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Review

Expanding the Scope of the Automatic Stay to Co-Defendant

Mark G. Douglas

A basic tenet of federal bankruptcy law is that the automatic stay suspends creditor collection efforts and litigation against a debtor that files for bankruptcy protection, but does not apply to actions directed toward non-debtor third-parties. Still, there are exceptions to the rule. Under the right circumstances, the scope of the stay may be expanded to prevent actions against a non-debtor. One such circumstance — namely, where the debtor and a company that is wholly owned by him are co-defendants in litigation — was the subject of a decision recently handed down by the United States Court of Appeals for the Second Circuit. In *Queenie, Ltd. v. Nygaard Int'l*, the Second Circuit held that the automatic stay applied to preclude continued litigation against the debtor's wholly owned corporation because adjudication of a claim against the corporation would have an "immediate adverse economic impact" on the debtor.

The Automatic Stay

When a petition for relief under the Bankruptcy Code (other than an ancillary petition in furtherance of a qualified foreign insolvency proceeding) is filed by or against a debtor, a statutory injunction — or "automatic stay" — immediately becomes effective to suspend creditor collection efforts and litigation against the debtor and property of its bankruptcy estate. Bankruptcy Code section 362(a) stays, among other things, "the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case . . . or to recover a claim against the debtor that arose before the commencement of the case." The "automatic stay" also precludes the enforcement of a pre-bankruptcy judgment against the debtor or its

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property, "any act to obtain possession" of estate property, to exercise control over estate property and a wide variety of creditor enforcement actions, including perfecting a lien on the debtor's property and "any act to collect, assess or recover a claim against the debtor that arose before the commencement of the case."

The automatic stay is broad in scope and applies to almost every formal and informal action against the debtor or its property. Its purpose is to give the debtor a breathing spell from creditors during which either the debtor can devise a repayment or reorganization plan or a bankruptcy trustee can effect an orderly liquidation of the debtor's assets. The automatic stay also protects creditors by averting a scramble for the debtor's assets and facilitating an orderly liquidation procedure under which all similarly situated creditors are treated equally.

Automatic Stay Exceptions and Relief from Stay

Certain actions are excepted from the automatic stay. Most of these exceptions are based upon important policy considerations developed over many years predicated upon the perception that certain actions should not interrupted or foreclosed by a bankruptcy filing because the prejudice suffered by non-debtors outweighs the "breathing spell" policy underlying the automatic stay. Thus, Bankruptcy Code section 362(b) provides that the stay does not preclude, among other things, the commencement or continuation of criminal, paternity, child support, alimony or maintenance actions, certain setoffs by stock and commodities brokers, forward contract merchants and securities clearing agencies, tax audits or the issuance of a notice of tax liability and actions by a commercial lessor to obtain possession of leased property if the lease expired prior to the bankruptcy filing.

While the stay in Bankruptcy Code section 362(a) is automatic, it is not permanent. As a general rule, the stay of actions against a debtor's property continues until the asset is no longer part of the bankruptcy estate (*i.e.*, when the property has been sold or abandoned or when the estate no longer exists because the case is dismissed). The stay of any other act specified in the statute continues until the earliest of closure or dismissal of the bankruptcy case or the denial or grant of a discharge to the debtor. However, the automatic stay may be lifted earlier. Any entity seeking relief from or modification or termination of the stay may petition the bankruptcy court for this purpose. The court will grant the request if it finds "cause" to do so. "Cause" is typically found where the debtor cannot adequately protect a creditor's interest in property, or where the debtor lacks "equity" in the asset (*e.g.,* because it is encumbered by mortgages in excess of the value of the property) and the property is not necessary for the debtor, in a chapter 11, 12 or 13 case, to reorganize effectively.

Application to Non-Debtors

The automatic stay generally does not bar acts against non-debtors (such as a co-debtor who is liable on a debt with the debtor). However, a bankruptcy court may extend the stay or enjoin acts against non-debtors where such actions would adversely affect the debtor's estate, frustrate the statutory scheme embodied in the Bankruptcy Code or interfere with the debtor's efforts to reorganize. For example, if an act against a non-debtor would detrimentally influence the debtor and serve as an indirect means of collecting a claim against the debtor, the court may enjoin such an act in order to ensure that a creditor may not do indirectly that which the creditor is forbidden to do directly. The pivotal question is whether the debtor will suffer irreparable harm if the proceedings against the non-debtor go forward, since it is the debtor's interest, and not the interests of non-debtors, which the injunctive powers are designed to protect. It is an extraordinary exercise of a bankruptcy court's equitable discretion to stay acts against non-debtors. The court may do so only if unusual circumstances are present. In *Queenie, Ltd. v. Nygaard Int'l*, the Second Circuit found that the facts before it were sufficiently unusual to warrant expansion of the automatic stay to preclude continued litigation against the debtor's co-defendant and wholly owned corporation.

Background

Queenie, Ltd. ("Queenie") was a corporation engaged in the distribution of women's garments. The company used fabric designs acquired from various third-parties to create its clothing, which was manufactured by overseas fabric mills. Queenie's sole shareholder was Marc Gardner ("Gardner"). Queenie did business for approximately eight years with Heavenly Fabrics, Inc. ("Heavenly"). Heavenly was a textile importer that contracted for the manufacture of fabrics for women's apparel and provided designs for its clients, who in turn purchased fabric from Heavenly for the purpose of creating garments that used the designs.

In 1996, Queenie commenced litigation against a competitor, Nygaard International ("Nygaard"), contending that Nygaard had appropriated various copyrighted designs. A flurry of counterclaims ensued, so that the copyright infringement litigation ultimately in-

What's New at Jones Day?

John J. Rapisardi's (New York) bimonthly bankruptcy column entitled "Thou Shalt Not Trade: Restrictions on Trading in Bankruptcy" appeared in the March 14, 2003 edition of the *New York Law Journal*. He coauthored an article with Mark G. Douglas (New York) entitled "Lockup Lockout?" that appeared in the January 7, 2003 edition of *The Daily Deal*.

Richard M. Cieri (Cleveland) was recognized in the December 15, 2002 edition of *Turnarounds & Workouts* as one of the "Outstanding Bankruptcy Lawyers of 2002" for his outstanding achievements as counsel to the Official Financial Institutions' Committee appointed in the Kmart Corp. chapter 11 cases, debtor's counsel in the Laidlaw Inc. and World Kitchen, Inc. chapter 11 cases and counsel in the Excel/NRG restructuring. He and ***Paul D.Leake*** (New York) were included among the leading U.S. insolvency and restructuring attorneys in the 2003 edition of *International Financial Review 1000*. Mr. Cieri was also selected for listing in the 2003 edition of the *K & A Restructuring Register*: America's Top 100.

