JONES DAY

RECENT DEVELOPMENTS IN BANKRUPTCY AND RESTRUCTURING

VOLUME 9 ▪ NO. 4 ▪ JULY/AUGUST 2010

BUSINESS RESTRUCTURING REVIEW

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THE END OF *FRENVILLE:* RELIEF OR MORE CONFUSION?

Paul M. Green

As part of the overhaul of bankruptcy laws in 1978, Congress for the first time included the definition of "claim" as part of the Bankruptcy Code. A few years later, in *Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.)*, the Third Circuit became the first court of appeals to examine the scope of this new definition in the context of the automatic stay. In interpreting the definition of "claim," the Third Circuit focused on the "right to payment" language in that definition and ultimately held that a claim arises when a claimant's right to payment accrues under applicable nonbankruptcy law. Subsequent to the decision in *Frenville*, courts in other jurisdictions almost unanimously criticized the Third Circuit's adoption of the "accrual" test because it appeared to contradict the broad definition of "claim" envisioned by Congress and the Bankruptcy Code.

On June 2, 2010, the Third Circuit issued an en banc decision in *Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.)* specifically overruling *Frenville* and 26 intervening years of precedent. In *Grossman's*, the court rejected the widely criticized accrual test initially adopted in *Frenville* and instead opted for a version of the "conduct" test used by other courts to determine when a claim arises for purposes of the Bankruptcy Code. With this ruling, the Third Circuit fundamentally altered how courts in the Third Circuit will determine whether an entity has a claim in bankruptcy.

BACKGROUND

In 1977, Mary Van Brunt purchased products that allegedly contained asbestos from Grossman's, Inc., a home-improvement retail store. The retailer and its affiliates (collectively, "Grossman's") filed for chapter 11 relief in April 1997 in Delaware and

confirmed a chapter 11 plan in December 1997. At the time of its bankruptcy filing, Grossman's had not been the subject of any asbestos claims, nor were any such claims filed during its bankruptcy case. Grossman's was aware, however, that it had previously sold asbestos-containing products. Nonetheless, Grossman's did not seek a channeling injunction pursuant to Bankruptcy Code section 524(g), nor did it seek the appointment of an individual to represent the interests of future asbestos claimants. Additionally, the bar date notice did not reference asbestos liability or an intent to cover future claims.

> Given the lack of clarity provided by the Third Circuit's selection of the exposure test, it appears likely that the full effect of the court's decision in *Grossman's* will remain unknown until courts further refine the test's application. Moreover, until such decisions are forthcoming, it is also unclear how the exposure test will apply outside the asbestos context and related areas.

Van Brunt began to develop symptoms of mesothelioma in 2006, and she was diagnosed with the disease in 2007. Soon after her diagnosis, Van Brunt filed an action against Jeld-Wen, the successor in interest to Grossman's. Jeld-Wen in turn sought to reopen the Grossman's bankruptcy case and obtain a ruling that Van Brunt's claim had been discharged pursuant to the 1997 chapter 11 plan. Both the bankruptcy and district courts concluded, pursuant to *Frenville*, that Van Brunt's claim had not been discharged pursuant to the 1997 bankruptcy because her claim accrued in 2006, when Van Brunt first manifested symptoms of mesothelioma.

After noting that the lower courts had correctly applied the accrual test set forth in *Frenville* in determining that Van Brunt's claim had not been discharged, the Third Circuit questioned whether that result was appropriate in light of the significant criticism of *Frenville*. The court noted that other courts "have declined to follow *Frenville* because of its apparent conflict with the Bankruptcy Code's expansive treatment of the term claim." Explaining that "claim" is specifically defined in section 101(5) as a "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," the Third Circuit acknowledged that, as these courts have concluded, the accrual test fails to account for the fact that unliquidated, contingent, and unmatured claims can exist under the Bankruptcy Code before a right to payment accrues under state or applicable law. Reexamining the ruling in *Frenville*, the Third Circuit, sitting en banc, unanimously determined it was appropriate to overrule the accrual test.

DETERMINING WHEN A CLAIM ARISES

After expressly overruling *Frenville* and the accrual test, the Third Circuit had to decide what test it should adopt to determine when a claim arises. The court first examined the policy implications related to the definition of "claim." On the one hand, a broad definition allows a greater number of potential liabilities to be discharged, consistent with congressional intent to provide debtors a fresh start. On the other hand, a definition that is too broad may disproportionately disadvantage involuntary creditors, such as tort victims whose injuries have not manifested. The court noted that these competing considerations must be weighed and that other courts have failed to reach a definitive resolution of this issue.

Consistent with a broad interpretation of "claim," some courts have adopted the "conduct" test, finding that a claim arises when the debtor engages in the conduct that ultimately causes harm, even if no harm was discovered prior to plan confirmation. This test was adopted by the Fourth Circuit in its 1988 ruling in *Grady v. A.H. Robins Co.*, which dealt with a claimant who used an intrauterine contraceptive device the debtor manufactured prior to its bankruptcy. The *A.H. Robins* court ultimately held that the plaintiff's claim arose "when the acts giving rise to [the defendant's] liability were performed, not when the harm caused by those acts was manifested."

Some courts have expressed concern that the conduct test is too broad because it could require a claimant to be subject to a preexisting bankruptcy plan even though the claimant was not exposed to a product or hazardous substance until long after the bankruptcy case was concluded. Thus, those courts have sought to limit the definition of "claim" to

situations where there is some prebankruptcy relationship between the debtor and the purported claimant. Pursuant to the "relationship" test, as adopted by the Eleventh Circuit in its 1995 ruling in *Epstein v. Official Committee of Unsecured Creditors (In re Piper Aircraft Corp.)*, "[t]he debtor's prepetition conduct gives rise to a claim to be administered in a case only if there is a relationship established before confirmation between an identifiable claimant or group of claimants and that prepetition conduct." Like the accrual test, however, the relationship test has been criticized by commentators for failing to fully encompass the broad definition of "claim" envisioned by Congress and the Bankruptcy Code.

Faced with what appear to be two imperfect tests for determining when a claim arises for purposes of the Bankruptcy Code, the Third Circuit looked to asbestos-specific cases and determined that a consensus emerged in those cases in which a claim arose upon a victim's exposure to asbestos, not upon the manifestation of injury. On the basis of this consensus, the Third Circuit held that:

> a "claim" arises when an individual is exposed prepetition to a product or other conduct giving rise to an injury, which underlies a "right to payment" under the Bankruptcy Code. . . . Applied to the Van Brunts, it means that their claims arose sometime in 1977, the date Mary Van Brunt alleged that Grossman's product exposed her to asbestos.

IMPLICATIONS OF THE THIRD CIRCUIT'S DECISION

Unwilling to adopt outright either the conduct test or the relationship test, the Third Circuit appears to have developed a hybrid of both approaches, at least in the asbestos context. In a footnote, the court noted that it was defining the scope of a claim in the context of an asbestos case, so the determination of when a claim arises in other contexts, including environmental cases, will depend on the nature of the claim and the posture of the case. In reaching its decision, the court favorably cited decisions based on "a form of the conduct test"; however, by holding that a claim arises when an individual is exposed to the injury-causing product, the Third Circuit's test applicable to asbestos claims appears to be stricter than a pure conduct test, which focuses solely on the debtor actions that gave rise to the injury. By focusing on exposure, the Third Circuit also appears to embrace a test for asbestos claims at the very least that is broader than a relationship test, insofar as exposure does not necessarily create a prepetition relationship between an identifiable claimant and the debtor's prepetition conduct. Thus, it appears, at least in the asbestos context, that the Third Circuit sought to draw a line somewhere between the conduct and relationship tests.

Unfortunately, outside the asbestos context, the Third Circuit offered no real guidance. Indeed, the Third Circuit cited the Seventh Circuit's 1992 ruling in *Matter of Chicago, Milwaukee, St. Paul & Pacific R. Co.* that "the determination of when a party has a claim . . . seems to hinge on the nature of the claim and the posture of the case." This would seem to indicate a view by the Third Circuit that "exposure" could have a significantly different meaning in other nonasbestos contexts.

In short, given the lack of clarity provided by the Third Circuit's selection of the exposure test, it appears likely that the full effect of the court's decision in *Grossman's* will remain unknown until courts further refine the test's application. Moreover, until such decisions are forthcoming, it is also unclear how the exposure test will apply outside the asbestos context and related areas.

Finally, while numerous questions regarding the ultimate effect of *Grossman's* definition of "claim" remain unanswered, the Third Circuit made clear that regardless of the applicable definition of "claim," due process remains an important component of a court's determination of whether a claim has been discharged. In remanding the case on whether Van Brunt received adequate due process, the Third Circuit listed a number of factors the bankruptcy court should consider on remand, including:

> the circumstances of the initial exposure to asbestos, whether and/or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, whether the claimants had a colorable claim at the time of the bar date, and other circumstances specific to the parties, including whether it was reasonable or possible for the debtor to establish a trust for future claimants as provided by § 524(g).

This list of factors appears to go beyond existing tests adopted by courts to assess whether potential creditors have been provided due process in connection with a bankruptcy. As a result, future court decisions, including the opinion of the bankruptcy court on remand, will be necessary to understand the full impact of *Grossman's* on due process issues as well.

Jeld-Wen, Inc. v. Van Brunt (In re Grossman's Inc.), 607 F.3d 114 (3d Cir. 2010).

Epstein v. Off. Comm. of Unsecured Creditors (In re Piper Aircraft Corp.), 58 F.3d 1573 (11th Cir. 1995).

