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EUROPEAN PERSPECTIVE: *STANFORD*, LIQUIDATIONS AND THE SERIOUS FRAUD OFFICE

Steven D. Richards

Note From the Editors:

Beginning with this issue, the *Business Restructuring Review* will include a regular column discussing notable restructuring and insolvency-related developments in and affecting the European region. We do so recognizing the continuing importance of Europe in cutting-edge practices and developments in the field and as part of Jones Day's enduring commitment to integrated worldwide client service. This inaugural "European Perspective" column was contributed by Steven D. Richards, an associate in Jones Day's London Office who focuses on commercial litigation, particularly fraud, asset recovery, and contentious insolvency matters.

In relation to insolvent liquidations under U.K. law, one of the primary objectives will be the implementation of an efficient process to preserve and recover assets for the benefit of the creditors. This is particularly so where there is a need to instigate costly litigation or cross-border recognition proceedings and where the liquidator will want increased assurances as to the likelihood that those steps will generate positive returns. Difficulties can arise, however, where—as is often the case when fraud has contributed to the insolvency—criminal investigations are being conducted in parallel to the liquidation proceedings. In those circumstances, the criminal process is

often afforded a priority, which can have a prejudicial effect on civil recovery actions and the liquidation process generally. In this article, we take a brief look at the interaction between insolvency and criminal proceedings in the context of the recent decision of the U.K. Court of Appeal in *Re Stanford International Bank Ltd (In Liquidation)* [2010] EWCA Civ 137.

COMPETING STEPS BY THE SERIOUS FRAUD OFFICE

Suppose an English company, "Trading Limited," is wound up by an order of the English Courts. On appointment, the liquidators discover that substantially all of the assets of Trading Limited are in the form of deposits with banks situated in England. But what if evidence is then uncovered which suggests that Trading Limited has been used as a vehicle for money laundering, such that there are grounds to believe that the bank accounts in question have received proceeds of crime? In those circumstances, the liquidator may well ask himself whether his efforts to recover assets for the benefit of the general body of creditors could be prejudiced by steps taken by the Serious Fraud Office ("SFO") to take control of the tainted funds.

Before addressing this issue, it is first necessary to consider the types of orders that can be granted to the SFO (or other relevant prosecutors) by the English Criminal Courts.

1. *Domestic Restraint Order*: Akin to a civil freezing injunction, an English restraint order—granted pursuant to s.41 of the Proceeds of Crime Act 2002 ("POCA 2002")—is an anticipatory and protective measure designed for the purpose of "prohibiting any specified person from dealing with any realisable property held by him" (s.41.1) with a view to preserving assets against the possibility of a future confiscation order (discussed below). The specified person need not be an actual or potential defendant. To obtain a restraint order, the SFO must be able to demonstrate that, without it, there is a reasonable chance that the property would be dissipated (this may be inferred from the circumstances of the alleged offence) and that one of the statutory conditions has been met. These conditions include showing that a criminal investigation has been started in England and Wales and that there is reasonable cause to believe that the alleged defendant has benefited from his criminal conduct.

2. *External Restraint Order ("ERO")*: This is a restraint order applied for by the SFO following receipt of a request for assistance from an overseas authority (for example, the U.S. Department of Justice). The jurisdiction to grant an ERO is founded in s.444 of POCA 2002, as exercised by the Proceeds of Crime Act 2002 (External Requests and Orders) Order 2005 SI No: 3181 (the "ERO Act"). In cases involving external requests for the restraint of identified property, what matters is whether the foreign jurisdiction may make an order in relation to the property in question, so that there are reasonable grounds for believing that an ERO may be needed to satisfy a foreign confiscation order.

3. *Confiscation Order*: Once a defendant is convicted of a criminal offence, the prosecutor or the court may initiate a confiscation process. POCA 2002 provides for the confiscation of the defendant's "benefit" from the criminal conduct of which he has been convicted, and also from his general criminal conduct. The court must make a confiscation order if the defendant is found to have a criminal lifestyle and to have benefited from his general criminal conduct or from the specific criminal conduct giving rise to the prosecution. Any such confiscated proceeds will be paid to the SFO.

4. *Compensation Order*: If there are victims who have started or intend to start civil proceedings in respect of loss, injury or damage sustained in connection with the fraud, the court has the discretion to make an order compensating those victims, as an alternative or in addition to granting a confiscation order. The court will do so if it considers on public-policy grounds that a payment by way of compensation is more equitable in redistributing the misappropriated benefit to those who have suffered loss. If the defendant does not have the requisite funds to meet the terms of both the confiscation order and the compensation order, the compensation sums will take priority. It is not a prerequisite to making a compensation order that the defendant would be civilly liable for the loss.

In the scenario described above, assume also that the SFO applies for and obtains a restraint order which has the effect of prohibiting dealings with the funds held in the accounts

NEWSWORTHY

Corinne Ball (New York), cohead of the New York Office of Jones Day's Business Restructuring & Reorganization Practice, will lead the Firm's restructuring and distressed-M&A efforts in Europe.

Brad B. Erens (Chicago), ***David G. Heiman (Cleveland)***, ***Mark A. Cody (Chicago)***, and ***Timothy W. Hoffmann (Chicago)*** are part of a team of Jones Day professionals advising specialty retailer Harry & David Holdings, Inc., in connection with its prenegotiated chapter 11 filing on March 28 in Delaware.