Corinne Ball (New York) was among the faculty for the March 6-7, 2003 "Corporate Mergers and Acquisitions" program in San Francisco jointly sponsored by the American Law Institute and the American Bar Association Committee on Continuing Professional Education as part of their 18th Annual Advanced ALI-ABA Course of Study. A two-part article co-authored by her and ***John K. Kane*** (New York) entitled "A Practical Guide to Distress M&A" appeared in the January and February 2003 editions of *The M&A Lawyer*. Ms. Ball and ***David G. Heiman*** (Cleveland) were among the attorneys named in the January 15, 2003 edition of *Turnarounds and Workouts* as lead counsel in "Successful Chapter 11s - 2002."

Erica M. Ryland (New York) spoke at a seminar on Telecommunications Restructuring in New York City, sponsored by Law Seminars International, on February 13-14, 2003.

On January 16, 2003, ***Carl M. Jenks*** (New York) presented a paper entitled "Filing for Bankruptcy: A Starter Kit for Corporate Tax Advisors" to the BNA Tax Management Advisory Board in New York City that will ultimately be part of the new BNA portfolio on Corporate Bankruptcy.

An article discussing recent developments in the chapter 11 case of National Century Financial Enterprises, whose bankruptcy team is directed by ***Charles M. Oellermann*** (Columbus) and ***Paul E. Harner*** (Chicago), appeared in the "Weekly News and Comment" section of the December 24, 2002 edition of *Bankruptcy Court Decisions*. Mr. Harner was quoted in the February 28, 2003 issue of *The New York Times* in an article discussing the confirmation of a plan of reorganization in Laidlaw, Inc.'s chapter 11 cases.

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volved Queenie, as plaintiff and counterclaim defendant, Nygaard as defendant and counterclaim plaintiff, and Gardner, Heavenly and its principal, as counterclaim defendants. A jury rejected Queenie's copyright infringement claim. However, it found Queenie, Gardner, Heavenly and its principal liable to Nygaard for tortuous interference with economic advantage and awarded punitive damages against all of them. After the district court refused to vacate the judgment on various grounds, the counterclaim defendants appealed to the Second Circuit. Gardner also filed a petition for relief under chapter 11 of the Bankruptcy Code. Queenie did not file for bankruptcy.

Two issues were before the Court of Appeals: the propriety of the judgment below on the merits and whether the automatic stay applied not only to Gardner, but to Queenie and the other counterclaim defendants as well. The Court rejected the appeal on the merits in short order, finding that the record below supported the district court's ruling. Addressing the automatic stay issue, the Second Circuit remarked at the outset that it is well established that a suit against a co-defendant is not automatically stayed by the debtor's bankruptcy filing. However, the Court observed, the stay can apply to non-debtors, but "normally does so" only when a claim against the non-debtor will have an immediate adverse economic consequence for the debtor's

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Chapter 11 Plan Depriving Creditor of Default Rate Interest not Proposed in Bad Faith

Shana F. Klein and Mark G. Douglas

Among the important advantages afforded to a chapter 11 debtor-in-possession is the ability to leave a creditor unimpaired by reinstating a defaulted obligation according to its terms prior to default. However, there is a disagreement among courts as to whether "curing" outstanding defaults under a breached contract requires payment of interest at the default rate specified in the contract as well as any related late charges and fees. The Court of Appeals for the Ninth Circuit recently took the latest bite from an increasingly controversial apple in *In re Sylmar Plaza, L.P.* Addressing both the "cure" amount controversy and the Bankruptcy Code's requirement that a chapter 11 plan of reorganization be proposed in "good faith," the Ninth Circuit held that a plan of reorganization "crafted solely" to deprive a secured creditor of its contractual default rate of interest complied with all the requirements of section 1129 of the Bankruptcy Code, including the requirement of "good faith."

The Bankruptcy Code's Good Faith Requirement

Any chapter 11 plan of reorganization submitted to a bankruptcy court for approval, or "confirmation," must satisfy certain basic requirements set forth in the Bankruptcy Code. Among those requirements is the mandate in Bankruptcy Code section 1129(a)(3) that every plan be "proposed in good faith and not by any means forbidden by law." This "good faith" requirement, which is derived from a long history pre-dating the enactment of the Bankruptcy Code in 1978, is designed to ensure that a bankruptcy court has the discretion to prevent confirmation of reorganization schemes that arguably comply with the technical strictures of the statute, but are somehow at odds with the fundamental objectives and purposes of federal bankruptcy law. Thus, Bankruptcy Code section 1129(a)(3) has been construed to require that a plan be proposed with "honesty and good intentions" and with "a basis for expecting that a reorganization can be effected." In keeping with that mantra, bankruptcy courts are commissioned with determining whether every plan, viewed in light of the "totality of the circumstances," fairly achieves a result consistent with the Bankruptcy Code. The scope of the court's discretion in making that determination is considerable.

Reinstatement of Defaulted Obligations in Bankruptcy

A chapter 11 debtor's ability in a bankruptcy case to cure a default and reinstate the terms of a breached pre-bankruptcy contract, lease or other unexpired agreement is a cornerstone of United States bankruptcy law. Without this power, bankruptcy would not be nearly as effective as a means of enabling financially troubled debtors to rehabilitate operations and reorganize successfully unburdened by limiting considerations that precipitated the bankruptcy filing. Under Bankruptcy Code section 1123(a)(5)(G), a plan of reorganization may provide adequate means for its implementation such as, among other things "curing or waiving any default." The provision allows a reorganized debtor to reinstate a breached agreement after confirmation of a plan as if the breach never occurred. Other provisions of the Bankruptcy Code also permit a debtor to reinstate defaulted contracts by "assuming," or reaffirming, certain kinds of "executory" (unexpired) contracts or leases notwithstanding the existence of pre-bankruptcy defaults. In all cases, however, the debtor must "cure," or satisfy, outstanding defaults (except those relating to its financial condition or the filing of its bankruptcy case) under an agreement before it can be reinstated.

If the contract in question contains a clause providing for payment of post-breach interest at the default rate and other associated late charges or fees, it is unclear in one context whether these amounts must also be paid as part of the debtor's "cure" obligations. Where an executory contract providing for default interest is being assumed by a debtor, section 365(b)(2)(D) of the Bankruptcy Code expressly provides that a default need not be cured if it relates "to the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract." The answer is less clear if the debtor proposes in a plan of reorganization to reinstate, for example, a defaulted loan agreement that obligates the debtor to pay post-default interest at a significantly higher rate.

