JONES DAY®

RECENT DEVELOPMENTS IN BANKRUPTCY AND RESTRUCTURING

VOLUME 8 ▪ NO. 6 ▪ NOVEMBER/DECEMBER 2009

BUSINESS RESTRUCTURING REVIEW

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GOOD TIDINGS FOR CLAIMS TRADERS: SECOND CIRCUIT RULES THAT PURCHASED ADMINISTRATIVE CLAIMS NOT DISALLOWED BY OPERATION OF SECTION 502(d)

Mark G. Douglas

Participants in the multibillion-dollar market for distressed claims and securities had ample reason to keep a watchful eye on developments in the bankruptcy courts during each of the last four years. Controversial rulings handed down in 2005 and 2006 by the bankruptcy court overseeing the chapter 11 cases of failed energy broker Enron Corporation and its affiliates had traders scrambling for cover due to the potential for acquired claims/debt to be equitably subordinated or even disallowed, based upon the seller's misconduct. The decisions had players in the distressed-securities market rushing to devise better ways to limit their exposure by building stronger indemnification clauses into claims-transfer agreements.

The rulings' "buyer beware" approach, moreover, was greeted by a storm of criticism from lenders and traders alike, including the Loan Syndications and Trading Association; the Securities Industry Association; the International Swaps and Derivatives Association, Inc.; and the Bond Market Association. According to these groups, if caveat emptor is the prevailing rule of law, claims held by a bona fide purchaser can be equitably subordinated even though it may be impossible for the acquiror to know, even after conducting rigorous due diligence, that it was buying loans from a "bad actor."

The severity of the cautionary tale writ large in the bankruptcy court's *Enron* decisions was ultimately ameliorated on appeal in the late summer of 2007. District judge Shira A. Scheindlin vacated both of the rulings, holding that "equitable subordination under section 510(c) and disallowance under section 502(d) are personal disabilities that are not fixed as of the petition date and do not inhere in the claim." The key determination, she explained, is whether the claim transfer is in the form of an outright sale or merely an assignment. Despite Judge Scheindlin's holding, the 20-month ordeal (and the uncertainty it spawned) left a bad taste in the mouths of market participants.

2008 proved to be little better in providing traders with any degree of comfort with respect to claim or debt assignments involving bankrupt obligors. In *In re M. Fabrikant & Sons, Inc.*, a New York bankruptcy court took a hard look for the first time at the standard transfer forms and definitions contained in nearly every bank-loan transfer agreement, ruling that a seller's reimbursement rights were transferred along with the debt. The ruling indicates that the rights assigned to a buyer using the standard transfer forms are broad and include both contingent (and even post-petition) claims. The decision also fortifies the conventional wisdom that transfer documents should be drafted carefully to spell out explicitly which rights, claims, and interests are not included in the sale.

The latest development in the bankruptcy claims trading ordeal was the subject of a ruling handed down by the Second Circuit Court of Appeals in September 2009. Addressing the matter before it as an issue of first impression, the court of appeals held in *ASM Capital, LP v. Ames Department Stores, Inc. (In re Ames Department Stores, Inc.)* that section 502(d) of the Bankruptcy Code does not mandate disallowance, either temporarily or otherwise, of administrative claims acquired from entities that allegedly received voidable transfers.

ALLOWANCE AND DISALLOWANCE OF CLAIMS IN BANKRUPTCY

Section 502 of the Bankruptcy Code sets forth procedures governing the allowance or disallowance of a "claim or interest" in a bankruptcy case. Section 502(a) provides that a claim or interest, proof of which is filed with the court, "is deemed allowed," unless a party-in-interest objects. Under section 502(b), the bankruptcy court is obligated to resolve any objection in accordance with delineated criteria by ruling to allow or disallow the claim (in whole or in part). Section 502(c) directs the court in certain circumstances to estimate for the purpose of allowance certain contingent or unliquidated claims and any right to payment arising from an equitable remedy for breach of performance.

Section 502(d) creates a mechanism to deal with creditors who have possession of estate property on the bankruptcy petition date or are the recipients of pre- or post-bankruptcy asset transfers that can be avoided because they are fraudulent, preferential, unauthorized, or otherwise subject to forfeiture by operation of a bankruptcy trustee's avoidance powers. Section 502(d) provides as follows:

> Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(i), 542, 543, 550, or 553 of this title.

The purpose of the provision is to promote the pro rata distribution of the bankruptcy estate among all creditors and to coerce payment of judgments obtained by the trustee.

The allowance of post-petition administrative claims is governed by a different section of the Bankruptcy Code. Section 503 provides that "administrative expenses," such as post-petition employee wages, taxes, professional fees, rent under assumed nonresidential real-property leases, and other specified expenses, "shall be allowed" by the court after notice to affected parties and a hearing.

The focus of the courts' inquiry in *Enron* concerned whether transferred claims can be disallowed under section 502(d) even though the assignee or purchaser of the claim was not the transferee of an avoidable transfer. The Second Circuit

confronted a different but related issue in *Ames*—whether the language "any claim" in section 502(d) includes administrative expense claims allowed under section 503 that have been acquired from a creditor-transferee of a voidable transfer.

AMES DEPARTMENT STORES

Former nationwide retailer Ames Department Stores, Inc. ("Ames"), filed for chapter 11 protection in August 2001 in New York. Given Ames' inability to reorganize, the company's board of directors determined in August 2002 that the best course of action under the circumstances was to effect an orderly liquidation of the company.

ASM Capital, LP ("ASM"), is an investor in distressed debt. In 2002 and 2003, ASM purchased claims against Ames' estate from various creditors, including two claims held by G&A Sales, Inc. ("G&A"), one of Ames' suppliers. The claims consisted of an administrative claim in the amount of approximately $360,000 for post-petition goods and a reclamation claim in the amount of approximately $33,000, which, in accordance with the version of section 546(c) in effect at the time, the bankruptcy court granted administrative expense status in lieu of permitting G&A to exercise its reclamation rights.

Although the ruling is a positive development for claims traders, the Second Circuit skirted the $64,000 question on claims transfers: in view of its conclusion, the court stated that "we find it unnecessary to reach ASM's alternative argument that, even if section 502(d) did extend to administrative expenses under section 503(b), it could be invoked only against the recipient of the alleged preferential transfer and not against a subsequent holder of a claim that originated with the alleged transfer."

Ames suspended payment of its administrative claims in 2002 when it decided to liquidate. Sometime afterward, Ames sued several of its former suppliers, including G&A, to avoid as preferential payments made to G&A on the eve of Ames' chapter 11 filing. In 2004, while these actions were still pending, Ames began making partial distributions to administrative creditors. It refused, however, to make distributions to preference defendants or creditors that acquired claims from preference defendants. ASM sought a court order allowing its administrative claims and directing Ames to pay them. Ames opposed the motion, arguing that section 502(d) barred any payments in respect of ASM's claims until the entities from which ASM acquired its claims disgorged the payments that were the subject of the preference litigation. According to Ames, it made no difference that ASM itself had not received preferential payments.

Ames and defendants other than G&A settled the preference litigation before the bankruptcy court ruled on ASM's motion. Thereafter, the court allowed administrative claims held by ASM that had been acquired from the settling defendants. However, it ruled that section 502(d) barred allowance of claims acquired from G&A until such time as the avoidance litigation against it was settled or G&A disgorged the payments.

In 2006, the preference litigation against G&A was finally resolved by the entry of a default judgment. Because G&A later filed for bankruptcy and surrendered all of its assets to a secured creditor, the bankruptcy court ruled that disallowance of ASM's remaining administrative claims "will likely be permanent." The district court affirmed this ruling on appeal, observing that it was "in complete agreement" with the bankruptcy court that section 502(d) applies to administrative expense claims.

THE SECOND CIRCUIT'S RULING

ASM fared better on appeal to the Second Circuit. Noting that it was addressing the question as a matter of first impression, the court of appeals examined the plain language of section 502(d) to divine whether administrative expenses under section 503 qualify as "claims." It concluded that they do not.

First, the court explained that the Bankruptcy Code's definition of "claim" in section 101(5)(A) as any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured," does not distinguish between pre-petition and post-petition rights to payment. However, the court emphasized, section

101(10) defines "creditor" in terms that include only holders of pre-petition claims (and certain post-petition claims deemed to be pre-petition claims) and not holders of post-petition claims for administrative expenses under section 503. Moreover, section 348(d), which deals with the treatment of post-order for relief, pre-conversion claims, expressly applies to any post-petition claim "other than a claim specified in section 503(b)."

The Second Circuit agreed with the Delaware bankruptcy court's reasoning in *Camelot Music, Inc. v. MHW Adver. & Public Relations, Inc. (In re CM Holdings, Inc.)* that "the express exclusion of administrative expense claims from section 348(d), and the exclusion of administrative claim holders from the definition of 'creditor,' lend 'support to the view that administrative expense claims are claims that are separate and apart from pre-petition, or deemed pre-petition, creditor claims.' " The court rejected the view espoused by some courts, including a Ninth Circuit bankruptcy appellate panel in *MicroAge, Inc. v. Viewsonic Corp. (In re MicroAge, Inc.)*, that "Congress viewed expenses of administration as merely one specialized type of claim" and that lawmakers thus intended such expenses to be subject to section 502(d). Instead, the court of appeals concluded, "The structure and content of section 502(d) suggests that Congress intended it to differentiate between claims and administrative expenses, and not to apply to the latter."