Corinne Ball (New York), ***Paul D. Leake (New York)***, ***David G. Heiman (Cleveland)***, ***Brad B. Erens (Chicago)***, ***Heather Lennox (Cleveland and New York)***, ***Charles M. Oellermann (Columbus)***, ***Gregory M. Gordon (Dallas)***, ***Bennett L. Spiegel (Los Angeles)***, ***Richard L. Wynne (Los Angeles)***, ***Peter J. Benvenutti (San Francisco)***, ***Tobias S. Keller (San Francisco)***, ***Kevyn D. Orr (Washington)***, ***Carl E. Black (Cleveland)***, and ***Thomas A. Howley (Houston)*** were designated "Leaders in their Field" in the area of Restructuring/Insolvency and Bankruptcy by *Chambers USA 2011*.

Volker Kammel (Frankfurt) was recommended in the field of restructuring and insolvency by *The Legal 500 2011* with respect to the Europe, Middle East, and Africa region.

Paul D. Leake (New York), ***Corinne Ball (New York)***, ***David G. Heiman (Cleveland)***, ***Brad B. Erens (Chicago)***, ***Philip J. Hoser (Sydney)***, ***Volker Kammel (Frankfurt)***, ***Richard L. Wynne (Los Angeles)***, ***Peter J. Benvenutti (San Francisco)***, and ***Tobias S. Keller (San Francisco)*** were designated as either leading, recommended, or highly recommended in the Restructuring and Insolvency category in Practical Law Company's *Which lawyer? 2011*.

Lisa G. Laukitis (New York) was included among the "Outstanding Young Restructuring Lawyers" for 2011 by *Turnarounds & Workouts*.

Richard H. Engman (New York) sat on a panel discussing "Lehman—More Than Two Years Later: Lessons for Secured Parties, Derivative Counterparties and Owners of Custodied Financial Assets" at the Spring Meeting of the American Bar Association's Business Law Section on April 15 in Boston.

On April 14, ***Kevyn D. Orr (Washington)*** sat on a panel discussing "Getting the Most Value for Your Expert 'Bucks': A Primer on Preparing Valuation Experts to Testify" at the 2011 Joint Annual Conference of the American Bar Association's Section of Litigation and Criminal Justice in Miami Beach.

An article written by ***Charles M. Oellermann (Columbus)*** and ***Mark G. Douglas (New York)*** entitled "The Year in Bankruptcy—Part II" was published in the May/June 2011 edition of *Pratt's Journal of Bankruptcy Law*.

An article written by ***Patrick J. Leddy (Cleveland)***, ***Charles M. Oellermann (Columbus)***, and ***Joseph M. Witalec (Columbus)*** entitled "Assumption of Liabilities—It Means What We Thought It Meant" was published in the April 2011 issue of *The Bankruptcy Strategist*.

An article written by ***Charles M. Oellermann (Columbus)*** and ***Mark G. Douglas (New York)*** entitled "PRPs With Contribution Claims: Pay Up or Skip Court" appeared in the March 1, 2011, editions of *Bankruptcy Law360* and *Environmental Law360*.

Heather Lennox (Cleveland and New York) sat on a panel discussing "Intercreditor Issues and their Impact on the Chapter 11 Process" at the American Bankruptcy Institute's 29th Annual Spring Meeting in National Harbor, Maryland.

Richard L. Wynne (Los Angeles) sat on a panel discussing "Valuation from Start to Finish and Beyond: DIP Financing, Cramdown, Rights Offerings, and Warrants and Exit Financing" at the American Bankruptcy Institute's 13th Annual New York City Bankruptcy Conference on May 6. On May 20, he gave a presentation entitled "That's My Avatar! Intellectual Property Rights in Bankruptcy" at the California Bankruptcy Forum's 23rd Annual Insolvency Conference in Squaw Valley, California.

Charles M. Oellermann (Columbus) participated in a panel discussion entitled "The Impact of Health Care Reform on Community Hospitals: Why So Many Are In Critical Shape" at the William J. O'Neill Great Lakes Regional Bankruptcy Institute in Cleveland on May 17.

on behalf of Trading Limited. Does this mean therefore that the liquidator of Trading Limited cannot take control of and realise those same funds? The answer depends on whether the restraint order was granted before or after the date of the winding-up order for the liquidation. If granted first, the restraint order takes priority; if it is granted second, the liquidation prevails. This is the effect of s.426 of POCA 2002. In other words, in the case of domestic insolvencies, a liquidator's ability to deal with assets will be fettered only by a restraint order granted before his appointment. The policy behind this rule appears to be to stop a defendant in criminal proceedings from using an insolvency—commenced after a restraint order has been granted—to defeat that restraint order.

FOREIGN CONSIDERATIONS

It is important to note that s.426 of POCA 2002 does not apply to either an ERO or insolvency proceedings other than those governed by the laws of England, Wales or Scotland. Therefore, the usual rule on priority will not apply where a restraint order prohibits dealings in assets which are also the subject of insolvency proceedings commenced by way of an order of a foreign court. In those circumstances, what is the effect of a restraint order, and in particular one obtained after the date of commencement of the foreign liquidation, on the ability of the insolvency officeholder (*e.g.*, trustee, administrator, receiver, liquidator or other insolvency representative) to realise the assets in this jurisdiction? This was one of the issues before the Court of Appeal in *Stanford*.

STANFORD FACTS

At this stage, it would be useful to summarise the somewhat complicated procedural background to the *Stanford* matter.

1. Stanford International Bank ("SIB") was incorporated in Antigua in 1990. In 2009, allegations surfaced to the effect that SIB was involved in a "Ponzi" scheme orchestrated by Sir Allen Stanford and other associated individuals. On this basis, the U.S. Securities and Exchange Commission applied successfully to a U.S. District Court in Texas on 16 February 2009 for an order appointing a receiver (the "U.S. Receiver") over the assets of SIB, Allen Stanford and other individuals.