Grady v. A.H. Robins Co., 839 F.2d 198 (4th Cir. 1988).

Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.), 744 F.2d 332 (3d Cir. 1984).

Matter of Chicago, Milwaukee, St. Paul & Pacific R. Co., 974 F.2d 775 (7th Cir. 1992).

ADVISORY COMMITTEE ON BANKRUPTCY RULES RECOMMENDS SWEEPING REVISIONS TO BANKRUPTCY RULE 2019

Mark G. Douglas

Bankruptcy headlines in 2007 were awash with tidings of controversial developments in the chapter 11 cases of Northwest Airlines and its affiliates that sent shock waves through the "distressed" investment community. A New York bankruptcy court ruled that an unofficial, or "ad hoc," committee consisting of hedge funds and other distressed investment entities holding Northwest stock and claims was obligated under a formerly obscure provision in the Federal Rules of Bankruptcy Procedure—Rule 2019—to disclose the details of its members' trading positions, including the acquisition prices.

The ruling was particularly rankling to distressed investors, who play a prominent role in major chapter 11 cases, sometimes by virtue of collective participation in ad hoc creditor groups. Traditionally, these entities have closely guarded information concerning their trading positions to maximize both profit potential and negotiating leverage. Compelling disclosure of this information could discourage hedge funds and other distressed investors from sitting on informal committees, resulting in a significant shift in what has increasingly become a commonplace negotiating infrastructure in chapter 11 mega-cases.

Close on the heels of the rulings in Northwest Airlines, however, the Texas bankruptcy court presiding over the chapter 11 cases of Scotia Pacific Company LLC and its affiliates denied the debtors' request for an order compelling a group of noteholders to disclose the details of its members' trading positions, ruling that an informal creditor group jointly represented by a single law firm is not the kind of "committee" covered by Rule 2019.

Developments in these and other cases have been monitored closely by the distressed investment community, including trading-industry watchdogs, such as the Loan Syndications and Trading Association ("LSTA") and the Securities Industry and Financial Markets Association ("SIFMA"), which have been actively lobbying to repeal or

alter Rule 2019 since 2007. LSTA and SIFMA, two of the nation's leading industry groups in the debt and equity markets, have consistently expressed concern that construing Rule 2019 to apply to informal creditor groups "will have a serious detrimental impact on the willingness and ability of many stakeholders to participate in future chapter 11 cases."

The Rule 2019 ad hoc committee controversy lay relatively dormant for nearly two and a half years. Then, rulings handed down by no fewer than four bankruptcy courts at the end of 2009 and the beginning of 2010 breathed new life into the smoldering embers. The latest tally of bankruptcy courts considering this issue since 2007 shows three courts taking the position that Rule 2019 applies to informal creditor groups and three advocating the opposite approach. A detailed discussion of the rulings in the Northwest Airlines, Scotia Pacific, Washington Mutual, Six Flags, Philadelphia Newspapers, and Accuride chapter 11 cases as well as Rule 2019 and its legislative history is contained in the March/April 2010 edition of the *Business Restructuring Review*.

BANKRUPTCY RULE 2019

The present version of Rule 2019 (with emphasis added to the original) provides that, in a case under chapter 9 or chapter 11 of the Bankruptcy Code, "*every entity or committee*" (other than an official committee) "*representing more than one creditor or equity security holder*" and, unless otherwise directed by the court, every indenture trustee shall file a verified statement with the court disclosing the following information:

(1) the name and address of the creditor or equity security holder;

(2) the nature and amount of the claim or interest and the time of acquisition thereof unless it is alleged to have been acquired more than one year prior to the filing of the petition;

(3) a recital of the pertinent facts and circumstances in connection with the employment of the entity or indenture trustee, and, in the case of a committee, the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act; and

(4) with reference to the time of the employment of the entity, the organization or formation of the committee, or the appearance in the case of any indenture trustee, *the amounts of claims or interests owned by the entity, the members of the committee or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.*

THE RULES COMMITTEE'S INITIAL RECOMMENDATION FOR CHANGE

The Rule 2019 controversy and aggressive lobbying by LSTA and SIFMA created an impetus for the Advisory Committee on Bankruptcy Rules (the "Rules Committee") to consider revising the rule or even repealing Rule 2019 altogether. The Rules Committee initially recommended changes to Rule 2019 that would have required expanded disclosure. Under this proposal, the rule would have required disclosure not only by representative committees, but also by "every entity, group, or committee that consists of or represents more than one creditor or equity security holder."

Moreover, the required disclosures would have been expanded to include disclosure of each party's "disclosable economic interest," a term defined to mean "any claim, interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right that grants the holder an economic interest that is affected by the value, acquisition, or disposition of a claim or interest." Under the initial recommendation, the bankruptcy court would also have been given the authority to order the disclosure of amounts paid for claims or interests, but pricing disclosure would not have been required without a court order. The Rules Committee heard testimony on the proposed amendments to Rule 2019 on February 5, 2010. The comment period for the proposed changes closed on February 16. In connection with the comment process, LSTA submitted a letter to the Rules Committee opposing the required disclosure of proprietary price and date information.

THE RULES COMMITTEE'S FINAL RECOMMENDATION: RULE 2019 DEFANGED

The Rules Committee issued its final recommendation for changes to Rule 2019 on May 27. Instead of requiring enhanced disclosure, however, the recommendation adopts substantially all of the changes proposed by LSTA. Among

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NEWSWORTHY

Corinne Ball (New York), ***David G. Heiman (Cleveland)***, and ***Jeffrey B. Ellman (Atlanta)*** led a team of Jones Day professionals representing Old Carco LLC (formerly known as Chrysler Group LLC) in connection with the confirmation of a liquidating chapter 11 plan on April 21 by the U.S. Bankruptcy Court for the Southern District of New York. Auburn Hills, Michigan-based Chrysler, which was founded in 1925 and is today the third-largest automaker in the U.S., with more than 55,000 employees, filed for chapter 11 protection on April 30, 2009, to effectuate a sale of most of its operations under section 363 of the Bankruptcy Code to a new entity owned by Italian automaker Fiat SpA, as the lead investor, as well as a voluntary employee beneficiary association of Chrysler employees represented by the United Autoworkers and the U.S. and Canadian governments. Chrysler was the first U.S. automaker ever to file for bankruptcy protection. Old Carco's chapter 11 plan became effective on May 1. The other practice attorneys involved in the representation were ***Richard H. Engman (New York)***, ***Pedro A. Jimenez (New York)***, ***Brett P. Barragate (New York)***, ***Mark A. Cody (Chicago)***, ***Kevyn D. Orr (Washington)***, ***Robert W. Hamilton (Columbus)***, ***Veerle Roovers (New York)***, ***Carl E. Black (Cleveland)***, ***Brett J. Berlin (Atlanta)***, ***Robbin Rahman (Atlanta)***, ***Nathan Lebioda (New York)***, ***Jason M. Cover (New York)***, ***Joseph M. Tiller (Chicago)***, ***Robert E. Krebs (Chicago)***, ***Timothy W. Hoffmann (Chicago)***, ***Thomas A. Wilson (Cleveland)***, and ***Daniel J. Merrett (Atlanta)***.

Corinne Ball (New York), ***Paul D. Leake (New York)***, ***David G. Heiman (Cleveland)***, ***Heather Lennox (Cleveland)***, ***Brad B. Erens (Chicago)***, ***Charles M. Oellermann (Columbus)***, ***Gregory M. Gordon (Dallas)***, ***Bennett L. Spiegel (Los Angeles)***, ***Richard L. Wynne (Los Angeles)***, ***Peter J. Benvenutti (San Francisco)***, and ***Aldo L. Lafiandra (Atlanta)*** are included in *Super Lawyers*' 2010 "Corporate Counsel Edition" in the practice area of Bankruptcy.

An article written by ***Corinne Ball (New York)*** entitled "Bill's Resolution Authority Would Be Regulator-Centered" appeared in the June 24, 2010, edition of the *New York Law Journal*. On June 4, to celebrate the opening of Jones Day's Paris Office, she sat on a panel discussing "Financial Regulatory Reform" with Wilbur L. Ross, Jr.; Michel Prada, former head of the French equivalent of the U.S. Securities and Exchange Commission; and Professor Hal S. Scott, head of the International Financial Systems Program at Harvard Law School.

On May 26, the Second Circuit Court of Appeals unanimously affirmed as being "without merit" the dismissal of $4.3 billion in bankruptcy and related claims asserted by the Adelphia Recovery Trust against 430 lending institutions represented by a team of Jones Day lawyers led by ***Richard L. Wynne (Los Angeles)***.

Corinne Ball (New York), ***Paul D. Leake (New York)***, ***David G. Heiman (Cleveland)***, ***Charles M. Oellermann (Columbus)***, ***Erica M. Ryland (New York)***, and ***Richard H. Engman (New York)*** were recommended by *The U.S. Legal 500* in the field of Corporate Restructuring.

An article written by ***Corinne Ball (New York)*** entitled "Leveraged Buyouts Made Less Safe from Fraud Actions in Delaware" was published in the June 2010 edition of *The Bankruptcy Strategist*.

Adam Plainer (London) and ***Volker Kammel (Frankfurt)*** were included in the 2010 edition of *Chambers Europe: Europe's Leading Lawyers for Business* in the field of Restructuring/Insolvency.