In conjunction with section 501, the court explained, section 502 provides a procedure for the allowance of claims that is "entirely separate from the procedure for allowance of administrative expenses under section 503." In particular, the court noted, section 502 governs allowance of claims for which proof is filed under section 501. Because claims for administrative expenses cannot be filed under section 501, they are not subject to the deemed allowance and objection procedures set forth in sections 502(a) and 502(b).

The mechanism for filing and payment of administrative expense claims, the Second Circuit emphasized, is governed by section 503, which establishes procedures "independent from the procedures for filing and allowance of prepetition claims under sections 501 and 502, and differs in significant respects." Specifically, the court of appeals explained: (i) whereas section 501 allows only "creditors" to file proofs of claim, any "entity" may file a request for payment of an administrative expense; (ii) while section 502 requires notice and a hearing for a pre-petition claim only if there is an objection filed to the claim, section 503(b) requires notice and a hearing on all requests for allowance of an administrative expense, regardless of whether an objection has been made; and (iii) section 503(b), which enumerates the types of administrative claims, excludes "claims allowed under section 502(f)" (*i.e.*, deemed pre-petition claims in an involuntary case that are subject to sections 501 and 502). "[W]ith respect to the allowance of claims," the Second Circuit wrote, "sections 502 and 503 are separate and independent."

The court of appeals explained that the language of section 502(d) "suggests that it applies only in the context of section 502, and not to claims addressed by section 503." Among other things, the Second Circuit noted, the provision's language "introduces section 502(d) as an exception to the automatic allowance" of filed claims under sections 502(a) and 502(b) "and suggests that the subsection's scope is limited to that process and does not extend to claims allowable under section 503." According to the court, "That suggestion is reinforced by the absence from section 502(d) of any reference to section 503." Moreover, the remaining subsections of section 502 ((e) through (i)) "explicitly bring certain post-petition claims within the scope of section 502" by providing that such claims "shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) . . . the same as if such claim had become fixed before the date of the filing of the petition." The express invocation of section 502(d), the Second Circuit remarked, "suggests that the section did not already apply to such claims before they were within section 502's reach, and that it does not apply to postpetition claims remaining outside section 502, such as the requests for administrative expenses addressed by section 503(b)." Finally, the court emphasized, the mandatory terms in which section 503(b) is drafted (expenses "shall be allowed" by the court) conflict with section 502(d)'s equally mandatory disallowance of claims.

According to the Second Circuit, the "Bankruptcy Code establishes a clear division between an entity in its pre- and post-petition states." "More importantly," the court explained, the statute gives higher priority to administrative expense claims than to pre-petition claims in order to encourage parties to

supply goods and services to the estate, to the benefit of all stakeholders. That intent, the court concluded, "would be frustrated by allowing a debtor automatically to forestall or avoid payment of administrative expenses by alleging that the vendor had been the recipient of a fraudulent transfer."

OUTLOOK

The Second Circuit's *Ames* decision carefully parses the language of sections 502 and 503 and thoroughly examines the purpose underlying each of the relevant provisions. Moreover, the court's policy observation is accurate—postpetition suppliers would be more reluctant to deal with debtors if they faced the prospect of disallowance of their claims in the event that they were later sued in avoidance litigation.

Although the ruling is a positive development for claims traders, the Second Circuit skirted the $64,000 question on claims transfers: in view of its conclusion, the court stated that "we find it unnecessary to reach ASM's alternative argument that, even if section 502(d) did extend to administrative expenses under section 503(b), it could be invoked only against the recipient of the alleged preferential transfer and not against a subsequent holder of a claim that originated with the alleged transfer." Thus, we are left to speculate whether the Second Circuit, like the district court in *Enron*, would have made any distinction between assigned and purchased claims in this context.

ASM Capital, LP v. Ames Department Stores, Inc. (In re Ames Dept. Stores, Inc.), 582 F.3d 422 (2d Cir. 2009).

In re M. Fabrikant & Sons, Inc., 385 B.R. 87 (Bankr. S.D.N.Y. 2008).

In re Enron Corp., 379 B.R. 425 (S.D.N.Y. 2007).

Enron Corp. v. Avenue Special Situations Fund II, LP (In re Enron Corp.), 333 B.R. 205 (Bankr. S.D.N.Y. 2005), *rev'd and remanded*, 379 B.R. 425 (S.D.N.Y. 2007).

In re Enron Corp., 340 B.R. 180 (Bankr. S.D.N.Y. 2006), *rev'd and remanded*, 379 B.R. 425 (S.D.N.Y. 2007).

Camelot Music, Inc. v. MHW Adver. & Public Relations, Inc. (In re CM Holdings, Inc.), 264 B.R. 141 (Bankr. D. Del. 2000).

MicroAge, Inc. v. Viewsonic Corp. (In re MicroAge, Inc.), 291 B.R. 503 (Bankr. 9th Cir. 2002).

TOUSA RULING BAD NEWS FOR THE SAVINGS CLAUSE

Mark G. Douglas

The continued vitality of "savings clauses" in loan agreements designed to minimize the risk of a finding that a loan guarantor is insolvent in analyzing whether the loan transaction can be avoided as a fraudulent transfer was dealt a blow by a highly controversial ruling recently handed down by a Florida bankruptcy court. In the first test in the bankruptcy courts of the enforceability of savings clauses in "upstream guarantees," the bankruptcy court in *Official Committee of Unsecured Creditors of TOUSA, Inc. v. Citicorp North America, Inc*. set aside as fraudulent conveyances obligations incurred and liens granted by subsidiaries of the debtor under certain loan agreements and related guarantees. In doing so, the court unequivocally invalidated savings clauses in upstream guarantees.

The ruling has been greeted by the lending community and commentators with a mixture of shock, dismay, disbelief, and resignation that yet another highly touted and common risk-mitigation technique has not proved to be as reliable as anticipated. If upheld on appeal and followed by other courts, the ruling may have a marked impact on lenders and debtors alike and may portend an increase in litigation against lenders that have insisted upon guarantees in loan transactions which include savings clauses.

TOUSA

TOUSA, Inc. ("Tousa"), and its subsidiaries are a large conglomerate of home-building companies. As did most other home builders, Tousa suffered in the recent economic downturn. As Tousa's financial woes worsened, lenders (the "old lenders") holding $675 million in secured debt (the "old loans") at the parent level guaranteed by a Tousa subsidiary demanded repayment of the debt and ultimately sued to collect.

Tousa settled the litigation, agreeing to pay more than $421 million to the old lenders. To finance the settlement, Tousa entered into a loan transaction with new lenders (the "term lenders") that provided the parent company with approximately $200 million in first-tier secured term loans and $300 million in second-tier secured term loans. The term

lenders insisted that the term loans be guaranteed by Tousa subsidiaries that were not obligors in connection with the old loans or the settlement agreement. The term loans contained the following savings clause:

> Each Borrower agrees if such Borrower's joint and several liability hereunder, or if any Liens securing such joint and several liability, would, but for the application of this sentence, be unenforceable under applicable law, such joint and several liability and each such Lien shall be valid and enforceable to the maximum extent that would not cause such joint and several liability or such Lien to be unenforceable under applicable law, and such joint and several liability and such Lien shall be deemed to have been automatically amended accordingly at all times.

Tousa and certain of its subsidiaries filed for chapter 11 protection in January 2008 in Florida. The official creditors' committee commenced an adversary proceeding seeking to avoid the obligations incurred and liens granted by the guarantor subsidiaries in connection with the term loans as constructively fraudulent transfers under section 548(a)(1)(B) of the Bankruptcy Code and applicable state law. Among other things, the committee alleged that the subsidiaries were insolvent both before and after the term loan transaction.

The bankruptcy court ruled in favor of the committee, holding in a 182-page decision that, among other things, because savings clauses are unenforceable, the term lenders could not rely upon the clauses to show that the guarantor subsidiaries were solvent at the time they entered into the term loan transaction, which amounted to a fraudulent conveyance. The remedies granted by the court included: (i) avoidance of the claims of the term lenders against the guarantor subsidiaries, as well as the liens securing such claims; (ii) a directive that the term lenders disgorge any payments made by the guarantor subsidiaries in respect of the term loans; (iii) a directive that the old lenders disgorge funds received in connection with the settlement; (iv) an award of damages in favor of the guarantor subsidiaries in the amount of any diminution in the value of pledged assets subsequent to the term loan transaction; (v) an award of fees and costs to the creditors' committee; and (vi) a directive that the term lenders' professionals disgorge any fees paid by Tousa or its subsidiaries in connection with the term loan.

THE TROUBLE WITH SAVINGS CLAUSES

The bankruptcy court rejected the idea that the savings clauses prevented any finding of insolvency with respect to the guarantor subsidiaries for the following reasons:

- Because the guarantor subsidiaries were insolvent even before the term loan transaction and received no benefit from the loan, even if the savings clauses were enforceable, they would not have altered the insolvency finding. Even reducing the liabilities on the guarantees to nothing would still result in a finding of insolvency, and any liability imposed upon a guarantor subsidiary (or any lien securing such a liability) would be avoidable under section 548.

- Regardless of solvency, the savings clauses were unenforceable under section 541(c)(1)(B), which, according to the court, "provides that an interest of the debtor in property becomes property of the estate, notwithstanding any 'provision in an agreement' that is 'conditioned on the insolvency or financial condition of the debtor' that 'effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.' " Because the savings clauses were, on their face, "provision[s] in an agreement" that were "conditioned on the insolvency or financial condition of the debtor" and "effect[ed] forfeiture, modification, or termination of the debtor's interest in property," the clauses constituted unenforceable *ipso facto* clauses.