2. On 19 February 2009, the Financial Services Regulatory Commission of Antigua (the "FSRC") nominated Peter Wastell and Nigel Hamilton-Smith as joint receiver-managers of SIB.

3. On 26 February 2009, the FSRC applied successfully to the Court of Antigua for an order appointing Mr. Wastell and Mr. Hamilton-Smith as the joint receiver-managers of SIB. In March 2009, the FSRC then presented a petition to the Antiguan High Court for the compulsory winding up of SIB and, on 15 April 2009, an order was made for the liquidation of SIB and for the appointment of Mr. Wastell and Mr. Hamilton-Smith as its joint liquidators (the "Antiguan Liquidators"). Pursuant to the terms of that order, all of the assets of SIB wherever situated were vested in the Antiguan Liquidators.

4. Prior to the Antiguan liquidation order, on 6 April 2009, the U.S. Department of Justice (the "USDOJ") had sent a letter of request pursuant to the U.S./U.K. Mutual Assistance in Criminal Matters Treaty requesting the immediate assistance of the U.K. in relation to an investigation being carried out by the USDOJ in respect of the Stanford fraud. This letter requested the restraint of all assets in the U.K. of SIB, Allen Stanford and other individuals so that those assets might be secured for confiscation at a later date.

5. On 7 April 2009, the SFO dealt with the USDOJ's letter of request by applying (*ex parte*) to the Central Criminal Court in London for an ERO in respect of the assets identified in the letter of request. That application was successful and a restraint order was granted.

6. Meanwhile, the Antiguan Liquidators had identified the existence of assets of SIB held by various financial institutions in England. On 22 April 2009, the Antiguan Liquidators applied to the High Court in England under Article 15 of the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law")—implemented in the U.K. pursuant to the Cross-Border Insolvency Regulations 2006—for an order for recognition of the Antiguan liquidation of SIB (together with an order entrusting the distribution of the assets of SIB situated in Great Britain to the Antiguan Liquidators).

7. On 8 May 2009, the U.S. Receiver also applied to the High Court in England for recognition of the U.S. receivership of SIB (again under the Model Law).

8. The competing recognition applications of the Antiguan Liquidators and the U.S. Receiver were heard in June 2009 by Mr. Justice Lewison (who was not informed about the existence of the restraint order that had been granted in April 2009). Mr. Justice Lewison accepted the application of the Antiguan Liquidators and dismissed that of the U.S. Receiver. In giving judgment, Mr. Justice Lewison said that the Antiguan Liquidators were entitled to take control of the assets of SIB in the U.K., but that this right was stayed pending an appeal by the U.S. Receiver. The Antiguan Liquidators requested, therefore, that a portion of the assets be released to allow them to fund the ongoing costs of the liquidation in Antigua pending the hearing of the appeal. This request was allowed subject to, amongst other things, the Antiguan Liquidators' being able to overturn the restraint order that had been granted to the SFO in April 2009.

9. The Antiguan Liquidators then applied to the Central Criminal Court in London on 17 July 2009 for a variation of the restraint order to enable the directions of Mr. Justice Lewison to be carried out. On the morning of the hearing of that application, the Antiguan Liquidators were served with the evidence that had been submitted on behalf of the SFO in support of its original application in April 2009 for a restraint order. On the basis of this evidence, the Antiguan Liquidators amended their application to include an alternative request for the discharge of the restraint order (on the grounds of misrepresentation and material nondisclosure at the hearing in April 2009).

10. This application to vary or discharge the restraint order was heard on 24 July 2009. In giving judgment on 29 July 2009, the Court refused to vary or discharge the restraint order but granted permission to appeal to the Antiguan Liquidators.

STANFORD: COURT OF APPEAL DECISION

Against this background, the Court of Appeal was asked to determine, amongst other things, two related appeals: (i) the appeal of the U.S. Receiver from the order of Mr. Justice Lewison dismissing the U.S. Receiver's recognition application; and (ii) the appeal of the Antiguan Liquidators from the order of the Criminal Court refusing to vary or discharge the restraint order.

The subsequent decision by the Court of Appeal in *Stanford* is important for two reasons. Firstly, in relation to the appeal from Mr. Justice Lewison, the Court held that the U.S. receivership was not a "foreign proceeding" within the meaning of that expression as defined in Article 2(1) of the Model Law (and that the Antiguan liquidation was a foreign proceeding). In doing so, the Court of Appeal clarified the test to be applied for determining a company's centre of main interest, or "COMI"; it held that the key test is that the COMI must be ascertainable by third parties by virtue of the facts and circumstances of the debtor which are in the public domain or which a typical third party would learn as a result of dealing with the debtor in the ordinary course of its business. Applying that test in *Stanford*, the COMI of SIB was held to be Antigua.

Secondly, the Court of Appeal held that: (i) there had been material misrepresentation and nondisclosure by the SFO and the USDOJ on the *ex parte* application for the restraint order on 7 April 2009; (ii) the restraint order made on that date should therefore be set aside; and (iii) the restraint order should be granted afresh with effect from 29 July 2009. What this meant was that the new restraint order was later in time than the date on which SIB was wound up by the Antiguan courts. So far, so good for the Antiguan Liquidators.

But the Court of Appeal then went on to consider whether the restraint order nevertheless had administrative priority over the Antiguan liquidation. The Court of Appeal held that it did. In reaching this conclusion, the Court of Appeal relied on, amongst other things, what was referred to as the "legislative steer"—contained in Article 46(1)–(3) of the ERO Act (reproducing s.69(1)–(3) of POCA 2002)—which states, amongst other things, that the power to grant an ERO must be exercised "with a view to securing that there is no diminution in the value of the property identified in the external request" (Article 46(2)(b)). Applying this guidance, the Court of Appeal—having decided that references to "property" held by SIB included references to property vested in the

Antiguan Liquidators—held that it was necessary to grant a restraint order on 29 July 2009 in order to stop, for the time being, the risk of diminution in the value of the deposits held with the specified banks in the name of SIB in paying the costs of the Antiguan liquidation proceedings. Accordingly, the Court of Appeal held that it followed from the grant of this restraint order that administrative priority over the assets in England was conferred on the SFO/USDOJ.