NEWSWORTHY *(continued)*

Daniel P. Winikka (Dallas) was a panelist for the presentation entitled "Will the Sun Set on Unsecured Creditors? LBO Litigation in the Midst of a Financial Crisis" at the Association of Insolvency & Restructuring Advisors' 26th Annual Bankruptcy and Restructuring Conference in San Diego on June 11. Dan also sat on a panel on June 3 discussing "The Financing Landscape and Recent Trends in Loans to Distressed Companies" at the State Bar of Texas Advanced Bankruptcy Seminar in Dallas.

Corinne Ball (New York) is serving on the advisory board of the Schnelling Endowment at Fordham Law School for the Advancement of Business Reorganization, which launched on May 24.

Thomas A. Howley (Houston) was recently recognized by *H Texas* magazine as a top lawyer in Houston in the area of Bankruptcy & Workouts.

Adam Plainer (London) chaired the R3 Association of Business Recovery Professionals Debt Restructuring conferences in Leeds and London on June 8 and June 22, respectively.

An article written by ***Heather Lennox (Cleveland)*** and ***Thomas A. Wilson (Cleveland)*** entitled "A Tectonic Shift for Administrative Rent Claims? Bankruptcy Court Rejects 'Actual Use' Limitation on Debtor-Lessee's Obligation to Pay Postpetition Rent Under Commercial Equipment Lease" was published in the May/June 2010 edition of the *Norton Journal of Bankruptcy Law and Practice*.

Two interviews with ***Christian P. Staps (Frankfurt)*** discussing plans of the German government to reintroduce priority for claims of taxing authorities in German insolvency proceedings were published in the online edition of German magazine *WirtschaftsWoche* (www.wiwo.de) on June 15 and in the German newspaper *Boersen-Zeitung* on June 23.

An article written by ***Charles M. Oellermann (Columbus)*** entitled "Out-of-Court Workouts Gain Prominence as Bankruptcy Alternative" was published in the July 9, 2010, issue of *Columbus Business First.*

Heather Lennox (Cleveland) sat on a panel discussing "Credit Bidding" at the American Bankruptcy Institute's 12th Annual New York City Bankruptcy Conference on May 24.

Lori Sinanyan (Los Angeles) was a panelist on July 16 at the Turnaround Management Association Western Regional Conference "A New Year, A New Conversation: Deal Flow in 2010–2011" in Carlsbad, California. The topic of the panel discussion was "Trading Your Plunder—How to Maximize Value of Your Distressed Assets."

An article written by ***Mark G. Douglas (New York)*** entitled "The Year in Bankruptcy 2009: Part 2" was published in the April/May 2010 edition of *Pratt's Journal of Bankruptcy Law*. A version of the article also appeared in the April/May 2010 edition of *La Lettre de L'Association Française de Gouvernement d'Entreprise.*

An article written by ***David A. Beck (Columbus)*** entitled "*Sportsman's Warehouse* and the Latest from Delaware on Stub Rent" was published in the May 2010 issue of the *American Bankruptcy Institute Journal.*

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other things, the amended rule (as compared to the Rules Committee's initial recommendation) would:

- Remove any absolute requirement to disclose the price paid for a bankruptcy claim or reveal the claimant's disclosable economic interest.
- Delete any requirement to disclose the acquisition date of the claimant's disclosable economic interest, except in rare cases where an unofficial group or committee claims to represent any entity other than its members (and even then, only the quarter and the year must be reported).
- Eliminate the authority of the court to order disclosure of the purchase price paid for a disclosable economic interest.
- Exempt administrative agents under credit agreements from the requirements of the rule.
- Exempt groups composed entirely of insiders or affiliates of one another from the requirements of the rule.
- Delete any obligation to file monthly supplemental statements; supplemental statements must be filed only when a fact disclosed in the most recent 2019 statement has changed materially, and the entity or group "takes a position before the court or solicits votes on the confirmation of a plan."

Assuming that the recommendation is ultimately approved, the changes are unquestionably a welcome development for hedge funds and other distressed investors, which closely guard trading information, such as the acquisition price of stock or claims, disclosure of which to the public might compromise the funds' ability to maximize investment returns.

As amended in accordance with the Rules Committee's final recommendation, the full text of Rule 2019 would read as follows:

Rule 2019. Disclosure Regarding Creditors and Equity Security Holders in Chapter 9 and Chapter 11 Cases

(a) **DEFINITIONS.** In this rule the following terms have the meanings indicated:

(1) "Disclosable economic interest" means any claim, interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right granting the holder an economic interest that is affected by the value, acquisition, or disposition of a claim or interest.

(2) "Represent" or "represents" means to take a position before the court or to solicit votes regarding the confirmation of a plan on behalf of another.

(b) **DISCLOSURE BY GROUPS, COMMITTEES, AND ENTITIES.**

(1) In a chapter 9 or 11 case, a verified statement setting forth the information specified in subdivision (c) of this rule shall be filed by every group or committee that consists of or represents, and every entity that represents, multiple creditors or equity security holders that are

(A) acting in concert to advance their common interests, and (B) not composed entirely of affiliates or insiders of one another.

(2) Unless the court orders otherwise, an entity is not required to file the verified statement described in paragraph (1) of this subdivision solely because of its status as:

(A) an indenture trustee;

(B) an agent for one or more other entities under an agreement for the extension of credit;

(C) a class action representative; or

(D) a governmental unit that is not a person.

(c) **INFORMATION REQUIRED.** The verified statement shall include:

(1) the pertinent facts and circumstances concerning:

(A) with respect to a group or committee, other than a committee appointed under § 1102 or 1114 of the Code, the formation of the group or committee, including the name of each entity at whose instance the group or committee was formed or for whom the group or committee has agreed to act; or

(B) with respect to an entity, the employment of the entity, including the name of each creditor or equity security holder at whose instance the employment was arranged;

(2) if not disclosed under subdivision (c)(1), with respect to an entity, and with respect to each member of a group or committee:
   (A) name and address;
   (B) the nature and amount of each disclosable economic interest held in relation to the debtor as of the date the entity was employed or the group or committee was formed; and
   (C) with respect to each member of a group or committee that claims to represent any entity in addition to the members of the group or committee, other than a committee appointed under § 1102 or 1114 of the Code, the date of acquisition by quarter and year of each disclosable economic interest, unless acquired more than one year before the petition was filed;
(3) if not disclosed under subdivision (c)(1) or (c)(2), with respect to each creditor or equity security holder represented by an entity, group, or committee, other than a committee appointed under § 1102 or 1114 of the Code:
   (A) name and address; and
   (B) the nature and amount of each disclosable economic interest held in relation to the debtor as of the date of the statement; and
(4) a copy of the instrument, if any, authorizing the entity, group, or committee to act on behalf of creditors or equity security holders.

(d) **SUPPLEMENTAL STATEMENTS.** If any fact disclosed in its most recently filed statement has changed materially, an entity, group, or committee shall file a verified supplemental statement whenever it takes a position before the court or solicits votes on the confirmation of a plan. The supplemental statement shall set forth the material changes in the facts required by subdivision (c) to be disclosed.

(e) **DETERMINATION OF FAILURE TO COMPLY; SANCTIONS.**
   (1) On motion of any party in interest, or on its own motion, the court may determine whether there has been a failure to comply with any provision of this rule.
   (2) If the court finds such a failure to comply, it may:
      (A) refuse to permit the entity, group, or committee to be heard or to intervene in the case;
      (B) hold invalid any authority, acceptance, rejection, or objection given, procured, or received by the entity, group, or committee; or
      (C) grant other appropriate relief.

WHERE DO WE GO FROM HERE?

Although the Rules Committee has unanimously recommended that the most recent changes be approved, the recommended revisions to Rule 2019 must be approved by the Standing Committee on Rules of Practice and Procedure, the Judicial Conference, and the U.S. Supreme Court before they become effective. Assuming that the recommendation is ultimately approved, the changes are unquestionably a welcome development for hedge funds and other distressed investors, which closely guard trading information, such as the acquisition price of stock or claims, disclosure of which to the public might compromise the funds' ability to maximize investment returns. Hedge funds and other distressed investors have made and continue to make enormous investments in all levels of the capital structures of distressed companies. As a consequence, these funds and investors have regularly assumed prominent roles in major chapter 11 cases. As amended, Rule 2019 would preserve this dynamic.

In re Northwest Airlines Corp., 363 B.R. 701 (Bankr. S.D.N.Y. 2007).

In re Scotia Development LLC, Case No. 07-20027-C-11 (Bankr. S.D. Tex. Apr. 18, 2007).

In re Washington Mutual, Inc., 419 B.R. 271 (Bankr. D. Del. 2009).

In re Premier Int'l Holdings, Inc., 423 B.R. 58 (Bankr. D. Del. 2010).

In re Accuride Corp., Case No. 09-13449 (Bankr. D. Del. Jan. 20, 2010).

In re Philadelphia Newspapers, LLC, 422 B.R. 553 (Bankr. E.D. Pa. 2010).

DEATH AND TAXES ASSURED: CONFIRMATION OF SHELL CORPORATION'S TAX-AVOIDANCE CHAPTER 11 PLAN DENIED

Mark G. Douglas

Preservation of favorable tax attributes, such as net operating losses that might otherwise be forfeited under applicable nonbankruptcy law, is an important component of a business debtor's chapter 11 strategy. However, if the principal purpose of a chapter 11 plan is to avoid paying taxes, rather than to effect a reorganization or the orderly liquidation of the debtor, the Bankruptcy Code contains a number of tools that can be wielded to thwart confirmation of the plan. The Seventh Circuit Court of Appeals was recently called upon to weigh in on this issue as an apparent matter of first impression in the circuit courts of appeal. In *In re South Beach Securities, Inc.*, a unanimous three-judge panel of the court affirmed an order denying confirmation of a chapter 11 plan proposed by a company whose sole asset consisted of tax attributes and whose only creditor was a related company attempting to acquire the attributes to avoid taxes.

