debtor's assets, or a combination of these options.

To the extent that the implementation of a restructuring plan requires a shareholder resolution, the court-confirmed restructuring plan will act as a substitute for such a resolution.

Employee claims that arise from employment contracts will, however, be excepted from the Dutch Scheme's scope, as the Dutch legislature is currently considering separate legislation addressing the effect of insolvency on employment contracts.

**The Voting Process.** Once the final restructuring plan has been negotiated, the debtor (or the restructuring expert, if appointed) will have to present the plan to the affected creditors and shareholders at least eight days prior to voting. The voting procedure may be determined by the debtor, is flexible, and allows voting to take place electronically, in writing, or in person.

All creditors and shareholders whose rights will be affected under the plan are entitled to vote. Voting may take place in classes formed on the basis of similarity of existing and prospective rights with respect to the debtor. Although the WHOA allows ample flexibility in formation of those classes, it does prescribe several rules concerning specific creditor groups. Firstly, to the extent that secured creditors' claims are only partly covered by security rights, their claims must in principle be split and placed into two separate voting classes: secured creditors and general unsecured creditors. To what extent a claim is secured shall be calculated based on the value that the secured creditor would be expected to receive in a bankruptcy by virtue of his security rights.

Moreover, if the plan offers less than 20% distribution on the claims of small trade creditors, they must be included in a separate class for voting purposes. A creditor qualifies as a small trade creditor if it:

- Has a small enterprise with a maximum of 50 employees, or less than €6 million in assets and €12 million net annual revenue; and
- Has claims resulting from supplied goods or services or from tort.

Voting will take place per stakeholder class. Acceptance of the restructuring plan by a class requires a two-thirds majority in the amount of the total debt or equity of the class's stakeholders participating in the vote. Contrary to the UK Scheme and the current Dutch plan offering instruments in formal insolvency proceedings, the Dutch Scheme does not require a qualified majority in headcount.

**Court Confirmation and the Cross-Class Cram-Down.** The debtor (or restructuring expert) may request that the court confirm the plan if at least one class of impaired creditors has voted in favor of the restructuring plan. The court will in principle hold a confirmation hearing following the creditor vote within eight to 14 days following the confirmation request.

On the court-tested requirements for confirmation, the WHOA distinguishes between cases where the voting requirement has been met in all classes, and those where one or more classes have voted against the plan. If all classes have voted in favor of the plan, the court will deny confirmation of a restructuring plan—either on its own motion or on request of an affected creditor or shareholder—when, inter alia:

- It is reasonably unlikely that the debtor could continue to pay its debts if the plan were implemented;
- One of the prescribed formal requirements of the WHOA has not been met;
- Performance of the restructuring plan is not properly guaranteed; or
- The debtor wants to attract new financing as part of its restructuring efforts and incurring such financing would materially disadvantage creditors.

Dissenting creditors may also request that the court refuse confirmation if, under the plan, they will receive less value, whether in cash or in non-cash consideration, than they would expect to receive in a liquidation scenario ("best interest of creditors test").

If one or more classes have voted against the restructuring plan, the court may still confirm it and impose a "cross-class cramdown." However, dissenting stakeholders in a dissenting class may ask the court to refuse confirmation of the plan, if:

- The separate class of small trade creditors receives less than a 20% distribution on class creditor claims, absent compelling grounds for such a lower distribution;
- The reorganization value is not distributed to the dissenting class in accordance with statutory and contractual priorities—unless there is a reasonable ground for such deviation and the deviation does not disadvantage affected stakeholders (i.e., the "absolute priority rule" combined with a reasonableness exception);
- They are not entitled to a cash distribution for the amount that they would expect to receive if the debtor's assets were liquidated, to the extent that those stakeholders are not secured financial creditors; or
- They are secured creditors who have provided financing to the debtor on a commercial basis (secured financial creditors) and are entitled to a distribution only in the form of (certificates of) shares.

If the court confirms the restructuring plan, it is binding on all stakeholders qualified to vote. Once approved by the court, the plan confirmation order may not be appealed.