This is so notwithstanding the arguably clear dictates of Bankruptcy

Code section 1123(d), which provides that "if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law." What is required to cure a reinstated obligation in accordance with the terms of a chapter 11 plan is of great significance in the context of enfranchisement for the purpose of plan approval or rejection. Only creditors whose claims are "impaired" under a plan have the right to vote. Unimpaired creditors are statutorily deemed to have voted in favor of a plan. Bankruptcy Code section 1124(2) provides that a creditor's claim is impaired unless the plan either "leaves unaltered the legal, equitable, and contractual rights to which such claim" entitles its holder, or notwithstanding any contractual provision or applicable law that entitles the holder of a claim to demand accelerated payment, the plan "cures any such default," reinstates the maturity and terms of the claim and compensates the holder for damages it incurred reasonably relying upon the acceleration clause. Despite the unambiguous language of section 1123(d), many courts have refused to construe the language of the statute to require payment of default interest because it is perceived as being inconsistent with the idea that "[c]uring a default commonly means taking care of the triggering event and returning to pre-default conditions." The approach adopted by these courts has fueled a growing controversy.

Ninth Circuit Law and the 1994 Bankruptcy Amendments

In a 1988 case before the Ninth Circuit Court of Appeals, *In re Entz-White Lumber and Supply*, the debtor sought to "cure" a defaulted and matured loan by paying off the entire principal due, together with interest at the non-default rate. The creditor objected, arguing that it was entitled to default interest. The Court cited the seminal case from the Second Circuit on cure, *In re Taddeo*, for the proposition that, while undefined by the Bankruptcy Code itself, "[c]uring a default commonly means taking care of the triggering event and returning to pre-default conditions. The consequences are thus nullified. This is the concept of 'cure' used throughout the Bankruptcy Code." Although *Taddeo* was a chapter 13 case, the strategy was adopted in a series of chapter 11 cases in the mid-1980s. The bankruptcy court in those cases held that a debtor may cure a default, and "de-accelerate" a loan, by paying interest at the contract rate. The decisions have endured as the foundation for much of the section 1124(2) jurisprudence to date. The *Entz-White* Court adopted the reasoning of these cases.

The problem arises from Congress' amendment of the Bankruptcy Code in 1994 to add section 1123(d), which applies to contracts entered into after October 22, 1994. Prior to section 1123(d), the Bankruptcy Code did not contain any statutory language relating to the amount required to cure a default pursuant to a plan of reorganization; section 1123(a)(5)(G) permitted a cure or waiver of a default pursuant to a plan of reorganization but did not provide any definition of cure or any statutory guidance as to the amount required to cure the default. Some commentators and courts have concluded that section 1123(d) is unambiguous and concretely requires that default interest, if provided under an agreement and not prohibited by applicable law, must be paid as part of a section 1124(2) cure, notwithstanding prior judicial determinations to the contrary. Commentators have also suggested that because Bankruptcy Code section 365(b)(2)(D), which was also enacted in 1994, specifically relieves the debtor from any obligation to pay default-rate interest when it assumes a contract, the absence of express language to that effect in section 1123(d), by "negative implication," means that Congress intended otherwise.

Illustrative of this view are decisions rendered by a California district court in *In re Pacific Gas and Electric Co.* and the Ninth Circuit bankruptcy appellate panel in *Hassen Imports P'Ship v. KWP Financial VI (In re Hassen Imports P'Ship).* Both of these courts found that section 1123(d) of the Bankruptcy Code calls the specific holding of *Entz-White* into question. The Fifth Circuit also called the continued vitality of *Entz-White* into doubt in a 1998 decision. In *Matter of Southland Corp.*, the Court of Appeals held that the debtor was required to pay interest on a secured creditors' claim at the default rate specified in its credit agreement where the debtor's plan of reorganization did not

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reinstate, but rather impaired, the creditor's claim. Rejecting the debtor's contention that the *Entz-White* rationale should be applied in a context other than determining whether a claim is unimpaired under section 1124(2), the Court of Appeals remarked that "[a]part from the doubtfulness of adopting *Entz-White* or extending its reasoning in this circuit, we note that Congress, in bankruptcy amendments enacted in 1994, arguably rejected the *Entz-White* denial of contractual default interest rates."

On the other hand, *In re Phoenix Business Park Ltd. P'ship*, an Arizona bankruptcy court, after analyzing the legislative history of sections 1123(d) and 365(b)(2)(D), held that *Entz-White* was not legislatively overruled. The court rejected the "negative implication argument," and held that the limiting language of section 1123(d) does not apply to "cure" for purposes of impairment within the meaning of section 1124(2) because if Congress had intended it to do so it would have included an express reference in the statute to make clear that it was overruling *Entz-White*. Judging by the Court of Appeals' decision in *Sylmar Plaza, Entz-White* continues to be good law in the Ninth Circuit.

> The fact that the debtor's sole purpose in proposing the plan is to avoid the higher interest payment does not necessitate a finding of bad faith since that purpose is authorized by the Bankruptcy Code.

The Ninth Circuit's Opinion

The Hornwoods, a family of successful real estate investors, obtained a loan of approximately $8 million in 1992 secured by a shopping center. The terms of the loan agreement entered into by the Hornwoods and the lender relating to interest payments provided, in relevant part, for a fixed rate of 8.87% and, should the Hornwoods default under the terms of the agreement, a default interest rate of 13.87%.

Approximately five years after obtaining the loan, the Hornwoods transferred the shopping center to a newly created limited partnership without the lender's consent and the balance of their real estate portfolio to four other newly created limited partnerships. Immediately thereafter, the Hornwoods ceased making payments, which, in effect, entitled the lender to the 13.87% interest rate. As a result of the default, the lender filed a foreclosure action against the Hornwoods. The foreclosure was stayed when the limited partnership that owned the shopping center filed for chapter 11.

The bankruptcy court confirmed the debtor's plan of reorganization, which provided for full payment of the lender's secured claim, which the plan designated as unimpaired. Full payment, however, did not include the 13.87% interest rate, thereby depriving the lender of approximately $1 million dollars to which it was entitled under the contract as default interest. The lender appealed, contending that, among other things, a plan intended to nullify the consequences of a default and avoid default interest payments was proposed in bad faith in derogation of Bankruptcy Code section 1129(a)(3). According to the lender, the plan was, *per se*, a sham solely designed to deprive the creditor of the benefit of the default rate of interest. After the bankruptcy appellate panel affirmed the bankruptcy court's confirmation order, the lender appealed to the Ninth Circuit.

Applying the "totality of the circumstances" test, the Court of Appeals rejected the lender's "per se" argument. The Ninth Circuit noted that the Bankruptcy Code permits a debtor to cure its defaults and this power entails nullification of the consequences of a default, such as avoiding the higher interest payment. According to the Court, merely because "a creditor's contractual rights are adversely affected does not by itself warrant a bad faith finding." Remarking that "Congress made a determination that an eligible debtor should have the opportunity to avail itself of a number of Code provisions which adversely alter creditors' contractual and nonbankruptcy rights," the Court ruled that the fact that the debtor's sole purpose in proposing the plan was to avoid the higher interest payment does not necessitate a finding of bad faith since that purpose is authorized by the Bankruptcy Code.