TAX ATTRIBUTES AND CHANGES OF OWNERSHIP

A critical feature of almost every chapter 11 case involving a business that is attempting to reorganize by reworking its capital structure is preserving to the fullest extent possible the company's ability to use its existing net operating losses ("NOLs") to offset future income of the reorganized or successor entity for tax purposes. NOLs are an excess of deductions over income in any given year. They can generally be carried back to use against taxable income in the two previous years and, to the extent not used, may be carried forward for 20 years. Losses remain with the debtor during a bankruptcy case because a bankruptcy filing for a corporation does not create a new taxable entity.

Certain provisions in section 382 of the Internal Revenue Code ("IRC") significantly limit the company's ability to use its NOLs upon a more than 50 percent "change of ownership" of the company's stock owned by major shareholders. The vast majority of all corporate reorganizations under chapter 11 result in such a change of ownership under section 382. If the change occurs prior to the effective date of a chapter 11 plan, the standard NOL limitation of section 382 applies. This means that, on a going-forward basis, the company's allowed usage of prechange NOLs against future income will be capped at an annual rate equal to the equity value of the corporation immediately before the change of ownership multiplied by the long-term tax-exempt bond rate. Similarly, future use of built-in losses in assets (for example, through depreciation deductions) will be subject to the annual limitation. Because the equity value of the company while in bankruptcy prior to plan effectiveness typically will be *de minimis*, capping the NOLs at that value will most often prevent the company from using the NOLs thereafter.

Special rules apply for ownership changes occurring as a result of a debtor's emergence from bankruptcy. In general, if the ownership change occurs pursuant to the debtor's confirmed plan of reorganization, the debtor may use its postemergence equity value (after debt cancellation) instead of its equity value immediately before the change to calculate its annual limitation on the use of its prechange NOLs after emergence. For example, assuming a 4 percent long-term tax-exempt bond rate, a company having an equity value of $100 million immediately following emergence could use $4 million of its prechange NOLs annually to offset its future taxable income.

Under certain limited circumstances, a debtor can undergo a change of ownership under a chapter 11 plan and emerge without any section 382 limitation on its NOLs and built-in losses. To qualify for this provision (contained in section 382(l)(5) of the IRC): (i) shareholders and creditors of the company must end up owning at least 50 percent of the reorganized debtor's stock (by vote and value); (ii) shareholders and creditors must receive their minimum 50 percent stock ownership in respect of their interests in and claims against the debtor; and (iii) stock received by creditors can be counted toward the 50 percent test only if it is received in satisfaction of debt that (a) had been held by the creditor for at least 18 months on the date of the bankruptcy filing (*i.e.*, was "old and cold") or (b) arose in the ordinary course of the debtor's business and is held by the person who at all times held the beneficial interest in that indebtedness. This "no limitation on future use of losses" result comes with two caveats: (i) the available losses are first reduced for the amount of interest deductions taken in the three or more years before emergence; and

(ii) there can be no future ownership change within the two years following emergence without completely eliminating the ability to use the NOLs.

Both the IRC and the judge-made tax doctrine of "substance over form" may impose limitations on an acquired company's ability to use tax attributes to offset taxable income. These rules are designed to prevent "trafficking" in tax attributes via changes in corporate ownership, lest the change confer a tax benefit on an entity (the purchaser) other than the previous owner, which bore the economic brunt of the net operating losses. However, family members (*e.g.*, spouses, children, grandchildren, and parents) are treated as a single owner, stock owned by a corporation is treated as being owned by its shareholders, stock owned by partnerships is deemed to be owned by the partners, and stock owned by a trust is deemed to be owned by its beneficiaries. Thus, transfers among such family members or between entities and their shareholders, partners, or beneficiaries do not trigger the NOL limitations.

Section 269(a)(1) of the IRC also imposes restrictions on obtaining tax benefits from NOLs beyond the restrictions imposed by section 382. It disallows deductions and other tax benefits, including the use of NOLs, when tax avoidance is the principal purpose of, among other things, acquiring control (at least 50 percent of vote or value) of a corporation providing tax benefits that would not otherwise be available.

THE BANKRUPTCY CODE'S PROHIBITION OF TAX-AVOIDANCE CHAPTER 11 PLANS

Section 1129(d) of the Bankruptcy Code provides as follows:

> Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

One purpose of section 1129(d) is to codify the "substance over form" principle established by the U.S. Supreme Court's 1935 ruling in *Gregory v. Helvering*, which has also been incorporated into IRC section 269. Even if a bankruptcy court does not deny confirmation of a plan under section 1129(d), the Internal Revenue Service may deny claimed deductions based upon NOLs under IRC section 269, as previously described. The IRS has taken the position for many years that it has the independent power under section 269 to determine whether an acquisition pursuant to a chapter 11 plan was made for the principal purpose of evasion or avoidance of federal income tax, and in making that determination, the fact that the IRS failed to invoke section 1129(d) or invoked it but failed to carry its burden of proof in bankruptcy court is not controlling. This position has been subject to criticism based upon, among other things, principles of res judicata.

The "governmental unit," which most (but not all) courts have construed to include the Office of the U.S. Trustee, bears the burden of proof on the issue of tax avoidance. That burden is to show that the *principal* purpose of the plan is tax or securities law avoidance. Under section 1129(d), a plan may be proposed that takes advantage of tax attributes of the estate, provided that it is not the principal purpose of the plan. If a chapter 11 debtor is insolvent or in need of financial reorganization, tax or securities law avoidance would rarely be the principal purpose of the debtor's plan. According to one bankruptcy court, "the principal purpose" in section 1129(d) "should be strictly construed and essentially means 'most important.' "

With respect to the Securities Act, the principal purpose of the provision is to ensure that a "shell" corporation whose primary asset is a registration on a national securities exchange does not use the exemption in section 1145 of the Bankruptcy Code from registering a securities transaction under the Securities Act of 1933 and applicable state or local law in order to confirm a chapter 11 plan that is essentially a "blind pool" investment.

The interplay between section 1129(d) of the Bankruptcy Code and sections 269 and 382 of the IRC was the subject of the Seventh Circuit's ruling in *South Beach Securities*.

SOUTH BEACH SECURITIES

South Beach Securities, Inc. ("South Beach"), was formerly a registered securities broker/dealer. South Beach is wholly owned by NOLA, LLC ("NOLA"), a limited liability company with three members. One is the father of Leon A. Greenblatt III ("Greenblatt"), who achieved notoriety in the late 1990s by instructing Scattered Corporation ("Scattered"),

a company of which he is a director, to sell short more shares of LTV Corporation than actually existed—a feat that ultimately led to Scattered's censure and excommunication from the securities business. The other two members of NOLA are the fathers of Scattered's other officers and directors. NOLA is managed by a company named Teletech Systems, Inc., the president and sole employee of which is Greenblatt, who therefore effectively controlled South Beach.

South Beach's only creditor is Scattered, which asserted a claim in the amount of approximately $3.2 million. Scattered acquired the claim from another related company that had loaned money to South Beach in a convoluted and largely indecipherable series of transactions involving affiliated entities.

South Beach and NOLA filed for chapter 11 protection in Chicago on April 27, 2005. At the time of the filing, both companies were corporate shells with no business operations or income. The only assets of South Beach were NOLs. South Beach later proposed a chapter 11 plan under which the stock of South Beach held by NOLA would be canceled and new stock issued to Scattered. Scattered would then pay South Beach an amount sufficient to enable it to use up the NOLs, shielding the payment from taxes. The plan had only two classes, both of which contained insiders: NOLA, in the single class of interest holders, and Scattered, in the single class of creditors.

After reviewing the petitions and schedules, the Illinois bankruptcy court, with the support of the U.S. Trustee, ruled that both cases should be dismissed under section 1112(b) of the Bankruptcy Code as having been filed in bad faith, neither case appearing to have any "legitimate reorganizational objective." South Beach (but not NOLA) appealed, and the district court reversed. The district court acknowledged that Scattered was "likely an insider vis-à-vis South Beach" but concluded that there is no "blanket prohibition on insider creditors collecting on their debts" in bankruptcy. Although there was "certainly a basis for concern" about South Beach's relationship with Scattered, the district court ruled, "more was needed" before the case could be dismissed. The district court accordingly remanded the case for further proceedings below in which the bad-faith question could be revisited.

South Beach Securities is an important development because it represents the first time that any of the federal circuit courts of appeal have weighed in on section 1129(d) of the Bankruptcy Code and, more specifically: (i) whether the U.S. Trustee has standing to raise an objection to confirmation based upon the provision; and (ii) under what circumstances the "principal purpose" of a chapter 11 plan will be deemed tax avoidance.

On remand, however, the U.S. Trustee elected not to pursue dismissal, but instead objected to South Beach's plan on two grounds: (i) that no impaired, noninsider creditor class had accepted the plan, as required by section 1129(a)(10) of the Bankruptcy Code; and (ii) that the plan could not be confirmed in accordance with section 1129(d) because its principal purpose was avoidance of taxes. The bankruptcy court denied confirmation on these grounds, holding, moreover, that the U.S. Trustee had standing to object to confirmation under section 1129(d). The district court affirmed on appeal in July 2009.