STANFORD CONSEQUENCES

In the circumstances, the effect of *Stanford* appears to be that—where s.426 of POCA 2002 does not apply—a restraint order will take precedence over competing liquidation proceedings and, in turn, the powers conferred on the liquidator, irrespective of whether the restraint order was obtained before or after the date of the winding-up order.

The *Stanford* decision will not be welcomed by either officeholders or creditors. Firstly, the Court of Appeal justified its decision by reference to the fact that the SFO/USDOJ, whose aim was to recompense the victims of the fraud, would carry out their functions at the public expense, and that the funds available for distribution would not be eroded therefore by the costs of the Antiguan Liquidators. However, there may well be creditors of SIB who are not "victims" for the purposes of any public distribution. Any such creditors would end up empty-handed.

Secondly, the process of identifying foreign assets and obtaining cross-border recognition orders can be time-consuming and expensive. If the officeholder knows that a restraint order has been granted, or that the SFO intends to make an application for a restraint order, advice can be taken in advance by the officeholder as to whether that restraint order would take priority. In turn, this will inform the decision as to whether the grant of a recognition order would serve any practical purpose. But the SFO may not be willing to disclose its intentions in this regard or may not have made any decision at that time about the need for a restraint order. In those circumstances, the liquidator would risk wasting significant resources in the event that his attempts to obtain foreign recognition—even if successful—were then trumped by a late request to or decision by the SFO to apply for a restraint order over the same assets. This places the liquidator in a very difficult position.

Thirdly, the result in *Stanford* would have been different if SIB had been wound up under the Insolvency Act 1986 and the SFO had applied for a domestic restraint order. In other words, in the event that the fraud had been perpetrated within the confines of the U.K., the restraint order would not have taken priority over the insolvency proceedings and the liquidators of SIB would have had the ability to realise the assets in question. This is an artificial and inconsistent approach, and English law should afford equal protection to the creditors of both domestic and foreign insolvencies. Subject therefore to any appeal to the U.K. Supreme Court, such inconsistency may be remedied only through legislative intervention.

BANKRUPTCY CLAIMS TRADERS BEWARE: ENSURE THAT THE CURE COMES WITH THE CLAIM

Scott J. Friedman and Mark G. Douglas

Over the past five years, courts have issued rulings of potential concern to buyers of distressed debt. Courts have addressed, among other things, "loan to own" acquisition strategies resulting in vote designation; equitable subordination, disallowance, and other lender liability exposure based upon the claim seller's misconduct; disclosure requirements for ad hoc committees of debtholders; the adequacy of standardized claims-trading agreements; and claim-filing requirements in the era of computerized records. One of the latest developments in the growing body of bankruptcy jurisprudence affecting this area was contributed recently by the Seventh Circuit Court of Appeals. In *In re UAL Corp.*, the court affirmed a ruling below that the purchaser of a claim based upon an executory contract which was ultimately rejected by a chapter 11 debtor in possession ("DIP") is not entitled to cure amounts as part of its allowed claim.

ASSUMPTION AND REJECTION OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES

Section 365(a) of the Bankruptcy Code allows a DIP or bankruptcy trustee, subject to court approval, to "assume" (reaffirm) or "reject" (disavow) almost any "executory contract or unexpired lease" to which the debtor was a party prior to filing for bankruptcy. Although the term is not defined in the statute, "executory" is generally understood to mean that performance remains due to some extent on both sides of an agreement as of the bankruptcy petition date, such that the failure to perform would constitute a breach-excusing performance by the other contract party.

In a chapter 11 case, the DIP or trustee may make the decision to assume or reject such agreements (other than unexpired leases of nonresidential real property) at any time prior to confirmation of a chapter 11 plan, unless the court orders otherwise upon request of the nondebtor contracting party. This latitude affords the DIP an opportunity to determine which of its executory contracts should be retained as part of its overall restructuring strategy and which should be discarded because they are burdensome or unnecessary.

Assumption is subject to certain restrictions and conditions. For example, if a contract or lease is in default, section 365(b) of the Bankruptcy Code provides that it can be assumed only if the DIP or trustee cures the default, compensates the other party for any pecuniary loss resulting from the default, and provides adequate assurance of future performance under the agreement. Rejection of an executory contract or unexpired lease amounts to a court-authorized breach of the agreement. In most cases, the claim resulting from rejection will be treated as a prepetition claim against the estate on a par with the claims of the debtor's other general unsecured creditors.

Whether the buyer of a claim based upon an executory contract is entitled to cure amounts that would be payable upon assumption of the contract was the subject of the Seventh Circuit's ruling in *UAL Corp.*

UAL CORP.

Prior to filing for chapter 11 protection in Illinois in 2002, air carrier holding company UAL Corporation ("United") entered into various contracts for telecommunications services with AT&T Corporation ("AT&T"). Because United defaulted on the contracts, AT&T filed a proof of claim in the bankruptcy case alleging that it held a general unsecured claim in the amount of approximately $5 million arising from breach of the contracts. Shortly afterward, ReGen Capital I ("ReGen"), a financial firm that operates as a claims trader, filed a claim-transfer notice with the court indicating that ReGen had acquired AT&T's claims against United pursuant to a January 2002 assignment agreement. That agreement defined a "claim" as:

> any general pre-petition unsecured claim of AT&T against a debtor together with interest, if any, payable thereon from and after the Effective Date [of the assignment agreement], and any actions, claims, lawsuits or rights of any nature whatsoever, whether against a debtor or any other party, arising out of or in connection with the Claim, including, Assignor's right to receive, from and after the Effective Date, any cash, securities, instruments, and/or other property as distributions on the Claim.