- The term lenders' efforts to use the savings clauses to "contract around" the Bankruptcy Code were invalid. If enforced, the clauses would nullify the protection provided by section 548(a)(1)(B) and the limits that section 548(c) places on the ability of good-faith transferees to retain property "to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation." The only purpose of the savings clauses would be to ensure that a transferee could preserve its claim "to every last penny of the debtor's remaining assets without providing reasonably equivalent value" to

NEWSWORTHY

An article written by ***Corinne Ball (New York)*** entitled "Looking at the Crisis and Chrysler's Rebound" was featured in the October 8 edition of *The New York Times* DealBook as part of the first NYT DealBook Dialogue, an online round table of financial-industry thought leaders engaged in a digital discussion of the topic "Too Soon to Rethink? Assessing the Financial Crisis."

Tobias S. Keller (San Francisco) and ***Michaeline H. Correa (San Francisco)*** coauthored an article published in the Fall edition of the State Bar of California's *Business Law News* entitled "In a Real Estate Downturn: Section 1111(b)(2) or Not (b)(2)? That Is the Question."

Heather Lennox (Cleveland) was a panelist at an October 29 webinar sponsored by the Turnaround Management Association entitled "Pressure on the Supply Chain—Beginning of the End or End of the Beginning." She was quoted in an article published in the November 2 edition of *Prospect News Distressed Debt Daily* entitled "Auto industry experts see obstacles, hope in the supply chain."

An article written by ***Pedro A. Jimenez (New York)*** and ***Mark G. Douglas (New York)*** entitled "Rise In Section 363 Sales Not Confined To Ch. 11" was published in the November 11 edition of *Bankruptcy Law360*.

Thomas A. Howley (Houston) chaired the Texas Bar CLE 27th Annual Advanced Business Bankruptcy Course held in Houston on October 1 and 2.

A team of Jones Day attorneys that included ***Adam Plainer (London)*** and ***Linton Bloomberg (London)*** successfully represented a $500 million noteholder of Sigma Finance Corporation, the first and largest structured investment vehicle with total liabilities in excess of $9 billion and assets once valued at $27 billion, in connection with the first judgment on appeal handed down by the Supreme Court of the United Kingdom. Jones Day took the lead in the House of Lords in a bid to overturn a Court of Appeal ruling that Sigma's receivers were obliged to distribute assets to certain creditors holding early-maturing notes following an event of default, a ruling that would have led to no return for all other secured creditors who held notes maturing at a later date. The case will have a dramatic impact on the recoveries by many investment banks, hedge funds, and other secured creditors of Sigma.

Robert Trodella (San Francisco) and ***Michaeline H. Correa (San Francisco)*** presented a seminar on October 20 regarding the Bankruptcy Code section 1111(b)(2) election to the Commercial and Bankruptcy Section of the Bar Association of San Francisco.

Jeffrey B. Ellman (Atlanta) was a panelist on October 28 at the annual conference of the National Attorneys General Training & Research Institute, the National Association of Attorneys General, and the States Association of Bankruptcy Attorneys entitled "Bankruptcy from a Government Perspective." The topic of the panel was "Asset Sales and Rejections: The New Paradigm for Chapter 11 Cases."

Gregory M. Gordon (Dallas) spoke at the Texas Bar CLE 27th Annual Advanced Business Bankruptcy Course held in Houston on October 1. His presentation was entitled "Current Issues in 363 Sales."

Kevyn D. Orr (Washington) was a panelist on November 10 at a program sponsored by the University of Maryland School of Law's Business Law Society entitled "Counseling Business Clients in a Global Recession: Stories from the Front Lines." He was listed among Washington, D.C.'s top lawyers in *Washingtonian* magazine.

Richard L. Wynne (Los Angeles) was a panelist on October 27 in Beverly Hills at a program sponsored by the Turnaround Management Association entitled "Complex Real Estate Transactions: Where the Big Boys Play and Get Hurt." On October 17, he sat on a panel in Los Angeles at the University of Southern California's 2009 Institute on Entertainment Law and Business discussing "Entertainment Bankruptcy Issues: Protection and Enforcement."

the detriment of other creditors in the case that would otherwise receive a greater distribution. Savings clauses, the court wrote, are "a frontal assault on the protections that section 548 provides to other creditors. They are, in short, entirely too cute to be enforced."

- The savings clauses were unenforceable as a matter of contract law because the existence of multiple savings clauses executed contemporaneously, "each of which purport to reduce obligations after accounting for all other obligations," made it impossible to determine the extent of an obligation arising from application of any particular savings clause. Such a moving target created an insoluble circular problem, creating inherently indefinite contract terms that are unenforceable as a matter of contract law.

- The parties to the term loans failed to take steps required under the loan agreement to modify the guarantor subsidiaries' obligations (*i.e.*, written and signed amendments reducing the principal amount of the loan or releasing any borrower from its obligations).

OUTLOOK

The bankruptcy court's ruling in *TOUSA* is on appeal, the court on October 30, 2009, having conditioned the issuance of a stay pending appeal on the posting of a $700 million bond. Whether or not it withstands appellate scrutiny, the decision has thrown a formidable wrench into the works of the lending industry. Lenders unable to rely on savings clauses to minimize avoidance exposure may be reluctant to extend credit in a market that is already tight. At the very least, lenders are likely to insist upon alternative forms of credit enhancement to supplant upstream guarantees fortified with savings clauses. All of this is decidedly unwelcome news to companies struggling to line up financing necessary to restructure or reorganize businesses. It also remains to be seen whether other courts will adopt the same approach to this controversial issue.

Several aspects of the court's ruling in *TOUSA* may be the focus of argument on appeal. For example, the court's analysis of section 541(c)(1)(B)'s invalidation of *ipso facto* clauses omits language from the section making it applicable only to provisions that are conditioned on the insolvency or financial condition of the debtor "on the commencement of the [bankruptcy case]." The savings clauses in *TOUSA* were not conditioned on the commencement of the chapter 11 cases by Tousa or its guarantor subsidiaries.

In addition, the court's holding that a savings clause represents an invalid attempt to "contract around" the Bankruptcy Code likely will be disputed. The Bankruptcy Code does not include any provision that prohibits lenders and borrowers from agreeing to reduce the maximum liability under a loan guarantee if it turns out that the guarantors are unable to satisfy the obligation. The bankruptcy court's after-the-fact decision to modify the terms of arm's length commercial negotiations, and thereby deprive the lenders of the benefit of their bargain, will undoubtedly be challenged on appeal.

The bankruptcy court's ruling in *TOUSA* is on appeal, the court on October 30, 2009, having conditioned the issuance of a stay pending appeal on the posting of a $700 million bond. Whether or not it withstands appellate scrutiny, the decision has thrown a formidable wrench into the works of the lending industry.

Another possible challenge might involve the court's finding that the savings clauses were unenforceable because "the liabilities under the term loans are *inherently* indeterminate" due to the "interaction between the two savings clauses." Although it may have been difficult to value the guarantor subsidiaries' assets and liabilities giving effect to the savings clauses, a reasonable estimate would certainly appear to be possible.

Finally, the bankruptcy court's determination that the clauses were ineffective because necessary actions were never taken under the express terms of the loan agreements is in dispute. The savings clauses did not purport to reduce the principal amount of the term loans or release any borrower from its obligations, such that they would be effective only upon written notice. Instead, the loan documentation provided that the savings clauses were to take effect automatically.

The tone of the *TOUSA* decision suggests that the bankruptcy court was particularly unsettled by the conduct of

Tousa and the lenders. Among other things, the court found that employees, officers, directors, and advisors knew or should have known that Tousa was in dire financial straits and that both Tousa and its guarantor subsidiaries were insolvent prior to the term loan transaction, but that various parties proceeded with the transaction in order to reap outsized fees and bonuses. As such, we are left to speculate whether the court would have reached a different conclusion under different circumstances.

Official Committee of Unsecured Creditors of TOUSA, Inc. v. Citicorp North America, Inc., 2009 WL 3519403 (Bankr. S.D. Fla. Oct. 30, 2009).

FOCUS ABROAD

THE RETAIL SECTOR: RESTRUCTURING OPTIONS IN THE CURRENT CLIMATE IN THE U.K., FRANCE, AND GERMANY

Michael Rutstein, Laurent Assaya, and Christian Staps

The ready availability of credit over the first seven years of the past decade fueled a massive, property-led consumer boom. Although perhaps a long time coming, the restriction in the continuing availability of credit since mid-2007 has resulted in a serious recession. The scale of the problems will take time to unwind, but given the continuing restrictions on credit and the general climate of economic uncertainty, consumers are spending less, especially on high-value, nonessential items, and the retail sector is suffering. In this article, we examine the health (or otherwise) of the retail sector in the U.K., France, and Germany and the restructuring tools available in each country to deal with struggling retail businesses.

THE UNITED KINGDOM

Retail is a very important sector of the U.K. economy, employing over 3 million people, equal to one in 10 members of the workforce (more than the whole of the manufacturing sector). However, many retailers are struggling with a triple hit of falling sales, crushed margins, and rising costs. Consumers have been adversely affected by the collapse in property values, the weak state of the labor market, the lack of job security, and the prospect of future tax increases.

Over the past 12 months, the U.K. has witnessed a continuing trend of collapses in the retail industry, which has been one of the sectors hardest hit by the volatile financial climate and falling customer confidence. There are, however, some signs of recovery after what has been a turbulent year. In the third quarter of 2009, according to Begbies Traynor's Red Flag Alerts, there has been a decrease of 4 percent in county court judgments and winding-up petitions compared to the same period last year. This contrasts with the first quarter of 2009, which, according to PwC research, saw a jump of 60 percent in retailer insolvencies over the same period in 2008, from 440 to 705. Nevertheless, some big names are still

adding to the roll call of the fallen, including Birthdays, the greeting card chain (in which Jones Day acted for the administrators); Bay Trading Clothing; and the bookstore chain Borders. Over the course of 2009, however, an overall rise of retail sales occurred through the second and third quarters, with an increase of 2.8 percent in September compared to the same period last year.