THE SEVENTH CIRCUIT'S RULING

South Beach and Scattered fared no better in the Seventh Circuit. Writing for a unanimous three-judge panel, circuit judge Richard A. Posner initially addressed the U.S. Trustee's standing under section 1129(d), which by its terms can be invoked as a basis for denial of confirmation only by "a party in interest that is a governmental unit." Judge Posner acknowledged that a certain amount of inconsistency exists in both the Bankruptcy Code and case law on whether the U.S. Trustee qualifies as a "governmental unit" or a "party in interest." Even so, he discounted contrary court rulings on the role of the U.S. Trustee as a "governmental unit" and concluded that "the view that the U.S. Trustee can be a party in interest makes better sense," given the U.S. Trustee's important role as a watchdog in bankruptcy cases. Moreover, Judge Posner emphasized, a bankruptcy court has the power to consider issues of tax avoidance on its own initiative under section 105(a) of the Bankruptcy Code.

Addressing the merits of the controversy as an apparent matter of first impression in the circuits, Judge Posner reiterated

and adopted the reasoning of the lower courts. He explained that, outside of bankruptcy, South Beach's NOLs could be used to obtain a tax benefit only if the company received a capital infusion that enabled it to obtain income against which to offset the losses, or if the assets were acquired by a company that had income or assets. However, he noted that a 1996 IRS private letter ruling lays out the general rule that taxpayers may not transfer NOLs to other taxpayers.

If the bankruptcy court had confirmed South Beach's proposed chapter 11 plan, Judge Posner observed, "[t]he result would be to shield income of Scattered from federal tax, because South Beach's income would be Scattered's income since Scattered would be South Beach's sole owner." According to the judge, imposing limitations on using the purchase of a company as the basis for deducting the target company's NOLs from the purchaser's taxable income is consistent with the IRC and the judge-made tax doctrine of "substance over form."

Judge Posner expressed some doubts regarding whether the NOL preservation and transfer scheme proposed in South Beach's chapter 11 plan would pass muster under the tax laws, but he discounted this consideration in addressing the substance of the confirmation objection:

> So it looks as if the plan of reorganization, even if approved, wouldn't confer the tax benefit that Greenblatt sought. But that doesn't affect whether the plan was rightly rejected; for South Beach's disclosure statement suggests no purpose other than to beat taxes, and we know that a plan of reorganization may not be confirmed if that is its principal purpose, whether or not the purpose will actually be accomplished or will be nixed later by the Internal Revenue Service. The object of bankruptcy is to adjust the rights of the creditors of a bankrupt company; it is not to allow a solvent company to try to lighten its tax burden.

Judge Posner also ruled that the chapter 11 plan could not be confirmed under section 1129(a)(3) of the Bankruptcy Code on the "closely related ground that it hadn't been proposed in good faith." To be proposed in good faith, Judge Posner wrote, a chapter 11 plan must have "a true purpose and fact-based hope of either 'preserving [a] going concern' or 'maximizing property available to satisfy creditors.' " According to the judge, the absence of any real debt or outside creditors "shows that this case doesn't belong in bankruptcy court." Finally, Judge Posner dismissed as "bogus" Scattered's argument that a nontax motive for bankruptcy was to shield South Beach from lawsuits, remarking that "South Beach's bankruptcy schedule listed no claims other than Scattered's, and the deliberate omission of creditors from the list submitted by the debtor is unlawful and is ground for dismissal of the bankruptcy proceeding."

OUTLOOK

South Beach Securities is an important development because it represents the first time that any of the federal circuit courts of appeal have weighed in on section 1129(d) of the Bankruptcy Code and, more specifically: (i) whether the U.S. Trustee has standing to raise an objection to confirmation based upon the provision; and (ii) under what circumstances the "principal purpose" of a chapter 11 plan will be deemed tax avoidance. The ruling also indicates that, even in cases where stakeholders do not object to a chapter 11 plan that violates the provisions of, and bedrock principles underlying, the Bankruptcy Code, the U.S. Trustee and, in the final instance, the bankruptcy court serve as gatekeepers to confirmation.

South Beach Securities, however, does not provide a great deal of guidance regarding the "principal purpose" test of section 1129(d). The Seventh Circuit had little difficulty concluding that the debtor's chapter 11 plan satisfied that test, based upon the utter absence of any plausible alternate motive. Other cases are likely to be more challenging on this issue. It is worth noting that the bankruptcy court's dismissal of the chapter 11 case *as having been filed in bad faith* was reversed on appeal, even though the reversing court was aware of all of the relevant facts and the plan proposed by the debtor. The entrance gate to chapter 11 is sometimes easier to navigate successfully than the exit.

In re South Beach Securities, Inc., 606 F.3d 366 (7th Cir. 2010).

Gregory v. Helvering, 293 U.S. 465 (1935).

In re Rath Packing Co., 55 B.R. 528 (Bankr. N.D. Iowa 1985).

NO SAFE HARBOR IN A BANKRUPTCY STORM: MUTUALITY "BAKED INTO THE VERY DEFINITION OF SETOFF"

Mark G. Douglas

"Safe harbors" in the Bankruptcy Code designed to insulate nondebtor parties to financial contracts from the consequences that normally ensue when a counterparty files for bankruptcy have been the focus of a considerable amount of scrutiny as part of evolving developments in the Great Recession. One of the most recent developments concerning this issue in the courts was the subject of a ruling handed down by the New York bankruptcy court presiding over the Lehman Brothers chapter 11 cases. In *In re Lehman Bros. Holdings, Inc.*, Judge James M. Peck ruled that, absent mutuality of obligation, funds on deposit with a bank are not protected by the Bankruptcy Code's safe-harbor provisions and cannot be used to set off an obligation allegedly owed by the debtor under a master swap agreement. "A contractual right to setoff under derivative contracts," Judge Peck wrote, "does not change well established law that conditions such a right on the existence of mutual obligations."

SETOFF RIGHTS IN BANKRUPTCY

Section 553(a) of the Bankruptcy Code provides, subject to certain exceptions, that the Bankruptcy Code "does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . . ."

Under section 553(b), a bankruptcy trustee or chapter 11 debtor in possession can recover the amount of most setoffs effected within 90 days before the filing of a bankruptcy case that improve the creditor's economic position.

Section 553 does not create setoff rights—it merely preserves any such rights that exist under contract or applicable nonbankruptcy law to set off mutual prepetition debts. A creditor is generally precluded by the automatic stay from exercising its setoff rights without bankruptcy-court approval. The stay, however, merely suspends the exercise of such a setoff pending an orderly examination of the respective rights of the debtor and the creditor by the court, which will generally permit the setoff if the requirements under applicable law are met, except under circumstances where it would be inequitable to do so. Debts ("debt" being defined by section 101(12) as a "liability on a claim") are considered mutual when they are due to and from the same persons in the same capacity.

FINANCIAL CONTRACT SAFE-HARBOR PROVISIONS

Although one of the Bankruptcy Code's primary policies is to provide for the equitable distribution of a debtor's assets among its creditors, Congress recognized the potentially devastating consequences that might ensue if the bankruptcy or insolvency of one financial firm were allowed to spread to other market participants, thereby threatening the stability of entire markets. Beginning in 1982, lawmakers formulated a series of changes to the Bankruptcy Code to create certain "safe harbors" to protect rights of termination and setoff under "securities contracts," "commodities contracts," and "forward contracts." Those changes were subsequently refined and expanded to cover "swap agreements," "repurchase agreements," and "master netting agreements" as part of a series of legislative developments, including the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") and the Financial Netting Improvements Act of 2006 ("FNIA").

These special protections are codified in, among other provisions, sections 555, 556, and 559 through 562 of the Bankruptcy Code. Without them, sections 362 and 365(e)(1) of the Bankruptcy Code would prevent a nondebtor party to a financial contract from taking immediate action to limit exposure occasioned by a bankruptcy filing by or against the counterparty. Lawmakers, however, recognized that financial markets can change significantly almost overnight and that nondebtor parties to certain types of complex financial transactions may incur heavy losses unless the transactions are promptly and finally closed out and resolved. Congress therefore exempted most kinds of financial contracts from these prohibitions and amended the Bankruptcy Code to insulate these transactions from avoidance as preferential or fraudulent transfers unless the transactions were made with actual intent to hinder, delay, or defraud creditors of the debtor.

For example, section 560 provides in relevant part as follows:

> The exercise of *any contractual right* of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements *shall not be stayed, avoided, or otherwise limited by operation of any provision of this title* or by order of a court or administrative agency in any proceeding under this title (emphasis added).

This provision was added to the Bankruptcy Code in 1990. It was amended by BAPCPA to clarify that the provisions of the Bankruptcy Code that protect: (i) liquidation rights under securities contracts, commodity contracts, forward contracts, and repurchase agreements also protect termination or acceleration rights under such contracts; and (ii) termination rights under swap agreements also protect rights of liquidation and acceleration.

Section 561 addresses the contractual right to resolve positions under a master netting agreement and across financial contracts. Added to the Bankruptcy Code in 2005 as part of BAPCPA, it provides in relevant part that:

> Subject to subsection (b), the exercise *of any contractual right*, because of a condition of the kind specified in section 365(e)(1), to cause the termination, liquidation, or acceleration of or to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection with one or more (or the termination, liquidation, or acceleration of one or more) . . . [delineated financial contracts] . . . *shall not be stayed, avoided, or otherwise limited by operation of any provision of this title* or by any order of a court or administrative agency in any proceeding under this title (emphasis added).