United filed a chapter 11 plan in 2005. Among other things, the plan contained the following reservation-of-rights clause:

> The Debtors and Reorganized Debtors reserve the right to reject any executory contract or unexpired lease no later than fifteen (15) days after the later of (i) the Debtors or Reorganized Debtors and the counterparty to such executory contract or unexpired lease agree in writing to the amount of the Cure, or (ii) the entry of a Final Order establishing the Cure.

Annexed to the plan was a list of "Assumed Executory Contracts and Unexpired Leases," which included the contracts between United and AT&T but did not set forth any approved or agreed cure amounts for those contracts. The plan provided that confirmation "constitute[d] the Bankruptcy Court's approval of the proposed treatment of executory contracts" as well as a "determination that the Debtors have exercised reasonable business judgment in determining whether to assume or reject each of their executory contracts." Finally, the plan established a "cure bar date" for parties to submit claims for cure amounts due under assumed contracts.

Sabre, Inc. ("Sabre"), another contract party unrelated to United, ReGen, or AT&T, objected to the reservation-of-rights clause, claiming that it violated section 365(d)(2)'s dictate that the decision to assume or reject be exercised prior to plan confirmation. Sabre and United settled the dispute by exempting Sabre's claim from the scope of the reservation clause. ReGen, however, raised no such objection and voted in favor of the plan, which was confirmed by the court and became effective on February 1, 2006. ReGen received its pro rata share of new common stock under the plan, but only with respect to ReGen's general unsecured claim for damages arising from breach of the contracts.

ReGen then timely filed a claim for cure amounts allegedly due under the contracts. United responded by objecting to the claim and filing a notice on June 4, 2008—more than two years after the effective date of the plan—of its intent to reject the contracts. The bankruptcy court ruled that ReGen's general unsecured prepetition claim did not carry with it the right to receive a cure payment in connection with assumption of the underlying contract. It also held that United had properly rejected the AT&T contracts in accordance with the reservation-of-rights clause in the plan.

"[T]he right to cure does not arise out of a claim," the court wrote; rather, "[i]t arises out of a contract." According to the bankruptcy court, the general prepetition unsecured claim referred to in the assignment agreement between AT&T and ReGen could not become a cure claim. The district court affirmed on appeal, observing that "the only reasonable interpretation" of the assignment agreement was that ReGen purchased "general prepetition unsecured claims and the right to recover any distribution made on account of those general prepetition unsecured claims," but not the right to recover the full amount of the default.

THE SEVENTH CIRCUIT'S RULING

The Seventh Circuit affirmed. Because United rejected the underlying contracts in accordance with the express provisions of its confirmed chapter 11 plan, the court of appeals explained, no cure amounts were payable in respect of either such contracts or the claim acquired by ReGen from AT&T. According to the Seventh Circuit, regardless of whether the underlying contracts appeared on the list of contracts to be assumed upon confirmation, no assumption could have taken place until "cure or adequate assurance of prompt cure," as required by section 365(b)(1).

The court specifically declined to rule on the propriety of the rights-reservation clause, which effectively provided for the post-confirmation assumption or rejection of contracts. If ReGen wished to object to this aspect of the plan on the basis of section 365(d)(2) or otherwise, the Seventh Circuit emphasized, it could have done so prior to confirmation, as Sabre in fact did:

> We do not have occasion to decide here whether a timely challenge to United's reservation of the right to postpone the assumption decision would have been successful under section 365. Nevertheless, we can appreciate that such a reservation can make sound business sense in the context of the Code's balancing of the rights of debtors and creditors. The reservation gave the debtor protection from the risk that a creditor's demand for a

cure could be more expensive than expected, and it gave the debtor the opportunity to continue to do business with AT&T without making a final decision to assume or reject that would affect ReGen rather than AT&T.

However, the court of appeals faulted the lower courts' reasoning regarding the scope of the assignment agreement. According to the Seventh Circuit, the agreement's definition of "claim" was broad enough to include the right to collect a cure amount arising from AT&T's original contracts. The court rejected United's argument that, because a separate filing is required to seek a cure claim, the cure claim "is disconnected from the general unsecured claim." The claims, the Seventh Circuit wrote, "stem from the same transaction giving rise to a single right to payment." The court explained that this conclusion is supported by rulings handed down by the Second Circuit (on nearly identical facts) and, more generally, by long-standing U.S. Supreme Court and Seventh Circuit precedent.

OUTLOOK

UAL Corp. is a cautionary tale for claims traders, particularly those seeking to obtain payments on account of cure claims. As a contractual matter, claim-transfer documents should be drafted carefully to ensure that all rights and remedies appurtenant to a claim, including cure amounts payable upon assumption of the contract in bankruptcy, are expressly made part of the transaction if the parties intend to transfer cure claims. But even if a claim buyer purchases the right to a cure claim, there can be no assurance that the underlying contract will be assumed such that a cure claim becomes payable.

By the same token, although the parties to a sale transaction of the kind involved in *UAL Corp.* might ordinarily anticipate that the underlying contract would be rejected, this may not always be the case. As a consequence, claim-transfer agreements should expressly spell out the rights and obligations of the buyer and the seller in the eventuality that the underlying contract is in fact assumed, including which party is entitled to cure payments.