Some commentators say that the recent rise in sales is merely the calm before the next storm, and they predict that we are in the middle of a W-shaped recovery. The year-end brings with it some significant costs for retailers, including the need to pay suppliers, VAT liabilities, and the final quarter's rent. The expected Christmas-fueled rise in sales may not be enough to keep some in this sector from joining the list of casualties.

High rent obligations remain problematic for the retail sector, despite the fact that a large number of landlords have agreed to reduce rents and/or accept monthly rent payments. Retail insolvencies in the spring were given a reprieve because many retailers had made it clear to their landlords well in advance that quarterly rent was not feasible. Fortunately, many landlords agreed. One thing for certain is that retail businesses will continue to struggle in the current environment. Those for whom the strain becomes too great will likely seek survival through a formal insolvency procedure or a consensual out-of-court restructuring.

There are a number of vehicles for restructuring a distressed retailer, including a company voluntary arrangement (largely under the U.K. Insolvency Act of 1986), pre-packaged administration, trading administration, divestiture of an underperforming business or division, and purchase of distressed debt. We address each of these in turn below.

Company Voluntary Arrangement

If a company and its creditors can reach agreement on a plan to deal with the company's debts, an appropriate means of implementing such agreement may be a company voluntary arrangement ("CVA"). Under this process, the debtor makes a proposal to its creditors to repay a certain percentage of their claims over a specified period of time. If at least 75 percent in value of the debtor's creditors taking part in the creditors' meeting to consider the proposal vote in favor of the proposal, then, subject to certain safeguards, the proposal becomes binding on all creditors, including those who voted against it (although secured creditors need to consent specifically to a CVA in order for it to be binding on them). As we shall see, CVAs are becoming more acceptable in the retail sector, presumably because landlords would prefer to discount their rent claims rather than hazard the risk that the tenant will be forced into administration or liquidation with the consequent risk that the premises will become vacant and non-income-producing.

Pre-Packaged Administration

There have been a number of high-profile pre-packaged insolvencies in the retail sector, such as Whittard of Chelsea, USC, and The Officers Club. Pre-packaged administrations generally involve the sale of an insolvent company's assets, which is pre-arranged before the company goes into a formal insolvency process. The purchaser is identified and the terms of the sale are agreed upon in advance. The sale takes place immediately following the appointment of an administrator, who will execute the necessary documents. "Pre-packs" often involve the sale of the business to the existing owners or management.

Pre-packs have been praised as providing a lifeline to companies whose businesses would not survive a formal insolvency. They enable customer-facing businesses to avoid the brand devaluation and stigma of being in a lengthy insolvency process and to carry on trading seamlessly, with a transfer of staff (whose jobs and rights are protected by law) and salvageable assets to a new corporate vehicle.

Criticism is often leveled at pre-packs due to their lack of transparency. The process is often perceived as a vehicle whereby a failing company is supplanted by a new entity overnight, leaving creditors, such as landlords and suppliers, to suffer financial losses because the old company is an assetless shell. In many cases, the same management and owners who presided over the failing company bought the new businesses, which has led to anger and widespread criticism of the pre-pack procedure. A report by the Business and Enterprise Committee found that unsecured creditors fare worse during a pre-pack, recovering 1 percent of their

debts on average, compared with 3 percent in a standard business sale. However, independent research by Dr. Sandra Frisby of the University of Nottingham has established that in over 90 percent of pre-packs, all the jobs in the business are saved, compared to only approximately 60 percent in other insolvency business sales. Pre-packs can also reduce the risk of value destruction as a result of the insolvency process—they often realize more than simple liquidation, and they almost invariably cost less than a period of trading followed by a business sale.

Trading Administration

If time and financial resources permit, a failing retailer may decide to appoint administrators who will allow the company to continue operating pending a sale or liquidation of the business. This course of action gives the administrators time to identify and negotiate with prospective buyers and to arrange an orderly disposal of the business or its assets. Trading administrations may facilitate an easier reduction in the workforce before the sale of the business. Pre-packs do not have this advantage.

Divestiture of Underperforming Businesses or Divisions

If stakeholders of, or lenders to, a failing business are able to identify an underperforming subsidiary or part of the business, one option is to sell that part of the business and keep the core business going. Doing so will lead to better financial performance of the overall retail business by removing the loss-making part. A clean departure from the underperforming division may also avoid insolvency if the buyer has the will and resources to turn the distressed business around.

Purchase of Distressed-Debt Positions

When a business is distressed, the lender or stakeholder may wish to crystallize its exposure by selling its debt and any associated security. A secured-debt sale occurs when the bank believes it will realize more value by the sale of its debt to a third party than through a formal insolvency procedure.

Set forth below are three examples illustrating how CVAs, pre-packs, and trading administrations have been used recently to try to protect the core businesses of retailers.

Stylo plc

Stylo was an Alternative Investment Market-listed footwear retailer based in Bradford that acted as the holding company of a number of subsidiaries which sold high-street branded footwear such as Barratts, Dolcis, and Priceless. The company had a high cost base due principally to high rent obligations. Following losses of £12.5 million in 2008, the company appointed administrators in February 2009 over each of its operating subsidiaries and proposed a CVA to its creditors and landlords. The CVAs proposed that, in compromise of their claims for rent arrears, the landlords would receive 3 percent of shop turnover for three months beginning in June 2009, increasing to 7 percent for the remaining 11-month period of the CVA.

The proposed CVAs were ultimately voted down by the landlords because the proposal would have put them in the undesirable position of subsidizing Stylo's other creditors, who would be paid with the money the landlords would concede. They also believed that it was likely, even if the CVA had been approved, that under continuing pressure, they would ultimately lose their tenants in the following few months. However, commentators believe that the key reason for the rejection was that the landlords were concerned about setting a precedent that other struggling retailers might follow. It appears that the commercial-property industry intended to send a clear message to the retail sector—that CVAs were not going to be an easy way out.

Following rejection of the CVA proposal, administrators were appointed over the listed parent company, Stylo, and the core profitable elements of the business were "pre-packed" to an entity owned by the chairman of the Stylo group, with the unprofitable stores closing.

JJB Sports plc

JJB Sports, a sports equipment retailer, was struggling with a combination of a high cost base and low sales. In contrast to the rejected CVA proposed by Stylo, the CVA proposed by JJB to its creditors provided that the landlords of closed stores would be able to claim distributions from a fixed pot of £10 million on two payment dates in September and December 2009 and that the terms of the leases for the

open stores would be varied to permit monthly, as opposed to quarterly, rental payments. The CVA was approved by 99 percent in value of creditors, saving the retailer from administration. Early engagement with the landlords and other creditors was arguably the determining factor for the success of the JJB CVA. The success of the CVA also showed that most landlords are beginning to realize that CVAs will not be rejected out of hand.

Birthdays

Birthdays owned more than 330 stores nationwide selling greeting cards and related products. A combination of high rentals and reduced trading made its business uneconomical, although many individual stores were profitable and viable. Birthdays had to reduce its store base, but the cost of doing so outside insolvency was prohibitive, and so it entered into administration. The administrators operated the business for a month and sold a significant proportion of the stores as a going concern.

FRANCE

The current financial downturn has crept into every sector of the French economy, including the retail sector. Of 60,000 formal insolvencies in the past year in France, about 13 percent of the total have arisen in the retail sector.

France's insolvency law provides for the following procedures for restructuring a distressed retailer.

New Money Under the Ad Hoc Mediation (*Mandat ad hoc*) and Conciliation Procedures (*Conciliation*)

The ad hoc mediation and the conciliation procedures are two out-of-court confidential pre-insolvency proceedings that are widely used to restructure distressed businesses in France. In each case, a company's management has the right to request that the president of the commercial court appoint a mediator to help the debtor reach a voluntary agreement with its creditors or investors. In practice, the conciliation procedure can be extremely effective in distressed M&A transactions, because new-money investors benefit from a "super priority" (*privilège de conciliation*) over the debtor's other liabilities if the French court publicly approves (*homologué*) the conciliation agreement entered into by the debtor, its creditors, and the new-money investor. An important example of this was seen in June 2009 in the case of SIA, a leading European retailer of interior decoration products. Here, Vermeer Capital, a distressed investment fund, will be able to claim super priority for a shareholder loan it will make once it has completed its acquisition of the company.

Restructuring Plan Under a Safeguard Procedure (*Sauvegarde*)

The recently introduced safeguard procedure is also a very useful restructuring tool in France. This highly regulated procedure is a court-driven process available to companies facing financial difficulties. The safeguard procedure can result in the court approval of a restructuring plan involving the rescheduling of the company's debt over a maximum period of 10 years if there is no agreement between the debtor and the creditors. If there is an agreement between the debtor and the creditors, the debt restructuring can include a write-off, a debt-equity swap, or the rescheduling of the debt over a longer period than the statutory 10-year maximum.

Recently, Autodis, a leading French retailer of car parts to the public, was financially restructured through the conciliation procedure for the operating company and the safeguard procedures for the holding companies. The case may well prove a model for complex restructurings in France because the restructuring of this 5,000-employee company was implemented via a pre-packaged agreement entered into by management, the company's shareholders, its various classes of creditors, and a third-party investor, contemporaneously with the official commencement of the safeguard procedures.