The setoff procedures in section 553 were also modified after its enactment in 1978 to clarify that the safe harbor for financial contracts encompasses setoff rights. In particular, setoffs of the kind described in, among other provisions, sections 555, 556, 559, 560, and 561 are protected from certain of the strictures of section 553(a) or avoidance under section 553(b). The interplay among the section 560 and 561 safe harbors and a creditor's preserved setoff rights under section 553 was the subject of the bankruptcy court's ruling in *Lehman Brothers*.

LEHMAN BROTHERS

Prior to filing for chapter 11 protection in September 2008 in New York, Lehman Brothers Holdings, Inc. ("Lehman"), maintained a general deposit account with Swedbank AB ("Swedbank") in Stockholm. On the bankruptcy petition date, the account contained approximately 2.14 million krona. Swedbank placed an administrative freeze on the account shortly after Lehman filed for bankruptcy protection. Although the bank allowed deposits into the account, Swedbank prevented Lehman from withdrawing funds from it. The account balance eventually grew to 85 million krona, 83 million krona of which was deposited by Lehman postpetition.

Prior to filing for chapter 11, Lehman (through a U.K. branch) and certain of its affiliates had entered into various International Swaps and Derivatives Association master agreements (the "ISDA Master Agreements") with Swedbank. Lehman acted as the guarantor. Each of the ISDA Master Agreements defined "event of default" to include bankruptcy. The ISDA Master Agreements further provided that the occurrence of such an event of default triggers the early termination of the ISDA Master Agreements. Early termination in turn gave rise to a right to payment in favor of the party to the agreement that was then "in the money." Finally, the ISDA Master Agreement between Lehman and Swedbank contained a provision granting Swedbank a right of setoff upon the occurrence of an event of default:

> In addition to any rights of set-off a party may have as a matter of law or otherwise, upon the occurrence of an Event of Default or an Additional Termination Event and the designation of an Early Termination Date pursuant to section 6 of this Agreement with respect to a party ("X"), the other party ("Y") will have the right (but not be obliged) without prior notice to X or any other person to setoff or apply any obligation of X owed to Y (and

to any affiliate of Y) (whether or not matured or contingent and whether or not arising under this Agreement, and regardless of the currency, place of payment or booking office of the obligation) against any obligation of Y (and of any affiliate of Y) owed to X (whether or not matured or contingent and whether or not arising under this Agreement, and regardless of the currency, place of payment or booking office of the obligation).

Claiming that Lehman owed it $32 million, Swedbank announced its intent in November 2008 to use $11.7 million of the funds on deposit as a setoff for Lehman's obligations. Of the $32 million, approximately $14 million (approximately 97.5 million krona) was an obligation of Lehman as either counterparty or guarantor under the ISDA Master Agreements, and the remainder allegedly was based on a senior promissory note held by Swedbank.

Lehman responded by, among other things, seeking an order of the bankruptcy court enforcing the automatic stay and compelling Swedbank to surrender the funds on deposit. According to Lehman, Swedbank's administrative freeze of funds violated the automatic stay because the funds comprised postpetition deposits that lacked the requisite mutuality with Lehman's alleged prepetition debt under section 553. Swedbank countered that its contractual setoff rights in the ISDA Master Agreements were unaffected by the automatic stay because the swap agreements were protected by the safe harbors of sections 560 and 561 of the Bankruptcy Code.

THE BANKRUPTCY COURT'S RULING

Judge Peck ruled in Lehman's favor. The safe-harbor provisions, he wrote, "simply do not directly address the requirement of mutuality under section 553(a)." Instead, Judge Peck observed, "these exceptions permit the exercise of a contractual right of offset in connection with swap agreements, notwithstanding the operation of any provision of the Bankruptcy Code that could operate to stay, avoid or otherwise limit that right, but that right must exist in the first place."

In order to establish a setoff right under section 553(a), Judge Peck explained, the following prerequisites must be satisfied: (1) the amount owed by the debtor must be a prepetition debt; (2) the debtor's claim against the creditor must also be prepetition; and (3) the debtor's claim against the creditor and the debt owed to the creditor must be mutual. Mutuality, he wrote, "exists when the debts and credits are in the same right and are between the same parties, standing in the same capacity." No mutuality existed in this case, Judge Peck concluded, because the funds in the Swedbank account were deposited postpetition, while Lehman's indebtedness to Swedbank arose prepetition under the ISDA Master Agreements.

Judge Peck rejected Swedbank's contention that "the mutuality requirement of section 553 is rendered inapplicable by the safe harbor provisions of sections 560 and 561 of the Bankruptcy Code." According to Swedbank, the reference in section 560 that permits a derivative-contract counterparty to exercise "any" contractual right notwithstanding the automatic stay should permit Swedbank to exercise its contractual right to setoff arising from the ISDA Master Agreement, notwithstanding the undisputed lack of mutuality under section 553. Judge Peck found this argument to be untenable, observing that "Swedbank's self-interested interpretation of the relevant provisions of the Bankruptcy Code is without precedent and unsupported by a fair reading of the textual language."

By their plain terms, Judge Peck explained, the safe-harbor provisions "do not alter the axiomatic principle of bankruptcy law, codified in section 553, requiring mutuality in order to exercise a right of setoff." Given the silence of sections 560 and 561 with respect to the mutuality requirement of section 553, the judge declined to read an exception into the statute.

Judge Peck also rejected Swedbank's contention that the safe-harbor provisions "implicitly override the mutuality requirement." According to Swedbank, the "theoretical underpinning" of the prepetition mutuality requirement in section 553—the "well-established fiction that the debtor changes on the petition date"—is irrelevant when dealing with setoff under safe-harbored derivative contracts in light of the language in section 560 dealing with the application of the automatic stay (*i.e.*, "shall not be stayed . . . or otherwise limited by operation of any provision of this title"). Judge Peck wrote

that "Swedbank disregards the plain language of section 553(a), which expressly memorializes the pre- and postpetition distinction, independent of the so-called 'fiction' regarding the newly created debtor-in-possession." Moreover, the judge emphasized, this argument ignores the fact that section 553 itself delineates a number of specific exceptions, and "setoff under safe harbored derivative contracts is not one of them."

"Mutuality," Judge Peck concluded, "is baked into the very definition of setoff." He further explained that sections 560 and 561 were enacted long after the mutuality requirement of section 553 had been codified. "If Congress had intended to establish a plainly worded exception to the rule limiting setoff to mutual pre-petition claims, it would have done so explicitly," he wrote.

Judge Peck remarked that "[s]ections 560 and 561 preserve contractual rights of setoff for mutual pre-petition obligations—essentially assuring the nondebtor swap counterparty that the advent of bankruptcy will not frustrate pre-petition commercial expectations relating to setoff and netting." Although "the contractual rights of parties are to be respected and enforced," he added, "that does not justify overriding applicable bankruptcy jurisprudence."

Judge Peck rejected Swedbank's argument that changes to section 553 as part of BAPCPA "explicitly exclude" from the mutuality requirement transactions or setoffs covered by the safe-harbor provisions:

> Plainly, then, the 2005 amendments to section 553 with respect to sections 560 and 561 are narrow and leave intact the mutuality requirement of section 553(a). Such an interpretation dovetails with common sense. If Congress had intended to eliminate the mutuality requirement of section 553(a), it would have done so directly and with clarity.

He was similarly unpersuaded by Swedbank's contention that FNIA removed the requirement of mutuality from the automatic-stay exceptions found in section 362(d) of the Bankruptcy Code. The legislative history of FNIA, Judge Peck wrote, reveals that Congress intended merely to make "technical changes to the netting and financial provisions" of the Bankruptcy Code to "update the language to reflect current market and regulatory practices." These technical amendments, the judge remarked, "cannot be read as authority for so fundamental a change in creditor rights."

Judge Peck ruled that Swedbank's administrative freeze was unjustified and constituted a continuing violation of the automatic stay. He granted Lehman's motion and directed Swedbank immediately to release the freeze and allow Lehman access to all the funds deposited postpetition.

OUTLOOK

Lehman Brothers illustrates that, although the Bankruptcy Code's safe-harbor provisions for financial contracts are broad, they do not necessarily override other provisions in the statute designed to protect debtors and to preserve the bankruptcy estate consistent with the bedrock principle of equality of distribution. It also indicates that bankruptcy courts are increasingly casting a critical eye on the efforts of financial participants to limit their exposure by resorting to the Bankruptcy Code's safe-harbor provisions for financial contracts.

The scope and operation of the Bankruptcy Code's safe harbor for financial contracts continue to be a source of controversy and litigation in the courts, particularly in the Lehman Brothers chapter 11 cases. For example, in *Securities Investor Protection Corp. v. Lehman Bros. Inc.*, Judge Peck ruled on June 1 that section 562 of the Bankruptcy Code—which provides that when a debtor rejects a securities contract with a financial participant or when a financial participant terminates a securities contract with a debtor, the parties shall use the date of rejection or termination as the reference point to calculate damages—does not conflict with a provision in the Securities Investors Protection Act that designates the filing date of a stockbroker liquidation case as the correct date for determining claims based on a customer's short positions. Judge Peck also ruled in *Lehman Brothers Special Financing, Inc. v. BNY Corporate Trustee Services, Ltd. (In re Lehman Brothers Holdings, Inc.)* that a "flip clause" in an agreement executed as part of a swap transaction that shifted the priority of payments upon a bankruptcy filing by one of the participants was not saved from invalidation as an unenforceable "ipso facto" clause by the safe harbor for

swap agreements in section 560 because the provisions were clearly not part of (or even referred to in) the swap agreements and because the provisions did not relate to "the liquidation, termination, or acceleration" of a swap agreement. The disputes in the bankruptcy courts regarding safe-harbored financial contracts are likely to persist for some time.