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In Brief

The repercussions of the U.S. Supreme Court's ground-breaking decision early this year in *FCC v. NextWave Personal Communications, Inc.* have been swift but predictable. As reported in the February 2003 edition of the *Business Restructuring Review* (vol. 2, no. 2), the High Court, by a margin of seven to one, ruled in *NextWave* that section 525 of the Bankruptcy Code prohibited the Federal Communications Commission from revoking broadband capacity licenses auctioned to *NextWave*, a chapter 11 debtor, due to the company's inability to make timely payments owed to the FCC for the purchase of the licenses. The decision was a significant one for the telecommunications industry. It put an end to protracted litigation that had for many years limited access to the disputed broadband capacity. It was also viewed as having given the green light to technology developers eager to exploit the public airways by removing the shroud of controversy from these important broadband licenses.

NextWave was merely one of many companies who prevailed at auction and later found that the capital market for telecom development had dried up. These companies also discovered that they had vastly overpaid for broadband licenses auctioned by the FCC in 1996. Many of them filed for bankruptcy protection in an effort to prevent the FCC from revoking and re-auctioning their licenses. One such company, Kansas Personal Communications Services, Ltd., was the subject of a ruling handed down by the United States Court of Appeals for the Tenth Circuit in the aftermath of the Supreme Court's decision in *NextWave*.

Kansas PCS was the winning bidder of three licenses in the same block as those auctioned to NextWave. Similarly to NextWave, Kansas PCS failed to make installment payments on licenses, which then cancelled automatically under FCC rules. After Kansas PCS filed for bankruptcy, the bankruptcy court ruled that the Bankruptcy Code precluded the FCC's automatic cancellation regulation from being enforced. However, the district court reversed this decision on appeal, ruling that the license cancellation was automatic and was not covered by section 362 of the Bankruptcy Code. Kansas PCS appealed the decision to the Tenth Circuit, and commentators following developments in the embattled telecom industry postulated that the Court of Appeals might hand down a decision construing the scope of the FCC's regulatory power in bankruptcy proceedings in a different way than the other three circuits that have weighed in on this issue.

The Supreme Court decided *NextWave* before the Tenth Circuit had an opportunity to do so. Then, on March 4, 2003, the Court of Appeals issued its decision in *Kansas Personal Communications Services, Ltd. v. Federal Communications Commission (In re Kansas Personal Communications Services, Ltd.* In a brief unpublished opinion, the Tenth Circuit reversed the district court's ruling, observing that in accordance with *NextWave*, "[t]he Chapter 11 filing barred the FCC from taking any action against the license of Kansas Personal Communications Services, Ltd. without first obtaining authority to do so from the bankruptcy court."

NextWave and its progeny provide a glimmer of hope for beleaguered telecoms, but the prospects for the industry are still far from rosy, judging by recent statistics. One telecom research firm, Probe Research, recently issued a report entitled "Debt, Demographics and Telecom," which points to the possibility of an even bigger telecommunications crisis than the industry has suffered in the last few years. Stay tuned for further developments.

Federal Communications Commission v. NextWave Personal Communications, et. al., 123 S. Ct. 832 (2003).

In re Kansas Personal Communications Services Ltd., 252 BR 179 (Bankr. D. Kan. 2000).

United States of America v. Kansas Personal Communications Services, Ltd., 256 BR 807 (D. Kan. 2000).

Kansas Personal Communications Services, Ltd. v. Federal Communications Commission (In re Kansas Personal Communications Services, Ltd., 2003 WL 723952 (10th Cir. Mar. 4, 2003).

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> While the outcome is not controversial, the language of the Second Circuit's opinion leaves room for doubt concerning the precise reason for extending the stay to the non-debtor wholly owned corporation.

estate, such as a claim to establish an obligation guaranteed by the debtor, a claim against the debtor's insurer or actions involving "such identity of interest" between the debtor and the third-party defendant that the debtor may be said to be the real party defendant.

The Second Circuit found that the case before it warranted extension of the automatic stay to include Queenie, but not the other counterclaim defendants. According to the Court, "the stay applies to Queenie because it is wholly owned by Gardner, and adjudication of a claim against the corporation will have an immediate adverse economic impact on Gardner." It rejected the argument that the stay should apply to the other counterclaim defendants on the theory that allowing the litigation to go forward without Gardner and Queenie might deprive them of the ability to contest certain issues by reason of the doctrine of collateral estoppel. That threat alone, the Court observed, has never been a sufficient basis for extending the scope of the stay to interfere with enforcement of creditor rights against non-debtor co-defendants.

Analysis

Queenie, Ltd. v. Nygaard Int'l does not represent a departure from the approach employed by most courts when determining whether the automatic stay should preclude creditor enforcement actions against non-debtor entities closely affiliated with a chapter 11 debtor. However, while the outcome is not controversial, the language of the Second Circuit's opinion leaves room for doubt concerning the precise reason for extending the stay to the non-debtor wholly-owned corporation. As noted, the Court stated that the stay applied to Queenie because "it is wholly owned by Gardner, and adjudication of a claim against" Queenie would have an immediate adverse economic impact on Gardner.

The fact that the non-debtor was wholly-owned by the debtor should have been irrelevant. As noted by an Illinois district court in *In re Winer*, "[a]bsent a piercing-the-corporate veil situation (and none is claimed to exist here), the debtor's presence in the bankruptcy court cannot block actions implicating the nondebtor subsidiary." Efforts to stay actions against non-debtor subsidiaries on the theory that they might adversely affect property of the debtor's bankruptcy estate by depressing the value of stock held by the debtor have rarely been successful. Indeed, this has been the law in the Second Circuit for more than thirty years, although the Court of Appeals in *Queenie, Ltd. v. Nygaard Int'l* failed to even mention its previous ruling directly on this point in *In re Beck Industries.* In that case, the Second Circuit ruled that the immediate predecessor to the Bankruptcy Code "does not authorize the [bankruptcy] court to enjoin a suit against a solvent independent subsidiary of the debtor merely because its stock is held by the debtor in reorganization." According to the Court, extension of the stay to preclude actions against a subsidiary would require a showing that the subsidiary is a mere sham or alter ego of the debtor. *Queenie, Ltd. v. Nygaard Int'l* seems to indicate that the standard has become less stringent.

Standing alone, it would be relatively simple to ascribe the ambiguity lurking in the Second Circuit's words to inadvertence, but the Court has failed to make a distinction on this issue before. In *B.F. Goodrich v. Betkoski*, the Court of Appeals, in a seemingly innocuous remark that had little to do with the merits and significance of its ruling, stated that "[a]s the automatic stay protecting North Penn necessarily protects its subsidiary, Lombard Brothers, we believe that the claims against both entities should be dismissed without prejudice until the stay is lifted." Given its clear misstatement of the law in *B.F. Goodrich* on the scope of the stay, it is difficult to determine whether *Queenie, Ltd. v. Nygaard Int'l* is meant to suggest that the stay should apply to the non-debtor because it is wholly-owned by the debtor and irrespective of whether adjudicating a claim against it as a co-defendant would have an immediate adverse impact on the debtor.