The ruling may result in more challenges to plan provisions providing for post-confirmation assumption or rejection decisions, especially if a reservation-of-rights clause is open-ended. Absent a court determination that such provisions violate section 365(d)(2) or a specific exemption from such a provision, an assignee may not know whether it will have a cure claim until after the debtor has gone through the cure claims reconciliation process.

UAL Corp. represents only one of the latest case developments affecting claims trading. Another interesting development on that front earlier this year came in the chapter 11 cases of Mesa Air Group, Inc., and its affiliates. In that case, the court entered an order restricting the trading of large claims to protect the debtor's ability to use its net operating losses. A New York bankruptcy court ruled on January 20, 2011, that creditor BF Claims Holdings I LLC, which had acquired its claims in violation of the trading order, lacked standing to object to confirmation of the debtors' chapter 11 plan. Among other things, the decision emphasizes the importance of complying with court-established procedures for acquiring claims and properly documenting claims transfers.

Regan Capital I, Inc. v. UAL Corp. (In re UAL Corp.), 635 F.3d 312 (7th Cir. 2011).

ReGen Capital I, Inc. v. Halperin (In re U.S. Wireless Data), 547 F.3d 484 (2d Cir. 2008).

Shropshire, Woodliff & Co. v. Bush, 204 U.S. 186 (1907).

Dorr Pump & Manufacturing Co. v. Heath (In re Dorr Pump & Manufacturing Co.), 125 F.2d 610 (7th Cir. 1942).

In re Mesa Air Group, Inc., 2011 WL 320466 (Bankr. S.D.N.Y. Jan. 20, 2011).

CHAPTER 11 PLAN FEASIBILITY FOR NONPROFIT DEBTORS REQUIRES MORE THAN SUCCESSFUL FUNDRAISING TRACK RECORD

Charles M. Oellermann and Mark G. Douglas

The enduring impact of the Great Recession on businesses, individuals, municipalities, and even sovereign nations has figured prominently in world headlines during the last three years. Comparatively absent from the lede, however, has been the plight of charitable and other nonprofit entities that depend in large part on the largesse of donors who themselves have been less able or less willing to provide eleemosynary institutions with badly needed sources of capital in the current economic climate.

Nonprofits have sometimes resorted to bankruptcy protection as a form of financial triage, but with mixed results. Nonprofit bankruptcies are relatively rare—in most cases, a financially strapped nonprofit will simply close its doors and file a plan of dissolution with its state regulatory authority. Even so, certain nonprofit bankruptcy cases have achieved notoriety in the last 15 years, including: (i) no fewer than eight of the 194 Catholic archdioceses in the U.S., which filed for bankruptcy as a means of managing sexual abuse litigation exposure; (ii) the National Benevolent Association, a 117-year-old charitable organization that once managed more than 70 facilities financed by the U.S. Department of Housing and Urban Development and owned and operated 18 other facilities, including residential homes for seniors, at-risk children, and the disabled; and (iii) Allegheny Health, Education, and Research Foundation, once the largest nonprofit health-care chain in Pennsylvania, which filed for chapter 11 in 1998 to liquidate its assets amid allegations (later proved) that management raided more than 350 charitable endowments to prop up the nonprofit's ailing system.

Nonprofits seek bankruptcy protection for a variety of reasons. Regardless of the motive, however, the filings raise important questions regarding the utility of a bankruptcy filing as an effective means of dealing with the woes of nonprofits. Issues unique to nonprofits that may arise in a bankruptcy case can range from something as basic as the company's eligibility to file for bankruptcy to more complex matters concerning which assets are properly included as part of the debtor's bankruptcy estate and whether the debtor's business may be sold in bankruptcy notwithstanding nonbankruptcy regulatory rules making such transactions the exclusive province of the regulatory agency.

Another challenge confronted by nonprofits in chapter 11 cases concerns a workable exit strategy, especially if plan funding depends upon donor contributions. This obstacle was addressed in a ruling recently handed down by the Fifth Circuit Court of Appeals. In *In re Save Our Springs (S.O.S.) Alliance Inc.*, the court affirmed a decision below denying confirmation of a chapter 11 plan, ruling that "voluntary pledges [from donors] alone are too speculative to provide evidence of [plan] feasibility."

> Without a reliable source of funding to fund ongoing operating expenses or fund a chapter 11 plan, nonprofits may be forced to close their doors and liquidate their operations under state law or in chapter 7.

CHAPTER 11 PLAN-FEASIBILITY REQUIREMENT

Pursuant to section 1129(a)(11) of the Bankruptcy Code, a chapter 11 plan may be confirmed only if "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan." This "feasibility" requirement had its origins in various provisions of the former Bankruptcy Act of 1898, which required that the court find that the plan was "feasible." As articulated by the Ninth Circuit Court of Appeals in its 1985 ruling in *In the Matter of Pizza of Hawaii, Inc.*, the purpose of subsection 1129(a)(11) is "to avoid confirmation of visionary schemes which promise creditors more under a proposed plan than the debtor can possibly attain after confirmation."

Consistent with the plain language of the statute, courts have uniformly held that the feasibility requirement does not require a guarantee of the chapter 11 plan's success, but rather that the plan offer "a reasonable prospect" or "reasonable assurance" of success. However, courts have sometimes

varied widely in their determination of how likely success has to be under the circumstances.

The proponent of a chapter 11 plan bears the burden of establishing by a preponderance of the evidence that the plan is feasible. Factors recognized by the courts as relevant to evaluating the feasibility of a proposed plan have included: (i) the prospective earnings or earning power of the debtor's business, which must be based on sound and reasonable assumptions; (ii) the adequacy of the capital structure and working capital for the debtor's post-confirmation business; (iii) the debtor's ability to meet its capital expenditure requirements; (iv) economic conditions; (v) management's ability and the likelihood that current management will stay in place; and (vi) any other material factors that would affect the successful implementation of the plan.