In re Lehman Bros. Holdings, Inc., 2010 WL 1783395 (Bankr. S.D.N.Y. May 5, 2010).

Securities Investor Protection Corp. v. Lehman Bros. Inc., 2010 WL 2163358 (Bankr. S.D.N.Y. June 1, 2010).

Lehman Brothers Special Financing, Inc. v. BNY Corporate Trustee Services, Ltd. (In re Lehman Brothers Holdings, Inc.), 422 B.R. 407 (Bankr. S.D.N.Y. 2010).

INSIDER'S COMPENSATION CLAIM CAPPED AT ZERO UNDER SECTION 502(b)(4)

David G. Marks

The Bankruptcy Code treats insiders with increased scrutiny, from longer preference periods to rigorous equitable subordination principles, denial of chapter 7 trustee voting rights, disqualification in some cases of votes on a cramdown chapter 11 plan, and restrictions on postpetition key-employee compensation packages. The treatment of claims by insiders for prebankruptcy services is no exception to this general policy: section 502(b)(4) disallows insider claims for services to the extent the claim exceeds the "reasonable value" of such services.

A former chief financial officer of Delta Air Lines, Inc. ("Delta"), recently discovered the exacting scrutiny that bankruptcy courts often apply to insider claims. In *In re Delta Air Lines, Inc.*, a New York bankruptcy court ruled that the CFO remained an insider of the debtor even after she had submitted a resignation letter and while she was negotiating her subsequent consulting agreement, such that the consulting agreement was subject to the limitations in section 502(b)(4) of the Bankruptcy Code. Based on that insider status, the court held, pursuant to section 502(b)(4), that the former CFO's claim arising from the debtor's rejection of her prepetition consulting agreement should be capped at zero because of compensation she had already received.

LIMITATIONS ON INSIDER COMPENSATION CLAIMS

Section 502(b)(4) was designed to prevent overreaching by, or excessive generosity to, an insider or a debtor's lawyer prior to a bankruptcy filing. With this goal in mind, the provision prohibits claims for compensation by insiders or debtor attorneys that exceed the "reasonable value" of the services rendered:

> (b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if . . . [an] objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

> [...] (4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services . . . .

Courts have taken up the mandate in section 502(b)(4) with vigor, applying "rigorous scrutiny" to claims by insiders. As the bankruptcy court in *In re Siller* explained in April 2010,

> the particularized disallowance under § 502(b)(4) of claims . . . is a manifestation and expansion of the rule of *Pepper v. Litton* that insider dealings with a debtor are "subjected to rigorous scrutiny" and that the burden is on the insider "not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the [debtor] and those interested therein."

DELTA AIR LINES

M. Michele Burns served as Delta's CFO from August 2000 until April 30, 2004, the effective date of her resignation letter. On the same day that her resignation became effective, Burns executed a consulting agreement with Delta, in which she agreed to provide consulting services for five years with respect to "any matter within [her] general area of expertise as developed during [her] employment . . . that may from time to time arise during the consulting period." Burns also agreed that until May 1, 2009, she would not "solicit any person who is at the time an employee of Delta, or its subsidiaries, at the director or officer level" to provide services or accept employment from any other company. In exchange, Delta agreed to provide her with "unlimited positive space travel"—free, virtually unlimited first-class travel for life. During the course of the ensuing 16 months, Burns utilized her lifetime travel benefit to book 98 flights for destinations in the U.S. and Europe.

Delta filed for chapter 11 protection in New York on September 14, 2005. After Delta received court approval to reject the consulting agreement, Burns filed a claim for damages arising from the rejection. Delta objected to the claim under section 502(b)(4).

THE BANKRUPTCY COURT'S RULING

Bankruptcy Judge Cecilia G. Morris initially noted that the consulting agreement was an executory contract that could have been and was in fact rejected by Delta under section 365, because material performance was still required by both parties. Delta, Judge Morris explained, was obligated to provide the free first-class travel for the remainder of Burns' life, and Burns was obligated to provide consulting services for several more years after Delta's chapter 11 filing.

The court then considered whether Burns' claim was based upon services provided by an insider, or whether her status as a consultant exempted her from section 502(b)(4). Under section 101(31)(B) of the Bankruptcy Code, insiders of a corporation include directors, officers, general partners, relatives, and persons in control of the debtor, as well as partnerships in which the debtor is a general partner. As Judge Morris noted, this statutory list is not exhaustive, and courts will also evaluate: (i) the closeness of the relationship between the debtor and the individual; and (ii) whether the transaction in question was performed at arm's length.

Delta demonstrates the role of specific facts in a court's 502(b)(4) analysis.

Even though Burns was an insider while she was Delta's CFO, she provided services under the consulting agreement after her resignation became effective. Furthermore, the negotiations over the consulting agreement began after she submitted her letter of resignation, but prior to the effective date of the resignation. Citing the Pennsylvania bankruptcy court's 1992 ruling in *In re Allegheny Int'l, Inc.*, Judge Morris held that the important issue for determining insider status is whether the claimant was an insider when the consulting contract at issue was formed, not necessarily when the services were rendered. Since Burns was still a statutory insider while she was negotiating the contract, section 502(b)(4) applied, Judge Morris concluded.

Finally, Judge Morris valued Burns' unsecured claim for rejection damages. Under section 502(b)(4), her claim was limited to its "reasonable value." Even though Judge Morris acknowledged that Burns' consulting services provided some value, the judge rejected Burns' request for an evidentiary hearing as to the extent of that value. Instead, Judge Morris invoked her power under section 502(c) to estimate the claim and concluded that the 98 tickets Burns had already used

sufficiently compensated her for any services that she had provided under the consulting agreement. Thus, her claim was capped at its "reasonable value, which is zero."

THE IMPORTANCE OF SPECIFIC FACTS

Delta demonstrates the role of specific facts in a court's 502(b)(4) analysis. "Unlimited positive space travel" was an enormously valuable benefit that only certain executives received. The scope of the benefit was also lopsided in favor of Burns. Under the consulting agreement, Burns would receive the benefit for the rest of her life even though she had had to provide consulting services for only five years. Burns herself acknowledged that at the time of the bankruptcy filing, any information she provided concerning Delta matters "likely was of little value" and her contact with Delta employees was "*de minimis*." In the meantime, she utilized 98 tickets in approximately 16 months.

Additional facts, although unstated in the court's opinion, may have influenced the court's decision. First, in 2002, while at Delta, Burns helped the company establish bankruptcy-proof pension trusts for about three dozen executives. According to an article published in *The Atlanta Journal-Constitution*, those trusts provided her with at least $1 million that creditors could not reach. She was also one of many Delta executives who received controversial bonuses while the airline was cutting jobs and asking for federal aid: her annual salary prior to her resignation was $560,000, but her bonus during her last year of employment was $846,000. This backdrop of facts may have made Burns' claim appear to be precisely the type of excessive generosity to insiders that section 502(b)(4) was designed to prevent.

Finally, whether to designate Burns as an insider might have been a more difficult decision had she waited to negotiate her consulting agreement until after her resignation was effective.

In re Delta Air Lines, Inc., 2010 WL 423279 (Bankr. S.D.N.Y. Feb. 3, 2010).

In re Siller, 427 B.R. 872 (Bankr. E.D. Cal. 2010).

Pepper v. Litton, 308 U.S. 295 (1939).

In re Allegheny Int'l, Inc., 158 B.R. 332 (Bankr. W.D. Penn. 1992).

NEW U.S. SUPREME COURT RULINGS

Mark G. Douglas

When a bankruptcy court calculates the "projected disposable income" in a repayment plan proposed by an above-median-income chapter 13 debtor, the court may "account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation," the U.S. Supreme Court held in *Hamilton v. Lanning* on June 7. Writing for the 8-1 majority, Justice Samuel A. Alito, Jr., agreed with the Tenth Circuit Court of Appeals and concluded that a "forward-looking approach" is the proper way to calculate projected disposable income under section 1325(b)(1)(B) of the Bankruptcy Code, rather than the "mechanical approach" advocated by the chapter 13 trustee.

The forward-looking approach permits the amount of projected disposable income to be rebutted upon a showing of special circumstances at the time of plan confirmation. In reaching this conclusion, the court resolved a split among the circuits on the issue. The Eighth and Tenth Circuits had ruled in favor of the forward-looking approach, while the Ninth Circuit favored the mechanical approach. Justice Antonin Scalia dissented on grounds that the "plain meaning" of section 1325(b)(1)(B) requires application of the mechanical approach. It is the role of Congress, Justice Scalia wrote, to correct the law if "what it previously prescribed is wrong."

On June 17, the Supreme Court handed down its ruling in *Schwab v. Reilly*, where it considered whether a chapter 7 trustee who does not lodge a timely objection to a debtor's claimed exemption of personal property may nevertheless sell the property if he later learns that the property value exceeds the amount of the claimed exemption. The Third Circuit Court of Appeals ruled in 2008 that, where the debtor indicates the intent to exempt her entire interest in given property by claiming an exemption of its full value and the trustee does not object in a timely manner, the debtor is entitled to the property in its entirety. The Supreme Court agreed to review the ruling on November 3, 2009, to resolve a split in the federal circuit courts of appeal on the issue.