Queenie, Ltd. v. Nygaard Int'l, 2003 WL 462416 (2d Cir. Feb. 25, 2003).

Croyden Associates v. Alleco, Inc., 969 F.2d 675 (8th Cir. 1992).

Teachers Insurance and Annuity Ass'n v. Butler, 803 F.2d 61 (2d Cir. 1986).

McCartney v. Integra National Bank North, 106 F.3d 506 (3d Cir. 1997).

In re Johns-Manville Corp. v. Asbestos Litigation Group (In re Johns-Manville Corp.), 26 B.R. 420 (Bankr. S.D.N.Y. 1983).

A.H. Robins Co. v. Piccinin, 788 F.2d 994 (4th Cir. 1986).

In re Winer, 158 B.R. 736 (N.D. Ill. 1993).

In re Hudgins, 153 B.R. 441 (Bankr. E.D. Va. 1993).

In re Beck Industries, Inc., 479 F.2d 410, 415 (2d Cir.), *cert. denied sub. nom. Trustees of Beck Industries, Inc. v. Feldman*, 414 U.S. 858 (1973).

B.F. Goodrich v. Betkoski, 99 F.3d 505 (2d Cir. 1996).

LEGISLATIVE ALERT

True to his pledge, House Judiciary Committee Chairman James Sensenbrenner reintroduced long-stalled bankruptcy reform legislation in the 108th Congress shortly after lawmakers convened on January 7, 2003 with a reconstituted Republican majority. The Committee held the year's inaugural hearing on the pending bill on March 4, but left bill proponents and opponents scratching their heads over how this year's reform effort will eventually play out. Congressman Sensenbrenner introduced new bankruptcy reform legislation (H.R. 975) with 50 co-sponsors on February 27. It is an exact copy of the version that failed to pass in the last Congress (H.R. 333), minus any language relating to the controversial issue of how to treat debts incurred in connection with abortion clinic protest activity. Dispute over the abortion issue was primarily responsible for killing the legislation in 2002.

Apparently, the abortion issue is not the only hurdle that must be overcome. Major opponents of the bill as it is currently written argue that the bill's so-called "means test" is inherently flawed. The means test, which is based on a filer's income level, is designed to determine who can qualify for chapter 13 bankruptcy, which requires some repayment of debts over time, and who can file under chapter 7 liquidation. Critics claim the means test fails to target fraud and also fails to account for extraordinary events like the sudden loss of a job or health care. The issue is an important one, given the fact that individual bankruptcy filings accounted for the overwhelming majority (97.6 percent) of all bankruptcy cases filed in calendar year 2002.

Signaling a desire to avoid last year's legislative wrangling that doomed efforts to reform bankruptcy law for the sixth straight year, Senate Judiciary Committee Chairman Orrin Hatch has said he wants to bring bankruptcy reform legislation directly to the Senate floor and skip the customary committee mark-up process, but this approach has already drawn criticism from Senate Democrats. Meanwhile, the controversial abortion language will likely lie in wait again until the bill reaches conference or its sponsor, Senator Charles Schumer, attempts to add the amendment either in committee or on the Senate floor.

Bankruptcy Filing to Prevent Asset Sale Constitutes Bad Faith

Ann Marie Bredin and Mark G. Douglas

Record-setting business bankruptcy filings in 2002 and headlines touting what would appear to be a headlong rush to the bankruptcy courts by embattled corporate giants such as WorldCom, Conseco, United Airlines, Adelphia and Kmart have brought renewed attention to the propriety of bankruptcy relief as a panacea for a company's financial troubles. Highly publicized incidents of bankruptcy abuse have contributed to a growing perception that the bankruptcy process is rife with misconduct. In fact, abuse of the bankruptcy process by unscrupulous corporate debtors is the exception. For the vast majority of businesses, the filing of a petition under chapter 11 is the result of a thorough and, sometimes difficult, analysis of a variety of strategic options. However, in certain cases, the filing of a chapter 11 case is found to be inappropriate as having been undertaken in "bad faith." The Eleventh Circuit Court of Appeals recently addressed the appropriate remedy for bankruptcy abuse amounting to "bad faith" in *In re The Bal Harbour Club, Inc.* Confronted with a debtor that had invoked the bankruptcy process to prevent a purchaser from acquiring certain property sold by the debtor before a change in control of the debtor's board of directors, the Court of Appeals affirmed a bankruptcy court's dismissal of the debtor's chapter 11 case as having been failed in "bad faith."

Business Judgment and Filing for Bankruptcy

Given the significance of a bankruptcy filing on a business, both in terms of its practical effects on day-to-day operations and its subtler impact on public perception of the company, the determination to enter chapter 11 is usually well-reasoned and well-supported. Like other significant decisions made by a company's management, the determination to file for bankruptcy must represent an exercise of sound business judgment, as gauged by the "business judgment rule." While not a bankruptcy-specific concept, the "business judgment rule" plays an important role in the administration of many bankruptcy cases. The rule is essentially a presumption that, in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith and in the honest belief that their actions are in the corporation's best interests. This rule generally protects directors from liability for detrimental corporation transactions if the transactions were effected in good faith and with due care and the relevant decisions were within the directors' authority.

Two primary rationales support the business judgment rule. First, it seems unfair, and fundamentally counterproductive, to permit shareholders to choose directors through the election process and then to collect from those same directors when their judgment — as opposed to their honesty or diligence — proves flawed. If directors were the victims of potentially costly "Monday-morning quarterbacking" with respect to their business decisions, few people would be willing to assume director positions. The second primary underpinning of the business judgment rule is that, as a general matter, courts are ill-equipped to take on the corporate decision-making process. Such responsibility, if even appropriate, likely would prove to be prohibitively time-consuming.