Courts have an affirmative obligation to evaluate a plan's likelihood of success and to make a particular finding as to feasibility. Although the court will not conduct its own analysis of the debtor's prospects for success, the court does play an important gatekeeper role by ensuring that the debtor has undertaken appropriate planning and analysis.

S.O.S.

Save Our Springs (S.O.S.) Alliance ("S.O.S.") is a nonprofit charitable organization that sues municipalities and developers to prevent what it perceives to be irresponsible use of aquifers in the Texas Hill Country. In connection with certain of these lawsuits, attorneys' fees have been awarded against S.O.S., which was forced to seek chapter 11 protection in April 2007 when it could not satisfy the obligations.

S.O.S.'s proposed chapter 11 plan would establish a $60,000 "creditor fund," consisting of charitable contributions from S.O.S.'s donors, within 60 days of plan confirmation. At the confirmation hearing, S.O.S. maintained that it had already obtained pledges in the amount of $20,000 and "expressed confidence" that it could raise the balance of the creditor fund through donations within the required 60-day window. However, S.O.S.'s executive director acknowledged that it would be difficult to do so because many of S.O.S.'s donors wanted to prevent their money from being used to pay judgment creditors. The director also acknowledged that it would be "extremely difficult" to take money from S.O.S.'s general operating fund, because "[w]e struggle to meet our monthly overhead every month," and donors had been assured that donations would not go to pay judgment creditors.

Six months after the hotly contested confirmation hearing, the bankruptcy court issued an opinion refusing to confirm the chapter 11 plan. Among other things, the court explained, the plan was not feasible because S.O.S. had not demonstrated a sufficiently "firm commitment" from its donors to contribute the plan funding. The district court affirmed on appeal.

THE FIFTH CIRCUIT'S RULING

The Fifth Circuit affirmed denial of plan confirmation. Among other things, the court of appeals found that S.O.S. had failed to produce evidence of even a reasonable assurance of success. According to the court:

> S.O.S.'s argument fails, because there was no evidence showing even a reasonable assurance of success. S.O.S. points to its past financial statements showing successful fundraising campaigns. But raising funds during bankruptcy is more difficult than at other times. That is particularly true here, given that S.O.S.'s donors are hesitant to give for the purpose of paying off judgment creditors. The bankruptcy court's conclusion that past donations are not evidence of future fundraising ability is thus appropriate.

The Fifth Circuit also emphasized that "voluntary donations" and "oral pledges" rather than "contracts . . . that commit [the donors] to give money in the future," without any evidence that the donors would be or were capable of honoring the pledges, are "too speculative to provide evidence of feasibility."

OUTLOOK

S.O.S. is emblematic of the formidable obstacles confronted by nonprofits during the Great Recession and its aftermath. Recent casualties of the still-struggling economy have included a diverse array of nonprofits, including the Southern Nevada Area Health Education Center, a Las Vegas-based nonprofit that provided community programs and education for health-care workers, which shut down after it filed a chapter 7 petition on January 20, 2011, and the 111-year-old

Philadelphia Orchestra, which became the first major U.S. orchestra to file for bankruptcy when it sought chapter 11 protection on April 17, 2011. Without a reliable source of funding to fund ongoing operating expenses or fund a chapter 11 plan, nonprofits may be forced to close their doors and liquidate their operations under state law or in chapter 7. The ruling also demonstrates that, for a nonprofit debtor, the feasibility requirement of section 1129(a)(11) demands something more than evidence of prior successful fundraising campaigns. Absent evidence of less speculative sources of capital, a proven track record of successful fundraising by a nonprofit that finds itself in chapter 11 may be insufficient to demonstrate even a reasonable assurance of plan success.

In re Save Our Springs (S.O.S.) Alliance Inc., 632 F.3d 168 (5th Cir. 2011).

In the Matter of Pizza of Hawaii, Inc., 761 F.2d 1374 (9th Cir. 1985).

SUBSTANTIVE CONSOLIDATION AND NONDEBTOR ENTITIES: THE FIGHT CONTINUES

Daniel R. Culhane

Although it has been described as an "extraordinary remedy," the ability of a bankruptcy court to order the substantive consolidation of related debtor-entities in bankruptcy (if circumstances so dictate) is relatively uncontroversial, as an appropriate exercise of a bankruptcy court's broad (albeit nonstatutory) equitable powers. By contrast, considerable controversy surrounds the far less common practice of ordering consolidation of a debtor in bankruptcy with a nondebtor. Whether a bankruptcy court has the power to grant this remedy was the subject of an important ruling recently handed down by a Florida bankruptcy court. In *In re S & G Fin. Servs. of S. Fla., Inc.*, the court denied a motion to dismiss a chapter 7 trustee's complaint seeking to substantively consolidate a debtor and two of its nondebtor affiliates. The court ruled that "it is well within this Court's equitable powers to allow substantive consolidation of entities under appropriate circumstances, whether or not all of those entities are debtors in bankruptcy" and that "this Court has jurisdiction over non-debtor entities to determine the propriety of an action for substantive consolidation insofar as the outcome of such proceeding could have an impact on the bankruptcy case."