When a debtor files a chapter 7 petition, all of the debtor's assets become property of the bankruptcy estate pursuant to section 541 of the Bankruptcy Code, subject to the debtor's right to reclaim certain property as "exempt" under section 522(l). Sections 522(b) and 522(d) of the Bankruptcy Code (unless the debtor's state of residence has opted out of the federal exemption scheme) specify the types of property debtors may exempt, as well as the maximum value of the exemptions a debtor may claim in certain assets.

Section 522(l) of the Bankruptcy Code provides that the debtor must "file a list of property that the debtor claims as exempt under subsection (b) of this section" and that "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt." That list of property is filed on Schedule C to Official Bankruptcy Form 6. Rule 4003(b) of the Federal Rules of Bankruptcy Procedure provides that, with certain exceptions, any objections to a debtor's claimed exemptions must be filed within 30 days of the conclusion of the creditors' meeting held pursuant to Bankruptcy Rule 2003(a).

Writing for the 6-3 majority, Justice Clarence Thomas concluded that where a debtor gives "the value of claimed exemptions" on Schedule C dollar amounts within the range the Bankruptcy Code allows for what it defines as "property claimed as exempt," a chapter 7 trustee is not required to object to the exemptions in order to preserve the estate's right to retain any value in the equipment beyond the value of the exempt interest. The trustee, the majority ruled, is entitled to sell the property subject to the exemption claim and distribute to the debtor the amounts claimed as exempt, retaining for the estate any excess.

Justice Ruth Bader Ginsburg filed a dissenting opinion, in which Chief Justice Roberts and Justice Breyer joined. The majority ruling, Justice Ginsburg wrote, "drastically reduces Rule 4003's governance, for challenges to valuation have been, until today, the most common type of objection leveled against exemption claims." According to the dissent, "[i]n addition to departing from the prevailing understanding and practice, the Court's decision exposes debtors to protracted uncertainty concerning their right to retain exempt property, thereby impeding the 'fresh start' [that] exemptions are designed to foster."

Hamilton v. Lanning, 2010 WL 2243704 (June 7, 2010), *affirming* 545 F.3d 1269 (10th Cir. 2008).

Coop v. Frederickson (In re Frederickson), 545 F.3d 652 (8th Cir. 2008).

Maney v. Kagenveama (In re Kagenveama), 541 F.3d 868 (9th Cir. 2008).

Schwab v. Reilly, 2010 WL 2400094 (June 17, 2010), *reversing In re Reilly*, 534 F.3d 173 (3d Cir. 2008).

In re Williams, 104 F. 3d 688 (4th Cir. 1997).

In re Wick, 276 F.3d 412 (8th Cir. 2002).

In re Green, 31 F.3d 1098 (11th Cir. 1994).

In re Barroso-Herrans, 524 F.3d 341 (1st Cir. 2008).

In re Hyman, 967 F.2d 1316 (9th Cir. 1992).

BANKRUPTCY STUDIES TO BE CONDUCTED UNDER NEW FINANCIAL REFORM LAW

President Barack Obama gave his imprimatur to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 on July 21. Relatively few of the provisions in the new law implicate the Bankruptcy Code. However, among other things, the law does call on the Board of Governors of the Federal Reserve System, in consultation with the Administrative Office of the U.S. Courts (the "Administrative Office"), to conduct two bankruptcy-related studies.

One study deals with the bankruptcy process for financial and nonbank financial institutions under chapters 7 and 11 of the Bankruptcy Code. The other concerns international coordination of the bankruptcy process for nonbank financial institutions under the Bankruptcy Code and applicable foreign law.

FINANCIAL COMPANIES RESOLUTION STUDY

Issues to be studied in connection with the resolution of financial companies include: (i) the utility of chapters 7 and 11 in achieving the orderly resolution or reorganization of systemic financial companies; (ii) whether a special financial resolution court or panel of special masters or judges should be created to oversee cases involving financial companies with a view toward mitigating financial market risk and minimizing "moral hazard"; (iii) whether the Bankruptcy Code should be amended to enhance the ability of the statutory framework to resolve financial companies in a way that mitigates market risk and minimizes moral hazard; (iv) whether the Bankruptcy Code, the Federal Deposit Insurance Act, and other applicable insolvency laws should be amended to address the manner in which companies are treated; and (v) the implications, challenges, and benefits associated with creating a new chapter or subchapter of the Bankruptcy Code to deal with financial companies.

The financial companies resolution study must be completed no later than one year after the date of enactment of the new law, and in each successive year until the fifth year after the date of enactment of the law. The Administrative Office must submit a report summarizing the results of the study to the Committees on Banking, Housing, and Urban Affairs and the Judiciary of the Senate and the Committees on Financial Services and the Judiciary of the House of Representatives.

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INTERNATIONAL COORDINATION STUDY

The study on international coordination relating to the bankruptcy process for nonbank financial institutions calls on the Board of Governors of the Federal Reserve System, in consultation with the Administrative Office, to consider several issues. Among these issues are: (i) the extent to which international coordination is currently the norm; (ii) the current framework for facilitating international cooperation; (iii) impediments to effective international coordination; and (iv) ways to enhance more effective international coordination of the resolution of financial companies in a way that mitigates financial-market risk and minimizes moral hazard.

A report summarizing the results of the study on international coordination must be submitted to the Committees on Banking, Housing, and Urban Affairs and the Judiciary of the Senate and the Committees on Financial Services and the Judiciary of the House no later than one year after the date of enactment of the new law.

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (2010).

THE U.S. FEDERAL JUDICIARY

U.S. federal courts have frequently been referred to as the "guardians of the Constitution." Under Article III of the Constitution, federal judges are appointed for life by the U.S. president with the approval of the Senate. They can be removed from office only through impeachment and conviction by Congress. The first bill considered by the U.S. Senate—the Judiciary Act of 1789—divided the U.S. into what eventually became 12 judicial "circuits." In addition, the court system is divided geographically into 94 "districts" throughout the U.S. Within each district is a single court of appeals, regional district courts, bankruptcy appellate panels (in some districts), and bankruptcy courts.

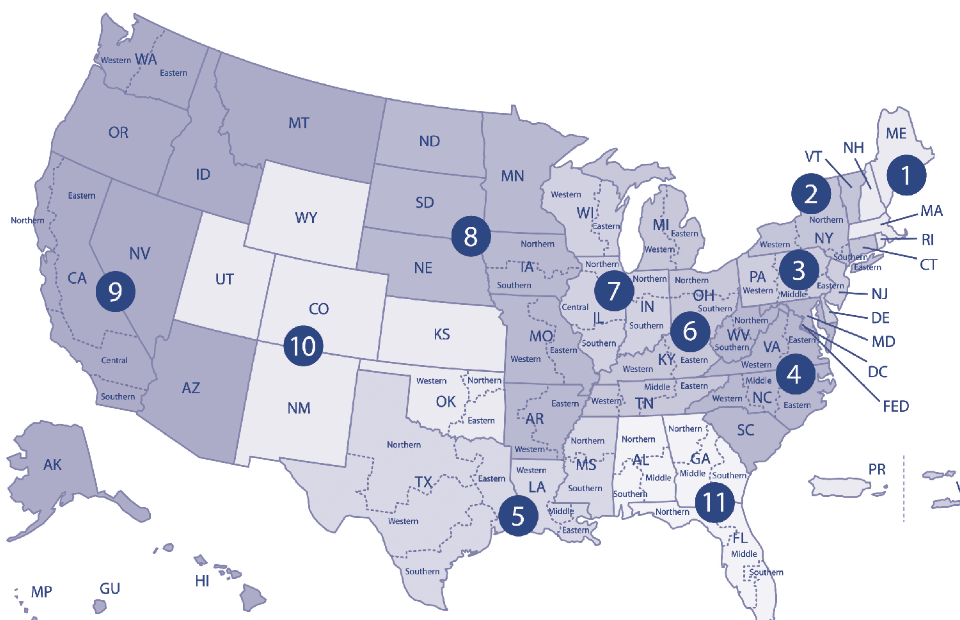
As stipulated by Article III of the Constitution, the Chief Justice and the eight Associate Justices of the Supreme Court hear and decide cases involving important questions regarding the interpretation and fair application of the Constitution and federal law. A U.S. court of appeals sits in each of the 12 regional circuits. These circuit courts hear appeals of decisions of the district courts located within their respective circuits and appeals of decisions of federal regulatory agencies. Located in the District of Columbia, the Court of Appeals for the Federal Circuit has nationwide jurisdiction and hears specialized cases such as patent and international trade cases. The 94 district courts, located within the 12 regional circuits, hear nearly all cases involving federal civil and criminal laws. Decisions of the district courts are most commonly appealed to the district's court of appeals.

Bankruptcy courts are units of the federal district courts. Unlike that of other federal judges, the power of bankruptcy judges is derived principally from Article I of the Constitution, although bankruptcy judges serve as judicial officers of the district courts established under Article III. Bankruptcy judges are appointed for a term of 14 years (subject to extension or reappointment) by the federal circuit courts after considering the recommendations of the Judicial Conference of the U.S. Appeals from bankruptcy-court rulings are most commonly lodged either with the district court of which the bankruptcy court is a unit or with bankruptcy appellate panels, which presently exist in five circuits. Under certain circumstances, appeals from bankruptcy rulings may be made directly to the court of appeals.

Two special courts—the U.S. Court of International Trade and the U.S. Court of Federal Claims—have nationwide jurisdiction over special types of cases. Other special federal courts include the U.S. Court of Appeals for Veterans' Claims and the U.S. Court of Appeals for the Armed Forces.

Geographic Boundaries

of United States Courts of Appeals and United States District Courts



BUSINESS RESTRUCTURING REVIEW

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

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