In the bankruptcy context, courts routinely defer to the business judgment of the directors of a chapter 11 debtor-in-possession with respect to decisions involving the management of the debtor's property and the operation of the debtor's business. For example, a debtor's decision to assume or reject a contract or lease is deemed to be a matter of business judgment. So too are decisions regarding the debtor's choice of bankruptcy counsel and other professionals, as well as determinations to sell assets outside the ordinary course of the debtor's business. The directors of chapter 11 debtor, however, are not empowered with carte blanche authority to run the company. The business judgment rule simply provides a presumption of propriety that ultimately may be refuted. Where something as basic as the debtor's initial determination to file for reorganization under chapter 11 is called into question, the Bankruptcy Code contains a mechanism to assess whether the debtor should be allowed to remain in chapter 11 and reap its benefits at the expense of creditors,

Dismissal or Conversion for "Cause"

Bankruptcy Code section 1112(b) allows the bankruptcy court, in its discretion, to convert a chapter 11 case to chapter 7 or to dismiss a chapter 11 case, whichever is in the best interests of creditors and the estate, for "cause." The Bankruptcy Code does not define "cause." Although section 1112(b) provides 10 example of cause, the list is merely illustrative, not exhaustive. In other words, a court may convert or dismiss a case for a reason that is not enumerated in section 1112(b), provided that the reason is sufficient to show the existence of cause. Examples from the explicit list in this statutory section include: "continuing loss to and diminution of the estate and absence of a reasonable likelihood of rehabilitation," "inability to effectuate a plan" and "unreasonable delay by the debtor that is prejudicial to creditors."

Courts consistently have found that the prosecution of a chapter 11 case in "bad faith" — not one of the 10 listed examples — constitutes "cause" under section 1112(b). A bad faith filing generally refers to filing with the purpose of abusing the judicial process. In some instances, the filing is deemed improper because, despite the best intentions of the company, it appears improbable that the benefits of reorganization will be achieved at a reasonable cost or within a reasonable time period. In other cases, courts have found that the insiders of the company have acted in bad faith, attempting to abuse the judicial process and protections afforded by chapter 11. In these cases, despite the typical judicial deference to the business judgment of the directors of a company, a court will convert the chapter 11 case to a chapter 7 liquidation case or dismiss the proceeding altogether. As discussed in the *Bal Harbour* decision, the analysis of whether a chapter 11 filing was in bad faith largely parallels the analysis undertaken by courts employing the business judgment rule.

Background

Bal Harbour Club (the "Club") was a not-for-profit Florida corporation that owned and operated a private social and yacht club in Florida. In 1993, the Club's Board of Governors (the "Board") decided to sell its oceanfront property, consisting of 5.5 acres. In June 1995, the Board found a buyer, AVA Development, Inc. ("AVA"), and agreed to sell the property to AVA for $34 million, conditioned on a favorable modification (for AVA) in the applicable zoning regulations. While AVA was pursuing such modification, Joseph Imbesi acquired control of the Club's Board and immediately took steps to prevent AVA from acquiring the oceanfront property. To this end, the Board resolved that the Club file a chapter 11 case in October 1998. Two weeks after the Club's bankruptcy filing, AVA moved to dismiss the Club's petition pursuant to Bankruptcy Code section 1112(b). AVA asserted that the Club's lack of good faith constituted cause for dismissal.

After an evidentiary hearing, the bankruptcy court granted AVA's motion, finding that "the bankruptcy filing in this case was an improper use of the bankruptcy process and the Court." The court found that evidence of such improper use included Imbesi's "purchase of proxies to influence" the selection of Board members, and "the initiation of litigation to frustrate" AVA's acquisition of the oceanfront property. Additional evidence included the "highjacking" of the Debtor by replacing the Board through the use of "phony loans," and the "borrowing of $1.145 million, without agreeing to any terms of repayment or an interest rate from a person holding the control of an insider [*i.e.* Imbesi or a company he controlled] in a last minute rush in order to gain strategic advantage over another interested party." The Club appealed the bankruptcy court's dismissal of its chapter 11 petition to the district court, which affirmed, finding no error in the bankruptcy court's application of section 1112(b) to the facts before it and concluding that dismissal of the case was a decision that fell well within the bankruptcy court's discretion.

The Eleventh Circuit's Decision

The Club fared no better on appeal to the Eleventh Circuit. According to the Club, the bankruptcy court erred by failing to give the Club the benefit of the business judgment rule, which, according to the law in the Eleventh Circuit, dictated a "policy of judicial restraint born of the recognition that directors are, in most cases, more qualified to make business decisions than are judges." Acknowledging that the Club "properly points out" that, under the business judgment rule, courts "presume" that directors have acted in good faith, the Court of Appeals further observed that a "court will not call upon a

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director to account for his action in the absence of a showing of abuse of discretion, fraud, bad faith, or illegality." However, the Eleventh Circuit emphasized, a presumption only goes so far to protect the actions of a director. It can be overcome.

At the outset, the Court of Appeals noted that because AVA bore the burden of proving "cause" for dismissal under Bankruptcy Code section 1112(b), the Club did not need the benefit of a presumption, particularly given the fact that, unlike in the traditional situation, the Board possessed all of the evidence regarding its reasoning for filing the chapter 11 petition. Next, the Eleventh Circuit noted that the use of the word "presumption" in articulating the business judgment rule was not intended to create a presumption in the classical procedural sense: as a vehicle that puts the burden of going forward with the evidence on the party without the burden of proof. Instead, the Court noted, the term merely expresses the "substantive rule of director liability": that "so long as due care was exercised, the [rule] protects a 'good director' (one who did not act fraudulently, illegally, oppressively, or in bad faith) who made an honest error or mistake in judgment, but not a 'bad director' (one who acted fraudulently, illegally, oppressively, or in bad faith) who made a bad decision."

The Eleventh Circuit then turned to the merits, observing that the "question before the bankruptcy judge was a question the business judgment rule envisions — whether the Board acted in bad faith when it filed the instant petition." Concluding that AVA had met its burden of proof on that issue, the Court of Appeals ruled that Bankruptcy Code section 1112(b) authorized the bankruptcy court to dismiss the petition on a finding that it had been filed in bad faith, for the purpose of abusing the judicial process and the reorganization afforded by chapter 11.

Analysis

Bal Harbour is indicative of the kind of conduct that oversteps the bounds of propriety in the realm of corporate decision making when considering a solution for a company's financial problems. Because the Board's misconduct in *Bal Harbour* was egregious, other cases involving actions that more closely skirt the limits of permissible bankruptcy planning and strategy are probably more instructive in defining the boundaries of Bankruptcy Code section 1112(b). The Eleventh Circuit's decision, however, is an interesting articulation of the intersection of the business judgment rule and bad faith filing standard. As more companies consider bankruptcy as a strategic option, and as governmental and public scrutiny of corporate governance decisions becomes increasingly intense, directors must remain vigilant about their responsibilities and be aware of the limitations on the protections afforded to corporate insiders.

In re The Bal Harbour Club, Inc, 316 F.3d 1192(11th Cir. 2003).

In re Syndicom Corp., 268 B.R. 26 (Bankr. S.D.N.Y. 2001).

In re Long Bay Dunes Homeowners Ass'n, Inc., 246 B.R. 801 (Bankr. D.S.C. 1999).

FDIC v. Stahl, 89 F.3d 1510 (11th Cir. 1996).