**An Effective Group Restructuring Tool.** A restructuring plan in a Dutch Scheme proceeding may also alter certain claims that the debtor's creditors may have against group companies (e.g., guarantees), even though those group companies are not themselves subject to restructuring proceedings. With cross guarantees being the rule rather than the exception within multinational groups of companies, it will now be possible to restructure group guarantees within a single cross-border Dutch Scheme proceeding.

Moreover, as the Dutch Scheme permits courts to assert broad jurisdiction over foreign companies in nonpublic proceedings (see above), insolvency proceedings regarding multinational groups of companies may readily be centralized in the Netherlands. Jurisdiction for nonpublic proceedings may be asserted by a Dutch court if the foreign group companies have a "sufficient connection" to the Netherlands. Thus, the Dutch Scheme will permit multinational groups of companies to centralize their restructurings in the Netherlands by combining public proceedings for companies with a COMI in the Netherlands with nonpublic proceedings for foreign companies. This is particularly true if combined with instruments that provide for international recognition, such as the UNCITRAL Model Law, which has been enacted in more than 50 jurisdictions.

**Supportive Tools to Promote the Restructuring.** The Dutch Scheme provides for several additional tools that may be used to further promote the development and implementation of the restructuring plan:

- A moratorium on creditors' actions and insolvency proceedings upon the debtor's (or the restructuring expert's) request for a period of four months, with the option to extend to a total of eight months;
- Contractual provisions purporting to unilaterally or automatically terminate, amend, or suspend contract rights (i.e., "ipso facto" clauses) cannot be enforced during Dutch Scheme proceedings;
- Debtors may propose amendments to burdensome contracts (e.g., lowering periodic lease payments or interest payments) or terminate such contracts if the counterparty does not accept the proposed amendments. Damage claims resulting from termination may be included in the restructuring plan;
- To promote deal certainty, the debtor (or the restructuring expert), as it is developing a restructuring plan, may request that the court approve certain aspects of the plan in advance, including the proposed classification of stakeholders, voting procedures, stakeholder voting eligibility, and whether certain grounds to refuse confirmation (as discussed above) exist;
- The court may issue injunctive relief to protect stakeholders' interests; and
- The court may insulate new financing required for the implementation of a restructuring plan from claw-back provisions. Court approval will be granted if the relevant transaction is necessary to continue the debtor's business during the preparation of the restructuring plan (i.e., financing during the plan development period), if the transaction is in the interest of the debtor's creditor body as a whole, and if no individual creditor will be substantially damaged.

# UPHILL STRUGGLES IN THE SUNLIT UPLANDS? THE BREXIT DEAL AND UK-EU INSOLVENCIES

Kay Morley ■ Ben Larkin ■ Sion Richards ■ Adam Brown

The deal reached between HM Government and the European Union on December 24, 2020, does not include any framework for the coordination and mutual recognition of cross-border insolvencies and restructurings. For the purposes of insolvency law, the deal represents a "Hard Brexit."

Therefore, following Brexit, UK insolvency proceedings no longer benefit from automatic recognition across the European Union pursuant to Regulation (EU) 2015/848 of the European Parliament ("EU Insolvency Regulation"), and vice versa (save for those proceedings commenced prior to December 31, 2020). UK insolvency proceedings commenced after December 31, 2020, will, where necessary, need to be recognized in each relevant EU Member State.

Without the benefit of mutual recognition, cross-border insolvency proceedings involving both the European Union and the United Kingdom will undoubtedly become more complex, time-consuming, and expensive as stakeholders, advisers, and insolvency practitioners seek to navigate this new landscape. In many situations, parallel proceedings in multiple jurisdictions may now be required. Going forward, it is hoped that a new framework for the mutual recognition of insolvency proceedings can be agreed between the European Union and the United Kingdom. However, in the short term at least, notwithstanding the increased levels of financial distress and insolvency proceedings that are likely to follow as and when government support programs in the United Kingdom and Europe are withdrawn, mutual recognition of insolvency proceedings does not appear to be a high priority for the European Union and the United Kingdom at this time.

## THE STATUS QUO

Before the transition period ended on December 31, 2020, the United Kingdom enjoyed the benefit of the EU Insolvency Regulation. The EU Insolvency Regulation provides, inter alia, a framework for the automatic and mandatory recognition of insolvency proceedings between Member States of the European Union (excluding Denmark). The EU Insolvency Regulation also determines the applicable law in the case of cross-Member State insolvency proceedings.