Sale Plan Under a Reorganization Procedure (*Redressement judiciaire*) or a Liquidation Procedure (*Liquidation judiciaire*)

The reorganization procedure is a court-based proceeding available to insolvent companies that basically follows the rules of the safeguard procedure, except that one possible exit route is the sale of the company's assets under a sale plan. The sale plan is the usual feature of the liquidation procedure. In both cases, a third-party investor will purchase the assets of the debtor following a competitive, transparent, and orderly sale process. The third-party investor will typically also agree to take over all or a significant number of the

employees of the debtor. The purchase price for the assets is often less than the amount of the debtor's liabilities, but this is unsurprising, both in view of the state of the debtor's insolvency and because the court's priority is to preserve the continuity of employment of the workforce rather than to enforce repayment of the debtor's liabilities.

GERMANY

The retail sector in Germany has also been hit by the economic downturn. The German Retail Federation (*Hauptverband des Deutschen Einzelhandels,* or "HDE") expects a decline in retail sales of about 2 percent in 2009. The drop in sales may turn out to be even worse due to increased unemployment in the fall. According to the HDE, retail is the economic sector that is suffering most from the general squeeze on credit availability. In addition, rents in the retail industry are considered too high, and due to a change in trade tax rules that came into force last year (arguably at the worst possible time), rent payments up to a certain percentage may have to be included in income when calculating a company's trade tax liability. The newly elected German government—a coalition of the center-right Christian Democratic Union; its Bavarian sister party, the Christian Social Union; and the liberal, pro-business Free Democratic Party—plans to reduce this percentage. It remains to be seen, however, whether this proposed change in the law is possible, given anticipated opposition from the federal states and municipalities, both of which benefit from trade tax revenues.

According to estimates, roughly 5,000 retail businesses will have to close their doors this year. Small, owner-managed stores will not be the only businesses affected; larger concerns will be victims as well. The sector has seen a number of high-profile insolvencies recently. These include Arcandor, the parent company of the well-known retail chains Karstadt and Quelle (the latter a mail-order company that is now being wound up), and Woolworth (which was independent of the U.K. business). These insolvencies followed the collapse last year of Wehmeyer, Sinn-Leffers, and Hertie.

Insolvency Proceedings

Insolvency proceedings (*Insolvenzverfahren*) under the German Insolvency Code (*Insolvenzordnung*) are the only judicial proceedings in Germany for formal insolvencies of companies. These proceedings are flexible and seek to effect either a liquidation of the company's business (including a sale of the business as a going concern by way of an asset deal) or a reorganization of the insolvent company itself by means of an insolvency plan.

A sale of the company's business as a going concern by way of an asset deal is a well-established way of rescuing a business in insolvency proceedings. It has the advantage of being a fairly simple means of realizing value for the estate. To adopt an insolvency plan and leave the debtor in possession has proved to be beneficial in large and complex insolvencies involving groups of companies, by combining the specific restructuring expertise of a reorganization specialist appointed to the board shortly before the insolvency with the knowledge and experience of existing management.

A recent example of a sale of a retail business as a going concern is Wehmeyer. A reorganization by means of an insolvency plan was successful in the case of Sinn-Leffers.

Wehmeyer

The fashion chain Wehmeyer applied to the German court for insolvency in July 2008. The sale of the business to Indian strategic investor Rajive Ranjan by way of an asset deal was announced by the insolvency administrator at the beginning of November 2008. The transaction involved 23 of the 39 original branches, and about 500 out of 900 employees were retained by the buyer. Although speed is naturally of the essence in every asset deal in insolvency proceedings, the sale in the fall of 2008 meant that the peak of the economic crisis was avoided. It probably would have been much more difficult to achieve the same result six months afterward, as investors have since become cautious.

Sinn-Leffers

Another well-known German fashion chain that went into insolvency in 2008 was Sinn-Leffers. In this case, a restructuring expert was appointed to the management board to advise the company and assess its options before the company applied to the court for insolvency. Once the application had been made, an insolvency plan was put together very quickly. The shareholder provided fresh money that enabled the insolvency plan and the restructuring to proceed. When the proceedings were formally opened, the plan was already prepared and the court left the debtor in possession (*i.e.*, it did not appoint an insolvency administrator to take over the company's affairs). The advantage of an insolvency plan over a sale by way of an asset deal was that the consent of the landlords for the transfer of lease agreements was not required.

CONCLUSION

Although economists' predictions for the retail sector remain uncertain, there are likely to be further insolvencies, with more U.K. high-street retailers (and their equivalents in France and Germany) struggling to meet their overheads and rental obligations. It is likely that the formal insolvency procedures and out-of-court restructurings described above will be utilized. We expect the use in the U.K. of CVAs to become more widespread as they become more acceptable to stakeholders and creditors.

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FIFTH CIRCUIT RULES THAT CREDITOR HAS STANDING TO SEEK SANCTIONS FOR AUTOMATIC STAY VIOLATION

Mark G. Douglas

The automatic stay triggered by the filing of a bankruptcy petition is one of the most important features of U.S. bankruptcy law. It provides debtors with a "breathing spell" from creditor collection efforts and protects creditors from piecemeal dismantling of the debtor's assets by discouraging a "race to the courthouse." The Bankruptcy Code also contains a mechanism—section 362(k)—to sanction parties who ignore the statutory injunction if their conduct amounts to a willful violation and another "individual" is injured as a consequence. However, courts disagree concerning precisely which stakeholders in a bankruptcy case (*e.g.*, individual debtors, corporate debtors, trustees, and/or creditors) should have standing to invoke the remedies set forth in section 362(k). The Fifth Circuit Court of Appeals recently considered this question as a matter of first impression. In *St. Paul Fire & Marine Ins. Co. v. Labuzan*, the court ruled that a creditor has standing to seek an award of damages under section 362(k), provided that its claim is direct rather than derivative.

THE AUTOMATIC STAY

Section 362(a) of the Bankruptcy Code provides that, upon the filing of a petition for relief under almost any chapter of the Bankruptcy Code (except for chapter 15, which applies to petitions for recognition in the U.S. of bankruptcy proceedings filed abroad), most but not all (there are now no fewer than 28 "exceptions" from the scope of the stay) actions against the debtor or its property to collect on a prebankruptcy debt are enjoined unless the "automatic stay" expires by operation of another provision in the statute or the court orders otherwise. Actions taken in violation of the stay are either void or voidable, depending upon the prevailing rule in the jurisdiction. Moreover, where a violation of the stay is "willful," the Bankruptcy Code establishes a mechanism both to provide compensation for the offense and to punish the offender.

Specifically, section 362(k) of the Bankruptcy Code provides as follows:

(1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

(2) If such violation is based on an action taken by an entity in the good faith belief that subsection (h) applies to the debtor [automatically terminating the stay with respect to certain pledged personal property in an individual debtor case if the debtor fails to perform prescribed acts], the recovery under paragraph (1) of this subsection against such entity shall be limited to actual damages.

Section 362(k) (formerly denominated section 362(h)) was added to the Bankruptcy Code as part of the "Consumer Credit Amendments" applying principally to consumer debtors in the Bankruptcy Amendments and Federal Judgeship Act of 1984. The section was re-designated as section 362(k)(1) in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which also added section 362(k)(2) (among other things) to the Bankruptcy Code.

Once a creditor becomes aware of the filing of the bankruptcy petition, any intentional act in violation of the automatic stay is considered "willful." However, under section 342(g)(2) (also added in 2005), a "monetary penalty" may not be imposed on a creditor under section 362(k) for violation of the stay unless the conduct that is the basis for the violation occurs after the creditor has received notice under section 342 of the filing of the bankruptcy case. Because actual damages are commonly perceived as being compensatory in nature, rather than a penalty, section 342(g)(2) arguably precludes only the recovery of punitive damages under section 362(k)(1).

Because section 362(k) refers to an "individual," rather than the "trustee" or the "debtor," the provision has generated a fair amount of controversy concerning exactly who (or what) has standing to invoke its remedies. The term "individual" is not defined in the Bankruptcy Code. Even so, it is used throughout the statute to refer to debtors and nondebtors (for example, in sections 522(b) (individual as debtor), 321(a)(1) (individual as trustee), and 1129(a)(5)(A)(i) (individual as "director, officer, or voting trustee of the [post-confirmation] debtor")).

Some courts have held that the section 362(k) remedies are available only to individual debtors. For example, in its 1990 ruling in *In re Chateaugay Corp.*, the Second Circuit Court of Appeals held that section 362(k) may not be used by corporate debtors and is limited to debtors who are "natural persons." The First, Eighth, Ninth, and Eleventh Circuits have adopted this approach. Other courts, including the Third and Fourth Circuits, have permitted corporate debtors to take advantage of section 362(k). In its 1986 ruling in *Budget Service Co. v. Better Homes of Virginia, Inc.*, the Fourth Circuit reasoned that

> it seems unlikely that Congress meant to give a remedy only to individual debtors against those who willfully violate the automatic stay provisions of the Code as opposed to debtors which are corporations or other like entities . . . [because] [s]uch a narrow construction of the term would defeat much of the purpose of the section.

There is also a dispute regarding whether a bankruptcy trustee is an "individual" for purposes of section 362(k). For example, in its 1995 ruling in *In re Pace*, the Court of Appeals for the Ninth Circuit gave "individual" a narrow construction to exclude a trustee because, although a trustee is a natural person, the interest the trustee represents is that of the bankruptcy estate rather than an individual. By contrast, in *In re Garofalo's Finer Foods, Inc.*, an Illinois district court rejected the Ninth Circuit's narrow reading of the term in favor of a broader definition designed to ensure that the bankruptcy estate can recover costs and attorneys' fees incurred by the trustee in, among other things, recovering property in the possession of a third party.