AS MORE COMPANIES CONSIDER BANKRUPTCY AS A STRATEGIC OPTION, AND AS GOVERNMENTAL AND PUBLIC SCRUTINY OF CORPORATE GOVERNANCE DECISIONS BECOMES INCREASINGLY INTENSE, DIRECTORS MUST REMAIN VIGILANT ABOUT THEIR RESPONSIBILITIES AND BE AWARE OF THE LIMITATIONS ON THE PROTECTIONS AFFORDED TO CORPORATE INSIDERS.

Managing Transnational Insolvencies

Fedra Fateh

The unprecedented expansion of global commerce continues to test the ingenuity of lawmakers scrambling to devise a workable framework of rules to govern international transactions. Until a legislative framework governing cross-border insolvencies is established, parallel U.S. and foreign bankruptcy proceedings will continue to present U.S. Courts with the potential of conflicting insolvency regulatory regimes. In *Stonington Partners, Inc. v. Lernout & Hauspie Speech Products N.V.*, the Third Circuit affirmed its policy of restraint in exercising its power to enjoin foreign proceedings in deference to the doctrine of international comity.

The Doctrine of International Comity

Comity is a doctrine that reconciles jurisdictional conflict by encouraging deference to the judgment of a foreign court under the appropriate circumstances. When compliance with the regulatory laws of both countries is impossible, courts use the principle of comity as a canon of construction, to limit the reach of a domestic statute, or to decline to exercise jurisdiction in a case properly adjudicated in a foreign court. In order to determine whether the foreign court is the more appropriate forum, the domestic court evaluates all relevant factors (similar to a choice-of-law analysis), including (i) the link between the regulating state and the relevant activity, (ii) the connection between the state and the person responsible for the activity (or protected by the regulations), (iii) the effect of the regulation on the parties' reasonable expectations, (iv) the significance of the regulation on the international system, (v) the scope of the state's regulations, and (vi) the likelihood of conflict with other states' regulations.

Comity is especially important in the bankruptcy context because cooperation with the foreign insolvency regime will facilitate an equitable and orderly distribution of the debtor's assets — the central aim of the U.S. Bankruptcy Code. Moreover, Congress explicitly acknowledged the importance of international comity in dealing with transactional insolvencies. Section 304 of the Bankruptcy Code allows an accredited representative of a company that is the subject of a foreign insolvency proceeding to file an "ancillary" bankruptcy proceeding in the U.S. to prevent piecemeal liquidation of its U.S. assets. The statute lists comity as one of several factors to be considered by a court when considering whether to grant relief to a foreign debtor. Although section 304 is unclear as to the weight to be given to each factor, the majority of courts gives preference to considerations of comity. Even though section 304 of the Bankruptcy Code only applies to ancillary proceedings filed as a complement to foreign bankruptcy or insolvency cases, bankruptcy and other courts presiding over transnational litigation have been motivated by the language and legislative history of section 304 to apply principles of comity in any insolvency proceeding involving a foreign court.

The Standard for Anti-Suit Injunctions

Faced with a conflict between U.S. law and that of a foreign state, bankruptcy and other federal courts are often asked to grant an anti-suit injunction, enjoining one of the parties from resorting to a foreign court or enjoining the foreign court itself. There is no uniform standard for determining when such anti-suit injunctions are warranted. The circuits are split over the degree of deference owed to foreign courts in cases involving parallel bankruptcy proceedings or non-bankruptcy litigation.

The Fifth, Seventh and Ninth Circuits have adopted a "liberal" standard. Courts ascribing to this standard will issue an anti-suit injunction under any of the following circumstances: (i) policy in the enjoining forum would be frustrated, (ii) the foreign proceeding would be vexatious, (iii) the foreign proceeding would threaten a domestic court's *in rem* or quasi *in rem* jurisdiction over assets or property, or (iv) allowing the foreign proceeding would delay the domestic proceeding.

Conversely, under the "restrictive" approach applied by the District of Columbia, Second, Third and Sixth Circuits, an injunction against a foreign proceeding is granted only (i) to protect the jurisdiction of the domestic court, or (ii) to safeguard an important public policy. For example, in *Laker Airways Ltd. v. Sabena*, the Court of Appeals for the District of Columbia Circuit upheld an anti-suit injunction where the foreign debtor initiated the foreign proceeding solely for the purpose of terminating the U.S. court's adjudication of antitrust litigation and the foreign court had enjoined the parties from pursuing the case in the United States. Courts applying the "restrictive approach" rarely rely on the public policy exception as justification for issuing an anti-suit injunction. As noted by the Sixth Circuit

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Court of Appeals in *Gau Shan Co. v. Bankers Trust Co.*, "only the evasion of the most compelling public policies" warrants the issuance of an anti-suit injunction, and the treble damages remedy at issue in the case did not rise to that level. In sum, courts applying the "restrictive" standard are willing to grant anti-suit injunctions only under exceptional circumstances. In *Stonington Partners*, the Third Circuit upheld its "restrictive" approach in declining to affirm the lower court's injunction again a creditor pursuing its claim under the more favorable laws of a foreign court.

Background

Lernout & Hauspie Speech Products N.V. ("Lernout") was a Belgian company with headquarters in the United States and Belgium that had initiated parallel plenary bankruptcy proceedings in both countries. Stonington Partners, Inc. ("Stonington") asserted a claim against Lernout resulting from an allegedly fraudulent stock transaction. Under U.S. bankruptcy law, Stonington's claim was a pre-petition claim arising from the rescission of a purchase of the debtor's securities, subject to mandatory subordination under section 510(b) of the Bankruptcy Code. However, under Belgian law, the claim would be treated as an unsecured claim, on parity with other unsecured claims. Lernout attempted to confirm a reorganization plan in Belgium that would have subordinated Stonington's claim, but the Belgian court rejected the plan because of the unequal treatment of creditors.

Presented with a true conflict of laws, the U.S. bankruptcy court had to determine whether principles of international comity precluded it from giving effect to the classification and treatment of claims prescribed by the Bankruptcy Code. This required a determination as to which sovereign had the most significant interest in the application of its laws to the case. The court found that the United States was the "center of gravity" and, therefore, its laws should prevail over the conflicting insolvency laws of Belgium. As a result, it enjoined the Stonington from pursuing its claim in the Belgian bankruptcy proceeding. Notably, the bankruptcy court disclaimed any intention of interfering with the Belgian court's application of its law. Stonington appealed. The district court upheld the bankruptcy court's finding that the United States was the "center of gravity" and therefore the denial of comity and grant of injunctive relief were appropriate.

The Third Circuit's Ruling

On appeal to the Third Circuit, the Court of Appeals reiterated its "restrictive" standard for issuing an anti-suit injunction. As a preliminary matter, the Circuit Court clarified that it saw no distinction between enjoining a party from resorting to a foreign court and enjoining a foreign proceeding. Then, as a point of departure for its analysis, the Court emphasized its "serious concern for comity" as the motivation behind its "restrictive" approach. Principles of comity, the Third Circuit found, had not been adequately considered by the U.S. court when it decided to enjoin foreign litigation.