## THE NEW LANDSCAPE

**Outbound UK Insolvency Proceedings.** Following Brexit and the end of the transition period on December 31, 2020, insolvency proceedings involving both an EU Member State and the United Kingdom are now in a rather different position.

If a UK insolvency proceeding requires recognition in the European Union, the company or relevant insolvency practitioner will need to seek recognition in each EU Member State where it is considered expedient to do so. In each case—with the exception of Greece, Poland, Romania, and Slovenia, which have each adopted the UNCITRAL Model Law on Cross-Border Insolvency ("Model Law")—the availability of recognition and the terms thereof will depend on any applicable terms for the recognition of a third country under the EU Insolvency Regulation or local laws for the recognition of foreign insolvency proceedings in each relevant Member State. Where a UK insolvency proceeding has been commenced in the United Kingdom, but an EU Member State considers that the center of main interests ("COMI") of the relevant entity is in the European Union, the EU Insolvency Regulation will continue to apply without regard to the UK proceeding.

**Schemes and Restructuring Plans.** For schemes of arrangement and the new restructuring plan, it was generally considered (but never tested) that the recognition of such proceedings across the European Union fell under the ambit of Regulation (EU) 1215/2012 of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) ("EU Judgments Regulation"). Following December 31, 2020, the EU Judgments Regulation has also ceased to apply to the United Kingdom, and therefore the United Kingdom and European Union will no longer benefit from mutual recognition of civil judgments.

As an alternative to the EU Judgments Regulation, there are a number of different routes pursuant to which English schemes and restructuring plans may be recognized in Europe. These routes include the Hague Convention and Regulation (EC) No. 593/2008 of the European Parliament ("Rome I"), both of which continue to apply to the United Kingdom and the European Union in the context of civil proceedings. The Hague Convention provides for the recognition of exclusive jurisdiction clauses where both contracting parties have agreed to the exclusive jurisdiction of a contracting state. Similarly, Rome I seeks to uphold and recognize the governing law of a contract as agreed between contracting parties. Like the EU Judgments Regulation, the application of the Hague Convention and Rome I have not as yet been tested in respect of schemes and restructuring plans.

Going forward, the United Kingdom has applied to join the Lugano Convention. Parties to the Lugano Convention include the European Union, Switzerland, and Norway. The Lugano Convention provides a framework for the recognition of civil law judgments between contracting states in a similar way to the EU Judgments Regulation. Given the generally accepted principle that schemes sanctioned by the English court constitute civil law judgments, it was anticipated that the Lugano Convention would provide an alternative route for the recognition of schemes and restructuring plans within the European Union and beyond.

However, in the recent case of *Re gategroup Guarantee Limited* [2021] EWHC 304 (Ch), the English High Court held that a restructuring plan constituted a bankruptcy proceeding and therefore fell outside the scope of the Lugano Convention. There are a number of distinguishing features between a scheme and a restructuring plan, and in coming to its decision, the court placed great emphasis on these differences. In particular, while a company may propose a scheme irrespective of its financial state, in order to propose a restructuring plan: (i) the company must have encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern; and (ii) the purpose of the restructuring plan must be to eliminate, reduce, prevent, or mitigate the effect of any of the financial difficulties noted in (i) above. Accordingly, the context in which a restructuring is proposed could be entirely different for a scheme or a restructuring plan and may justify the potential classification of a restructuring plan as a bankruptcy proceeding, but not a scheme. While the decision in *Re gategroup* does not directly affect schemes, this decision does create greater uncertainty as to the basis for recognition of both schemes and restructuring plans in Europe. Further, it may follow that restructuring plans will now similarly fall within the bankruptcy exception to the Hague Convention, thereby further limiting the available frameworks for the recognition of restructuring plans in Europe.