Yet another area of controversy regarding the scope of section 362(k) concerns whether the term "individual" should be construed to include creditors, an issue that has been considered by relatively few courts to date. The Fifth Circuit recently addressed this question as a matter of first impression in *St. Paul Fire & Marine*.

ST. PAUL FIRE & MARINE

Theodore F. Labuzan and his wife, Deeann Labuzan (the "Labuzans"), held substantially all of the limited and general partnership interests of Contractor Technology, Ltd. ("CTL"), a construction company located in Texas. St. Paul Fire & Marine Insurance Company ("St. Paul") furnished payment and performance bonds for several of CTL's construction projects. In turn, the Labuzans agreed to indemnify St. Paul for any payment obligations it incurred under the bonds.

Financial troubles led CTL to file for chapter 11 protection on May 15, 2005, in Texas. Approximately one week after the filing, St. Paul contacted the owners of CTL's ongoing construction projects and advised them that CTL was in bankruptcy and that if a project owner paid CTL and St. Paul was later obligated to pay on its bonds, St. Paul would reduce its liability to the project owner by any amount paid to CTL. Its revenue stream effectively shut off, CTL was forced to convert its chapter 11 case to a chapter 7 liquidation the following month.

St. Paul paid more than $32 million on the payment and performance bonds and sued the Labuzans in federal district court in November 2005 to enforce the indemnity agreement. Among the defenses interposed by the Labuzans was that St. Paul willfully violated the automatic stay by contacting CTL's creditors (thereby preventing CTL from reorganizing) and that St. Paul should be held accountable under section 362(k). The Labuzans sought an award of nearly $60 million in compensatory damages sustained by both CTL and themselves as a consequence of St. Paul's actions. In addition, both the Labuzans and CTL's chapter 7 trustee separately sued St. Paul in the bankruptcy court under section 362(k) for willfully violating the automatic stay.

The Labuzans' adversary proceeding and the St. Paul indemnity litigation were consolidated in the district court. Shortly afterward, the bankruptcy trustee and St. Paul reached a settlement in the adversary proceeding, whereby, among other things, St. Paul received $600,000 from the estate in exchange for reducing or waiving its remaining claims. The order approving the settlement also provided that the Labuzans would have an allowed claim against the bankruptcy estate in the amount of $200,000. In January 2008, the district court ruled that the Labuzans lacked standing to assert a claim under section 362(k) because the claim belonged to CTL. According to the court, because the Labazans were owners rather than creditors of CTL and the stay violation claim belonged to CTL, which had reached a settlement regarding the claim, the Labuzans could not independently assert a claim under section 362(k). The district court concluded that "on behalf of a debtor, creditors could seek equitable remedies for § 362(k) violations, but they could not recover damages." The Labuzans appealed the ruling to the Fifth Circuit Court of Appeals.

THE FIFTH CIRCUIT'S RULING

Considering the issue as a matter of first impression, the Fifth Circuit ruled in favor of the Labuzans and vacated the ruling below. The court framed the question before it as "whether, pursuant to § 362(k), individuals other than the debtor, who claim injury from an automatic stay violation, have standing to pursue a claim for resulting damages."

The Fifth Circuit's reasoning in *St. Paul Fire & Marine* is consistent with the broad purpose of the automatic stay in protecting both debtors and creditors. Moreover, in distinguishing between direct claims and derivative claims, the decision stakes out a position that should mitigate the potential for proliferation of requests for stay violation sanctions under section 362(k) by parties other than the debtor or a trustee.

First, the court of appeals examined the criteria for "standing" in federal courts (as well as under section 362(k)), explaining that the Labuzans must satisfy both "constitutional and prudential requirements." Constitutional standing, the court noted, can be established only if a plaintiff can demonstrate: (i) an injury in fact; (ii) that is fairly traceable to the actions of the defendant; and (iii) that will likely be redressed by a favorable decision. The Fifth Circuit concluded that the Labuzans easily satisfied this test because, among other things, the injuries they suffered as a consequence of CTL's failure to reorganize "can fairly be traced to St. Paul's claimed violation of the automatic stay by contacting the project owners and instructing them about the consequences of payments to CTL."

The judicially created concept of prudential standing, the court of appeals explained, adds an additional level of scrutiny, examining whether: (i) the plaintiff's grievance falls within the zone of interests protected by a statute; (ii) the complaint raises abstract questions or a generalized grievance more properly addressed by the legislature; and (iii) the plaintiff is asserting his legal rights and interests or those of third parties. However, because Congress can modify or even abrogate prudential standing requirements by statute, the Fifth Circuit examined the language of section 362(k) to divine whether lawmakers "expressed an intent to negate the background of prudential standing doctrine" in connection with claims based upon willful violations of the automatic stay.

The court found that no such intent is expressed unequivocally in section 362(k), principally because the term "individual" is not defined in the Bankruptcy Code. Confronted with the ambiguity of the statute on this point, the Fifth Circuit examined its legislative history in an effort to determine lawmakers' intent, as well as the rulings of other courts. Examining the purpose of section 362 in general, the court concluded that the automatic stay was designed to protect both debtors and creditors. The stay's expansive role in benefiting parties other than the debtor and, in the court's view, the weight of well-reasoned precedent in other jurisdictions strongly suggest that Congress intended to enable pre-petition creditors to assert automatic stay violations. According to the court, the validity of this conclusion is bolstered by section 1109(b) of the Bankruptcy Code, which expressly confers standing to be heard on any issue in a chapter 11 case upon a large universe of stakeholders, including creditors:

> When 11 U.S.C. § 1109(b) is read in conjunction with § 362(k), it becomes clear that Congress did not enact § 362(k) solely for the benefit of debtors. Accordingly, based on § 362(k)'s plain language, the above-discussed congressional purpose of § 362(k) to provide both debtor and creditor protection, and the weight of authority finding creditor-standing, we hold debtors and creditors are entities whose grievances fall "within the zone of interests" protected by § 362(k).

Moreover, because the automatic stay was designed to protect creditor as well as debtor interests, the Fifth Circuit found that the Labuzans had satisfied the second prudential standing concern by establishing that their claim did not "raise abstract questions or a generalized grievance more properly addressed by the legislative branch."

"A less obviously satisfied prudential concern," the Fifth Circuit remarked, is "whether the Labuzans are asserting claims that belong to CTL's bankruptcy estate." According to the court, even assuming that a bankruptcy trustee has the right to assert a claim under section 362(k) on behalf of the estate, the trustee's standing would not preclude a pre-petition creditor from asserting a section 362(k) claim for damages, so long as the injury suffered is personal rather than derivative. Congress, the court explained, "could have easily included § 362(k) claims under the 'property of the estate' umbrella of § 541" yet did not do so, nor did it substitute "trustee" for "individual" in section 362(k). By alleging that they were directly injured by St. Paul's conduct, the court ruled, the Labuzans demonstrated that they were asserting their own legal rights rather than those of the estate:

> Therefore, based on § 362(k)'s plain language, its legislative history, the Bankruptcy Code's purposes, and the weight of judicial authority, we hold: pursuant to § 362(k), the Labuzans, as *pre-petition creditors* of CTL, have standing to assert a claim against St. Paul. Accordingly, to the extent the Labuzans' claims are based on their status as owners/equity holders of CTL, § 362(k) cannot be invoked.

Finally, the Fifth Circuit rejected St. Paul's argument that only secured creditors may challenge automatic stay violations, observing that "[n]either the statute, its legislative history, nor the above-cited authority stands for this proposition."

OUTLOOK

The Fifth Circuit's reasoning in *St. Paul Fire & Marine* is consistent with the broad purpose of the automatic stay in protecting both debtors and creditors. Moreover, in distinguishing between direct claims and derivative claims, the decision stakes out a position that should mitigate the potential for proliferation of requests for stay violation sanctions under section 362(k) by parties other than the debtor or a trustee. On the other hand, bankruptcy courts may increasingly be called upon to distinguish between direct and derivative claims in this context.

The Fifth Circuit's reliance on section 1109(b) of the Bankruptcy Code in concluding that Congress intended the term "individual" in section 362(k) to include a creditor is somewhat curious. Because section 1109(b) applies only in chapter 11 cases, we are left to speculate as to whether, according to the Fifth Circuit's analysis, lawmakers may have intended to confer standing under section 362(k) on creditors in chapter 11 cases, but not in cases under other chapters of the Bankruptcy Code. In any case, the ruling does not address this issue.

Other recent developments concerning the availability of section 362(k) to redress harm caused by willful violations of the automatic stay are more mixed. In *Sternberg v. Johnston*, the Ninth Circuit Court of Appeals ruled in October 2009 that, although an award of damages under section 362(k)(1) does include attorneys' fees incurred in connection with enforcing the automatic stay, it does not include attorneys' fees incurred in "prosecuting a damages action" under the provision because, among other things, the "[s]tay is a shield, not a sword." The ruling creates a split in the circuits on the issue (the Fifth Circuit having ruled to the contrary in 2008 in *Young v. Repine (In re Repine)*), which may ultimately invite consideration of the issue by the U.S. Supreme Court.

St. Paul Fire & Marine Ins. Co. v. Labuzan, 579 F.3d 533 (5th Cir. 2009).

In re Chateaugay Corp., 920 F.2d 183 (2d Cir. 1990).