The Third Circuit ultimately reversed and remanded the district court's injunction on the ground that the applicable case law unequivocally directs courts to exercise restraint in enjoining foreign proceedings in light of comity concerns that were not taken into consideration by the lower courts. The Court expressed skepticism as to whether an anti-suit injunction was appropriate under these circumstances. Nonetheless, finding that the bankruptcy court was better suited to engage in the qualitative analysis required, the Circuit Court directed the bankruptcy court to apply the appropriate standard for enjoining foreign proceedings while considering the important comity concerns in order to determine whether these facts amount to the rare situation in which such relief is warranted.

Analysis

Stonington Partners reiterates the well-established reluctance of certain circuits to grant anti-suit injunctions in breach of the comity among the courts of separate sovereignties. The circumstances under which such relief is warranted under the "restrictive" approach are quite limited. No doubt, the willingness of U.S. courts to uphold the doctrine of international comity does promote cooperation with courts of other nations, which can be beneficial in the context of cross-border insolvencies. However, a creditor based in the United States, entering in an agreement governed by U.S. law, with an entity with a significant presence in the United States will inevitably be troubled by the uncertainty that results when a domestic court defers to a foreign court, even in a plenary bankruptcy proceeding conducted in the United States. For this reason, the more "liberal" approach of the other circuits

When confronted with debtors with assets and creditors widely dispersed throughout numerous sovereign states, cooperation among domestic and foreign legal regimes is essential in order to safeguard international legal norms with important foreign policy implications.

may result in a more predictable outcome because those courts seem to be more willing to entertain arguments supporting U.S. control of parallel transnational proceedings.

Ultimately, the rise in cross-border bankruptcies and the need for both juridical cooperation and commercial predictability highlight the need for adoption of international insolvency guidelines. Some progress in this direction has been made. The European Union has adopted a Regulation on Insolvency Proceedings, but it applies only to member states. In an ambitious effort at furthering global cooperation, the United Nations Commission for International Trade Law has promulgated a Model Law on Cross-Border Insolvency. Bankruptcy reform legislation passed by both the United States Senate and House of Representatives in 2000 and 2001 include similar versions of the Model Law. The legislation provides for the addition of a new chapter 15, incorporating the Model Law. These provisions would govern (i) ancillary proceedings, substituting section 304 of the Bankruptcy Code; (ii) situations where a domestic court seeks the assistance of a foreign court in connection with a case under the Bankruptcy Code; (iii) parallel plenary bankruptcy proceedings in a domestic and foreign court; and (iv) situations where creditors or other interested persons in a foreign country have an interest in initiating or participating in a case under the Bankruptcy Code.

The adoption of a new chapter 15 would homogenize the appellate courts' resolution of the competing demands of the domestic bankruptcy regime and the need for respect for international comity. When confronted with debtors with assets and creditors widely dispersed throughout numerous sovereign states, cooperation among domestic and foreign legal regimes is essential in order to safeguard international legal norms with important foreign policy implications. Moreover, the orderly and equitable distribution of debtors' assets, increasingly found all over the world, is a central goal of the Bankruptcy Code, which still requires legislative reform in order to be achieved. Unfortunately, proposed chapter 15 and other amendments that would effect the most sweeping changes to U.S. bankruptcy laws since 1994 have been mired in Capitol Hill trenches due to partisan infighting regarding aspects of the legislation that have nothing to do with international insolvency law considerations. This may soon change. The bankruptcy bill was recently re-introduced by lawmakers intent upon breaking the deadlock.

Stonington Partners, Inc. v. Lernout & Hauspie Speech Products N.V., 310 F.3d 118 (3rd Cir. 2002).

Laker Airways Ltd. v. Sabena, 731 F.2d 909 (D.C. Cir.1984).

Gau Shan Co. v. Bankers Trust Co., 956 F. 2d 1349 (6th Cir. 1992).

Kaepa, Inc. v. Achilles Corp., 76 F.3d 624 (5th Cir.), *cert. denied*, 519 U.S. 821 (1996).

Allendale Mut. Ins. Co. v. Bull Data Sys., Inc., 10 F.3d 425 (7th Cir. 1993).

Seattle Totems Hockey Club, Inc. v. Nat'l Hockey League, 652 F.2d 852 (9th Cir. 1981), *cert. denied*, 457 U.S. 1105.

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Analysis

The Ninth Circuit in *Sylmar Plaza* did not deviate from the general rule applied by most courts in determining "good faith" by viewing the "totality of the circumstances." The crux of its reasoning is that a plan whose terms comply with the provisions of the Bankruptcy Code — even those that alter a creditor's rights and remedies under applicable non-bankruptcy law — is proposed in good faith. However, curiously absent from *Sylmar Plaza* is any reference to section 1123(d) and the effect, if any, of the 1994 amendments to the Bankruptcy Code. In *Sylmar Plaza*, the Ninth Circuit merely relies on *Entz-White* as established precedent without disposing of, or even discussing, the controversy clouding its continued vitality. This could be ascribed to the fact that the loan agreement in *Sylmar* predated 1994, so that section 1123(d) does not apply, but we cannot be sure. In any event, parties relying on *Sylmar Plaza* should proceed with caution, given the split of authority within the courts as to whether the 1994 amendments to the Bankruptcy Code legislatively overruled *Entz-White* and the opinion's indifference to the existence of the controversy.

Hornwood v. Sylmar Plaza, L.P., Inc. (In re Sylmar Plaza, L.P.), 314 F.3d 1070 (9th Cir. 2002).

Great Western Bank & Trust v. Entz-White Lumber and Supply, Inc. (In re Entz-White Lumber and Supply, Inc.), 850 F.2d 1338 (9th Cir. 1988).

In re Taddeo, 685 F.2d 24 (2d Cir.1982).

Levy v. Forest Hills Assocs. (In re Forest Hills Assocs.), 40 B.R. 410 (Bankr. S.D.N.Y. 1984).

In re Manville Forest Products Corp., 43 B.R. 293 (Bankr. S.D.N.Y.1984), *aff'd in part, rev'd in part*, 60 B.R. 403 (S.D.N.Y. 1986).

In re Kizzac Management Corp., 44 B.R. 496 (Bankr. S.D.N.Y. 1984).

In re Hassen Imports P'ship v. KWP Fin. VI (In re Hassen Imports P'ship), 256 B.R. 916 (B.A.P. 9th Cir. 2000).

In re Pacific Gas and Elec. Co., 283 B.R. 41 (N.D. Cal. 2002).

In re Phoenix Business Park Ltd. Partnership, 257 B.R. 517 (Bankr. D. Ariz. 2001).

Matter of Southland Corp., 160 F.3d 1054 (5th Cir. 1998).

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