**Inbound EU Insolvency Proceedings.** Any EU insolvency proceedings commenced after December 31, 2020, will similarly cease to benefit from automatic mutual recognition in the United Kingdom. However, there are a number of different routes in the United Kingdom pursuant to which foreign companies and office-holders can seek recognition in the United Kingdom of foreign insolvency proceedings. These routes include:

- Cross Border Insolvency Regulations 2006 ("CBIR"), pursuant to which the Model Law has been incorporated into English law. The CBIR provides a framework for the recognition of main (COMI-based) and non-main (establishment-based) insolvency proceedings in the United Kingdom. Recognition is not automatic and requires an application to be made to the English court;
- Section 426 of the Insolvency Act 1986, which provides a framework for the recognition of insolvency proceedings in relation to certain designated jurisdictions, including Ireland; and
- English common law.

The grant of recognition and/or the provision of assistance pursuant to one of the above routes does not replicate the same terms as are applicable under the EU Insolvency Regulation. However, such frameworks: (i) do provide a clear and tested procedure for recognition of foreign proceedings; and (ii) are not dependent on there being reciprocal arrangements in place for the recognition of English insolvency proceedings. The existing regime in the United Kingdom will therefore undoubtedly assist foreign companies and insolvency practitioners in coordinating cross-border insolvency matters involving UK companies and/or assets.

For money judgments only, the Administration of Justice Act 1920 and the Foreign Judgments (Reciprocal Enforcement Act) 1933 each provide a regime for the recognition of debt claims. However, utilization of such regimes is dependent on equivalent arrangements being available to assist UK parties in the jurisdiction seeking the assistance of the English court.

**The Rule in *Gibbs*.** As a matter of English law, a contract governed by English law may be amended, discharged, or otherwise compromised pursuant to an English proceeding only, unless the relevant counterparty has submitted itself to the jurisdiction of the foreign proceeding. Submission to the jurisdiction of a foreign proceeding can occur in a number of ways, including a creditor submitting a proof of debt or voting in the relevant foreign proceeding.

Prior to December 31, 2020, the Rule in *Gibbs* was not applied while the United Kingdom was subject to the EU Insolvency Regulation. However, post-Brexit, contracts governed by English law will need to be carefully considered by all stakeholders in the context of any restructuring proceeding that attempts to compromise the rights of creditors with English law-governed contracts without such creditors submitting to the laws of the relevant jurisdiction.

In practice, a foreign proceeding that seeks to compromise the rights of creditors pursuant to an English law-governed contract may still (subject to the eligibility criteria being satisfied) be recognized in the United Kingdom, for instance pursuant to the CBIR. However, recognition does not mean that the English courts will be prepared to enforce the terms of the foreign proceeding on a creditor who has not submitted to the jurisdiction of the foreign court. This is a different and complicated question that will need to be considered on a case-by-case basis.

**Jurisdiction of English Courts.** As a consequence of the United Kingdom no longer being subject to the EU Insolvency Regulation, by virtue of the Insolvency (Amendment) (EU Exit) Regulations 2019, the English courts will no longer be limited to opening certain insolvency proceedings, such as administration, in those situations where a company has its COMI in the United Kingdom. In certain circumstances, this may provide additional flexibility to open proceedings in the United Kingdom where this was not previously possible. Issues of recognition will still need to be considered on a case-by-case basis, but this increased flexibility could be helpful in some cross-border situations.

## OUTLOOK

The EU Insolvency Regulation undoubtedly provides an important framework for the recognition of cross-border insolvency and restructuring situations. The fact that the United Kingdom and the European Union will no longer enjoy the benefits of mutual recognition of insolvency proceedings and civil judgments is regrettable, but not fatal.

The CBIR will provide an important gateway into the United Kingdom for the recognition of EU insolvency proceedings. The implementation of the Model Law across the European Union would similarly go some way to restoring the confidence of mutual recognition in EU–UK insolvency proceedings under the EU Insolvency Regulation, even if recognition under the Model Law is secured by court application as opposed to being automatic.

In the meantime, English law finance documents retain the primacy conferred on them by the *Gibbs* Rule, which, in spite of significant hostile commentary from other jurisdictions, continues to hold that foreign insolvency proceedings cannot discharge debts put in place by an English law contract. Moreover, the fact that the overwhelming majority of standard LMA-form international financing agreements will benefit from the protection of Rome I will be of some reassurance to certain stakeholders in the interim. Schemes and restructuring plans will therefore continue to play an important role in cross-border restructurings both within the European Union and in respect of non-EU companies that may continue to access schemes and restructuring plans in much the same way as before.