In re Spookyworld, Inc., 346 F.3d 1 (1st Cir. 2003).

In re Just Brakes Corp. Sys., 108 F.3d 881 (8th Cir. 1997).

In re Jove Eng'g, Inc., 92 F.3d 1539 (11th Cir. 1996).

Goodman v. Knight, 991 F.2d 613 (9th Cir. 1993).

Budget Service Co. v. Better Homes of Virginia, Inc., 804 F.2d 289 (4th Cir. 1986).

In re Atlantic Business and Community Corp., 901 F.2d 325 (3d Cir. 1990).

In re Pace, 67 F.3d 187 (9th Cir. 1995).

In re Garofalo's Finer Foods, Inc., 186 B.R. 414 (E.D. Ill. 1995).

In re Concretize, Inc., 2009 WL 3929890 (Bankr. D. Or. Nov. 18, 2009).

Sternberg v. Johnston, 2009 WL 3381162 (9th Cir. Oct. 22, 2009).

Young v. Repine (In re Repine), 536 F.3d 512 (5th Cir. 2008).

IT'S ABOUT TIME: NEW AMENDMENTS TO THE FEDERAL RULES OF BANKRUPTCY PROCEDURE REVISE TIME PERIODS

Joseph M. Witalec

On December 1, 2009, certain amendments to the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") became effective that impact the computation of virtually all time periods, ranging from the time to appeal court orders to the notice periods for disclosure statement and plan confirmation hearings. These amendments are part of a broader effort by the Judicial Conference's Committee on Rules of Practice and Procedure to standardize the computation of time periods across all federal courts, which resulted in similar revisions to the federal Civil Rules, Appellate Rules, and Criminal Rules.

THE TIME COMPUTATION AMENDMENTS

The centerpiece change to the Bankruptcy Rules is a virtually complete rewrite of Bankruptcy Rule 9006(a). The previous Bankruptcy Rule 9006(a) excluded weekends and holidays when counting days if the time period was less than eight days, but not if the period was eight days or more. This often caused confusion when calculating deadlines. Under the new Bankruptcy Rule 9006(a), weekends and holidays are always counted, regardless of the time period (unless the last day happens to be a weekend or holiday, in which case the deadline will fall on the next business day). For electronic filing, new Bankruptcy Rule 9006(a)(4)(A) also provides that the last day ends at midnight in the applicable court's time zone.

In addition, time periods of less than 30 days in the Bankruptcy Rules for the most part have been revised to be multiples of seven, so deadlines usually will fall on a weekday. Generally, the time periods in the Bankruptcy Rules will be revised as follows:

- Five-day periods become seven-day periods.
- 10-day periods become 14-day periods.
- 15-day periods become 14-day periods.
- 20-day periods become 21-day periods.
- 25-day periods become 28-day periods.

There are a few exceptions to this general rule. For example, the two-day periods in Bankruptcy Rules 1007(d) and 4001(a)(2) and the five-day periods in Bankruptcy Rules 4001(d)(3) and 7054(b) have remained the same.

The “mailbox rule” set forth in Bankruptcy Rule 9006(f) still applies to the calculation of time periods. Thus, parties have an additional three days to act when the applicable time period is triggered by service and that service is made by mail or one of the other methods set forth in the rule.

BANKRUPTCY APPEALS AND STAYS

Perhaps the amendments with the most notable impact will be the change to Bankruptcy Rule 8002, which extends the time to appeal a court order from 10 days to 14 days, and extensions of the corresponding stay periods in Bankruptcy Rules 6004(h) and 6006(d) from 10 days to 14 days. Parties to a significant transaction that requires bankruptcy-court approval, such as an asset sale or settlement, frequently are required to wait until any applicable stay period has expired (unless the court has ordered otherwise) and the court’s order has become final and nonappealable to close the transaction. Such a delay will be extended by four days under the amended rules.

OTHER AMENDMENTS

In addition, amendments to Bankruptcy Rules 7052 and 9021 and new Bankruptcy Rule 7058 make the separate judgment rule, which requires every final order to be set forth in a separate writing, applicable only to adversary proceedings. The separate judgment rule often proved impractical in contested matters, in which bankruptcy courts tend to enter a short order that incorporates certain factual findings.

Bankruptcy Rule 4008 also was amended to modify the procedures for reaffirmation agreements.

APPLICATION TO PENDING PROCEEDINGS

The new amendments to the Bankruptcy Rules became effective on December 1, 2009, and apply to cases filed prior to that date. According to the Rules Enabling Act, 28 U.S.C. § 2074, the new rules apply to all pending matters and proceedings unless such application would be infeasible or would cause an injustice.

CONFORMING CHANGES TO LOCAL BANKRUPTCY RULES

As a result of these amendments to the Bankruptcy Rules, most local bankruptcy-court rules have been or will be amended to reflect conforming changes. In many districts, such changes were implemented on or before December 1, 2009.

CHAPTER 15 FOUR-YEAR UPDATE: RISING PROMINENCE OF SECTION 363 SALES NOT CONFINED TO CHAPTER 11

Pedro A. Jimenez and Mark G. Douglas

Despite recent pronouncements that the worldwide recession has ended, an enduring overall financial malaise and credit crunch have caused a marked paradigm shift in U.S. bankruptcy cases. Companies struggling to find affordable financing in chapter 11 (in the form of debtor-in-possession financing, refinancing, or exit financing), or seeking to minimize the administrative costs associated with full-fledged chapter 11 cases, are increasingly opting for section 363 sales or prepackaged bankruptcies in an effort to fast-track the process.

The pervasiveness of sales of all or substantially all of a company's assets under section 363(b) of the Bankruptcy Code (as opposed to sales or reorganizations under a chapter 11 plan) even led the Second Circuit Court of Appeals to observe in its recent (now vacated) ruling upholding the sale of Chrysler's assets to a consortium led by Italian automaker Fiat that "[i]n the current economic crisis of 2008–09, § 363(b) sales have become even more useful and customary . . . [and] [t]he 'side door' of § 363(b) may well 'replace the main route of Chapter 11 reorganization plans.' " Expedited section 363 sales in other chapter 11 cases involving General Motors and the Chicago Cubs suggest that this prediction may be right on the mark.

Even foreign debtors with U.S. assets are rapidly becoming aware of the benefits of the section 363 sale process as a means of effecting an expeditious liquidation or transfer of assets. October 17, 2009, marked the four-year anniversary of the effective date of chapter 15 of the Bankruptcy Code, which was enacted as part of the comprehensive bankruptcy reforms implemented pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Governing cross-border bankruptcy and insolvency cases, chapter 15 is patterned after the Model Law on Cross-Border Insolvency (the "Model Law"), a framework of legal principles formulated by the United Nations Commission on International Trade Law in 1997 to deal with the rapidly expanding volume of international insolvency cases. The Model Law has now been adopted in one form or another by 17 nations or territories.

Although it has been largely overlooked in the evolving chapter 15 jurisprudence to date, the powers conferred upon the representative of a foreign debtor in a chapter 15 case include the ability to sell the debtor's U.S. assets under section 363(b) of the Bankruptcy Code. Only a handful of courts have addressed section 363 sales in chapter 15 in the short time since it was enacted. One of them was a New Jersey bankruptcy court presiding over a chapter 15 case filed on behalf of a company subject to insolvency proceedings in the British Virgin Islands. In *In re Grand Prix Associates Inc.* (discussed below), the court granted the foreign representative's motion to sell limited partnership interests held by the debtor under section 363(b) free and clear of competing interests and approved a master settlement agreement among the debtor and various creditors under Rule 9019 of the Federal Rules of Bankruptcy Procedure.

PROCEDURES AND RELIEF UNDER CHAPTER 15

Under chapter 15, a duly accredited representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding." "Foreign proceeding" is defined as:

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

Because more than one bankruptcy or insolvency proceeding may be pending against the same foreign debtor in different countries, chapter 15 contemplates recognition in the U.S. of both a "main" proceeding—a case pending in whatever country contains the debtor's "center of main interests"—and "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment."

Upon recognition of a foreign "main" proceeding, certain provisions of the Bankruptcy Code automatically come into force, while others may be deployed in the bankruptcy court's discretion by way of "additional assistance" to the foreign bankruptcy case. Among these are the automatic stay

(or an equivalent injunction) preventing creditor collection efforts with respect to the debtor or its assets located in the U.S. (section 362, subject to certain enumerated exceptions) and the right of any entity asserting an interest in the debtor's U.S. assets to "adequate protection" of that interest (section 361). The provisions also include the power to avoid unauthorized post-recognition asset transfers (section 549); rules regarding the post-recognition effect of security interests in a foreign debtor's U.S. assets (section 552); and procedures governing the use, sale, or lease of a foreign debtor's U.S. property (section 363).

In particular, section 1520(a)(2) of the Bankruptcy Code provides that "sections 363, 549, and 552 apply to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the sections would apply to property of an estate." Also, section 1521(b) states:

> Upon recognition of a foreign proceeding, whether main or nonmain, the court may . . . entrust the distribution of all or part of the debtor's assets located in the United States to the foreign representative or another person . . . authorized by the court, provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected.

If the foreign proceeding is recognized as a "nonmain" proceeding, the bankruptcy court may, but is not required to, grant a broad range of provisional and other relief designed to preserve the foreign debtor's assets or otherwise provide assistance to a main proceeding pending elsewhere.