Moving forward, the Lugano Convention could provide an alternative route for the recognition of schemes. However, in the case of restructuring plans, the decision in *Re gategroup* has, for now, ruled out the possibility of the Lugano Convention providing any framework for the recognition of restructuring plans. In the case of restructuring plans, on the other hand, the decision in *Re gategroup* has, for now, ruled out the possibility of the Lugano Convention providing any framework for the recognition of restructuring plans. In any event, the United Kingdom is not yet a signatory to the Lugano Convention (the European Union and Denmark have yet to give their support to the United Kingdom's accession). It is also worth noting that there would be a delay of three months between the United Kingdom's accession and it taking effect.

However, before further steps are taken to re-homogenize insolvency and recognition procedures between the United Kingdom and the European Union, stakeholders should prepare for the need to implement more complex and carefully planned restructurings, including, for example, parallel proceedings both in the United Kingdom and relevant EU Member States, in order to achieve certainty of outcome in any given situation.

*Robin Muir, an associate in the London Office, assisted in the preparation of this article.*

## NEWSWORTHY

***Jones Day*** received Virtual 2020 Turnaround Atlas Awards for deals in the following categories: (i) Turnaround of the Year—i-Heart Media restructuring and separation of Clear Channel Outdoor; (ii) Cross Border Turnaround of the Year—syncreon Group restructuring under an English scheme of arrangement, Chapter 15 and CCAA recognition in Canada; and (iii) Private Equity Acquisition of the Year—Nexus Capital acquisition from FTD Companies of FTD North America and Latin America Consumer and Florist businesses, including ProFlowers.

*Washingtonian* magazine named ***Kevyn D. Orr (Washington)*** to its 2020 Top Lawyers list, which features Washington's top legal talent, as voted by area lawyers, in the Bankruptcy practice area.

An article written by ***Corinne Ball (New York)***, ***George J. Cahill (New York)***, ***Kay Morley (London)***, ***Jayant W. Tambe (New York; Financial Markets)***, ***Bruce Bennett (Los Angeles and New York)***, and ***Heather Lennox (Cleveland and New York)*** titled "Chapter 15 and Bankruptcy Credit Events under Credit Default Swaps" was posted on February 16, 2021, on the Harvard Law School Bankruptcy Roundtable.

An article written by ***Mark A. Cody (Chicago)*** and ***Mark G. Douglas (New York)*** titled "Potential Barriers to Health Care Provider Bankruptcies" was published in the February 17, 2021, edition of *Law360*.

An article written by ***Brad B. Erens (Chicago)*** and ***Mark G. Douglas (New York)*** titled "New Appellate Court Ruling on Priority of Straddle-Year Taxes in Bankruptcy" was published on February 12, 2021, in the *International Law Office Newsletter*.

An article written by ***Daniel J. Merrett (Atlanta)*** and ***Mark G. Douglas (New York)*** titled "Chapter 11 Exit Financing Ruling: Section 364 Does Not Apply" was published on February 3, 2021, in *Lexis Practical Guidance*.

***Heather Lennox (Cleveland and New York)***, ***Katie Higgins (Sydney)***, ***Oliver S. Zeltner (Cleveland)***, and ***Isel M. Perez (Miami)***, were part of a team of Jones Day professionals that represented Peabody Energy Corporation in connection with a comprehensive series of recapitalization transactions to, among other things, provide the company with maturity extensions and covenant relief, while allowing it to maintain sufficient operating liquidity and financial flexibility.

An article written by ***Paul M. Green (Houston)*** and ***Mark G. Douglas (New York)*** titled "More Bankruptcy Courts Join the Fray in Dispute over Rejection of Gas Gathering Agreements" was published on February 2, 2021, in *Lexis Practical Guidance*.

An article written by ***Mark A. Cody (Chicago)*** and ***Mark G. Douglas (New York)*** titled "Focus on Healthcare Provider Bankruptcies" was published on February 2, 2021, in *Lexis Practical Guidance*.

***Roger Dobson (Sydney)*** received a Band 1 ranking in the field of Restructuring/Insolvency in the 2021 edition of *Chambers Asia-Pacific: Asia-Pacific's Leading Lawyers for Business*.


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