Once a foreign main proceeding is recognized by the bankruptcy court, the foreign representative is authorized to operate the debtor's business in much the same way as a chapter 11 debtor in possession. He can also commence a full-fledged bankruptcy case under any other chapter of the Bankruptcy Code, so long as the foreign debtor is eligible to file for bankruptcy in the U.S. and the debtor has U.S. assets. In fact, if the foreign representative seeks relief on the debtor's behalf under section 544, 547, or 548 (*e.g.*, for the purpose of avoiding preferential or fraudulent transfers), he is required to file a case on the foreign debtor's behalf under another chapter of the Bankruptcy Code.

The ability to sell a debtor's assets under section 363 of the Bankruptcy Code is an important tool that permits trustees, chapter 11 debtors in possession, and foreign representatives to effect an orderly and expeditious sale or liquidation of individual assets or even a debtor's entire business. The section 363 sale process can be undertaken by means of a public auction with detailed bidding procedures or through a private sale, depending upon whichever vehicle in the discretion of the bankruptcy court is most likely to result in the highest and best offer for the assets in question. To expedite the sale process, section 363(f) of the Bankruptcy Code authorizes sales free and clear of competing interests in the property under certain specified conditions. Section 363(m) promotes the finality of the bankruptcy sale process by providing that an order authorizing a sale to a good-faith purchaser cannot be undone even if the order is reversed on appeal unless the party challenging the sale obtains a stay pending appeal. A New Jersey bankruptcy court recently considered how the section 363 sale process should operate in a chapter 15 case in *Grand Prix Associates*.

GRAND PRIX ASSOCIATES

Grand Prix Associates Inc. and its affiliates ("Grand Prix") were incorporated under the laws of the British Virgin Islands ("BVI") for the purpose of investing in private equity limited partnerships. The investments were partially funded by Blackthorne Property, Inc. ("Blackthorne"), to which Grand Prix granted a lien on substantially all of its assets as security for the financing. A consortium of limited partnership lenders (the "LP Lenders") also provided financing to Grand Prix for the purpose of satisfying capital calls with respect to acquired partnership interests. As security for the obligation, Grand Prix pledged its shares and granted the LP Lenders security interests in accounts and securities located in New Jersey.

Substantially unfunded capital calls caused Grand Prix to commence insolvency proceedings on March 13, 2009, in the BVI (the "BVI Proceeding"). The BVI court appointed Plaza Management Overseas, S.A. ("Plaza"), as Grand Prix's foreign representative and directed Plaza to file a chapter 15 case on Grand Prix's behalf in the U.S. for the purpose of preventing creditors from seizing Grand Prix's pledged U.S. assets.

Plaza filed a petition for recognition under chapter 15 of the BVI Proceeding as a foreign main proceeding on March 18, 2009, in New Jersey. Together with the chapter 15 petition, Plaza filed a motion seeking provisional relief in the form of an injunction preventing any actions in the U.S. to collect against Grand Prix's assets. On March 24, 2009, the LP Lenders and certain other parties filed suit in New York State Supreme Court against the principals of Grand Prix, Blackthorne, and certain other parties alleging, among other things, that the defendants had engaged in fraud and tortious contractual interference in connection with the loan transactions. The bankruptcy court granted the injunctive relief on April 2, 2009.

Following extensive negotiations among Grand Prix, Blackthorne, the LP Lenders, and various limited partnerships in which Grand Prix held investments, Plaza filed an amended chapter 15 petition on May 8, 2009, together with a master settlement agreement resolving the disputes among the parties. The bankruptcy court entered an order recognizing the BVI Proceeding as a foreign main proceeding on May 18, 2009, directing, however, that the recognition order would be vacated *nunc pro tunc* to the date immediately preceding execution of the settlement agreement if that agreement was not ultimately approved by the court.

The master settlement agreement and an accompanying transaction agreement resolved the disputes among the parties (including the New York litigation) and provided for, among other things, the sale and/or assignment of various limited partnership interests held by Grand Prix to the LP Lenders and certain other parties and the exchange of mutual releases. Plaza filed a motion seeking approval of the sale under sections 363(b)(1), 363(f), and 1520(a)(2). Plaza also filed a motion seeking an order approving the master settlement agreement under Rule 9019 of the Federal Rules of Bankruptcy Procedure.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court approved both motions. Initially, the court noted, in keeping with chapter 15's underlying purpose in harmonizing foreign and U.S. bankruptcy or insolvency proceedings, sections 1525 and 1527 of the Bankruptcy Code expressly require communication and cooperation among U.S. courts, foreign courts, and foreign representatives with respect to the supervision and administration of a foreign debtor's assets, including approval of agreements related to the coordination of proceedings. According to the court, the master settlement agreement promotes the goals of these provisions because it "proposes a resolution that will conclude the instant Chapter 15 proceeding, the BVI Proceeding, and the claims and issues between the parties."

Representatives of foreign debtors are increasingly relying on chapter 15 as a reliable means of protecting a foreign debtor's U.S. assets pending a determination as to whether such assets (or their proceeds) should be repatriated abroad to be administered in the venue of the debtor's foreign main proceeding, which serves as a centralized forum to resolve all claims against the debtor or its assets.

Under Rule 9019, the court explained, the proponent of a settlement bears the burden of proving that a settlement is in the best interests of the estate and the debtor. In determining whether to approve a proposed settlement, the bankruptcy court must consider: (i) the probability of success in litigation; (ii) the likely difficulties in collection; (iii) the complexities of the litigation involved and the expense, inconvenience, and delay necessarily attending it; and (iv) the paramount interests of creditors. The court concluded that Plaza had satisfied its burden of demonstrating that the master settlement agreement and the sale transaction were negotiated in good faith, were reasonable given the circumstances, and should be approved under Rule 9019. Among other things, the evidence demonstrated that the litigation was extremely costly, complex, time-consuming, and of uncertain outcome and that other litigation would ensue in the absence of a settlement. All of these factors, the court reasoned, supported the conclusion that the settlement was in the best interests of creditors.

Turning to Plaza's motion to sell Grand Prix's limited partnership interests free and clear, the court explained that, because the sale transaction was outside the ordinary course of Grand Prix's business, Plaza must demonstrate that

"there is a sound business justification for the transaction." In addition, the court noted, Plaza bears the burden of proving that the sale satisfies the requirements of section 363(f) and that the purchaser is acquiring the assets in good faith under section 363(m). Thus, the standard applied by the court in assessing the propriety of a nonordinary-course asset sale in chapter 15 was no different from the standard governing section 363(b) sales in chapter 7 or 11 cases.

The bankruptcy court concluded that Plaza had satisfied these burdens, based upon its findings that the settlement and sale had a sound business purpose because they would resolve "expensive and lengthy" litigation and the proposed sales price was fair because it would satisfy all obligations to creditors, capital calls, and related costs. Finally, the court ruled that Plaza met its burden of proving that the purchaser "acted in good faith and without collusion" with respect to the sale transaction, based upon evidence showing, among other things, that the negotiations were undertaken at arm's length.

OUTLOOK

Chapter 15 filings remain relatively uncommon even four years after the U.S. enacted its version of the Model Law in 2005. Calendar years 2006, 2007, and 2008 saw 74, 42, and 76 chapter 15 filings, respectively. As of November 23, 2009, 117 chapter 15 cases had been filed in the U.S. in this calendar year.

Even so, representatives of foreign debtors are increasingly relying on chapter 15 as a reliable means of protecting a foreign debtor's U.S. assets pending a determination as to whether such assets (or their proceeds) should be repatriated abroad to be administered in the venue of the debtor's foreign main proceeding, which serves as a centralized forum to resolve all claims against the debtor or its assets. *Grand Prix Associates* and the handful of similar rulings to date (for example, a Virginia bankruptcy court's April 2008 decision in *In re Loy*) suggest that sales under section 363 are likely to be an important part of the chapter 15 process.

In re Chrysler LLC, 576 F.3d 108 (2d Cir.), *cert. granted, judgment vacated*, 2009 WL 2844364 (Dec. 14, 2009).

In re Grand Prix Associates Inc., 2009 WL 1850966 (Bankr. D.N.J. June 26, 2009).

In re Loy, 2008 WL 906503 (Bankr. E.D. Va. April 3, 2008).

NEW AMENDMENTS TO CANADIAN INSOLVENCY LAW TAKE EFFECT

A major package of reforms to Canada's Bankruptcy and Insolvency Act ("BIA") and Companies' Creditors Arrangement Act ("CCAA") came into force on September 18, 2009. The most significant features of the insolvency reforms pertaining to business cases include:

- Codification of a large body of case law developed in restructurings under the CCAA regarding a court's authority to authorize debtor-in-possession financing, to authorize the sale of assets in a restructuring proceeding, and to permit the debtor to reject or assign certain kinds of contracts;
- Enhanced protection for collective bargaining agreements and intellectual property licenses;
- Provisions authorizing the appointment of a national receiver with powers that are exercisable throughout Canada, rather than merely in the province where the appointment is made, and provisions specifying the powers that the court may confer upon a receiver;
- Limitations on the rights of equity holders in restructurings;
- The adoption of procedures for dealing with cross-border insolvency proceedings based on the UNCITRAL Model Law, which has been enacted in various forms in 17 countries or territories, including the U.S. (in the new chapter 15 of the U.S. Bankruptcy Code), Great Britain, and Japan;
- Provisions protecting a receiver or trustee in bankruptcy from personal liability for claims made in connection with collective bargaining agreements or pension plans; and
- The replacement of several technical remedies in the BIA with a general power to challenge "transfers at undervalue" by the debtor and the incorporation of this power in CCAA proceedings.

The amendments are effective in bankruptcies or restructurings that formally commenced under the BIA or CCAA on or after September 18, 2009.

BUSINESS RESTRUCTURING REVIEW

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

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