SUBSTANTIVE CONSOLIDATION

The Bankruptcy Code does not expressly authorize substantive consolidation, although it recognizes that a chapter 11 plan may provide for the consolidation of a "debtor with one or more persons" as a means of implementation. Rather, substantive consolidation is a product of judicial gloss that preceded enactment of the Bankruptcy Code in 1978. Today, courts generally find authority for the remedy in the broad equitable powers conferred in section 105(a) of the Bankruptcy Code, which authorizes the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. However, because of the dangers of forcing creditors of one entity to share equally with creditors of a less solvent debtor, courts generally hold that it is to be used sparingly and have labeled substantive consolidation an "extraordinary remedy."

The Standard for Substantive Consolidation

Different standards have been employed by courts to determine the propriety of substantive consolidation. Common to all of these tests is a fact-intensive examination and an analysis of consolidation's impact on creditors. For example, in *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, the Eleventh Circuit adopted a modified version of the standard articulated by the District of Columbia Circuit in *In re Auto-Train Corp., Inc.*, under which the proponent of consolidation must demonstrate that: (i) there is substantial identity between the entities to be consolidated; and (ii) consolidation is necessary to avoid some harm or to realize some benefit.

Factors that may be relevant in satisfying the first requirement include:

(1) Fraud or other complete domination of the corporation that harms a third party;

(2) The absence of corporate formalities;

(3) Inadequate capitalization of the corporation;

(4) Whether funds are put in and taken out of the corporation for personal rather than corporate purposes;

(5) Overlap in ownership and management of affiliated corporations;

(6) Whether affiliated corporations have dealt with one another at arm's length;

(7) The payment or guarantee of debts of the dominated corporation by other affiliated corporations;

(8) The commingling of affiliated corporations' funds; and

(9) The inability to separate affiliated corporations' assets and liabilities.

The Second Circuit established a somewhat different standard for gauging the propriety of substantive consolidation in *In re Augie/Restivo Baking Co., Ltd.* There, the court concluded that the factual elements considered by the courts are "merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit, . . . or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors."

The *Augie/Restivo* test was adopted by the Ninth Circuit in *In re Bonham*. Many other circuit and lower courts have adopted tests similar to the *Augie/Restivo* and *Eastgroup* standards. The Third Circuit addressed the issue for the first time in *In re Owens Corning*, opting for an "open ended, equitable inquiry" rather than a factor-based analysis, as employed by many courts.

Consolidation of Debtors and Nondebtors?

Courts disagree as to whether the remedy can be exercised to consolidate debtors with nondebtors. The majority rule permits such a consolidation under appropriate circumstances, with the caveat that increased caution should be exercised in assessing the propriety of the remedy. Some courts hold otherwise, citing jurisdictional concerns and/or ruling that substantive consolidation should not be used to circumvent the involuntary bankruptcy petition procedures of the Bankruptcy Code.

A bankruptcy court's substantive consolidation of entities not in bankruptcy has been vigorously critiqued, and criticisms have been based on a range of issues, from a lack of authority under the Bankruptcy Code to constitutional due process. One commentator, Kurt Mayr, has posited that every court decision applying substantive consolidation to nondebtors is based on the assumption that the "federal equity power can be used to expand the scope of 'property of the debtor's estate' to include non-debtor assets where the elements of substantive consolidation are satisfied." According to Mayr, this assumption is faulty because it directly contradicts the Supreme Court's mandate in *Butner v. U.S.* that the "basic federal rule is that state law governs" property interests in bankruptcy.

At the time his article was published in 2007, Mayr noted that the *Butner* argument had apparently not been presented to any court considering substantive consolidation with regard to nondebtor entities. This changed in *S & G*.

S & G

For the five-year period prior to filing for chapter 7 protection in Florida in March 2010, S & G Financial Services of South Florida, Inc. (the "Debtor"), was engaged in the business of making short-term mortgage loans. To finance its mortgage-lending activities, the Debtor obtained funding from various "investors." These investors were individuals or entities to whom the Debtor offered attractive potential returns and security on their investments in the form of full or partial assignments of the mortgages the Debtor originated. At the time of its filing, Jorge Galceran was the sole officer, director, and shareholder of the Debtor. In addition, Galceran was the sole member and manager of two limited liability companies: S & G Financial Services, LLC ("S & G"), and Merrick Financial Group, LLC ("Merrick").

Prior to the petition date, one of the Debtor's investors obtained a judgment against the Debtor for approximately $850,000. The investor later caused writs of garnishment to be served on two of the Debtor's banks, resulting in the freezing of the Debtor's accounts. Subsequently, S & G opened a bank account at a separate institution and began depositing checks payable to the Debtor into that account. Galceran also instructed certain of the Debtor's mortgagors to make checks payable to Merrick in order to circumvent the writs of garnishment.

Once in bankruptcy, the chapter 7 trustee filed an adversary proceeding seeking, in separate counts, to substantively consolidate the Debtor with nondebtors S & G and Merrick. The complaint alleged that because Galceran diverted assets of the Debtor to S & G, the Debtor's financial statements were inaccurate as to receivables owed to the Debtor. Further, the trustee alleged that S & G had no legitimate business purpose independent of the Debtor and that because the finances of the Debtor were so intermingled with those of S & G and Merrick, equity dictated that the nondebtor entities should be substantively consolidated with the Debtor.

The defendants moved to dismiss, arguing that section 105 of the Bankruptcy Code is not a source of authority for establishing jurisdiction over a nondebtor entity. The defendants asserted that allowing the substantive consolidation of the nondebtors with the Debtor would amount to allowing the rule of equity to redefine the defendants' property interests, which should be defined by reference to state law under *Butner*. Furthermore, they argued, the trustee could utilize sections 303 (involuntary petitions) and 548 (avoidance of fraudulent transfers) of the Bankruptcy Code to achieve the same results against S & G and Merrick, without resorting to substantive consolidation.

THE BANKRUPTCY COURT'S DECISION

The bankruptcy court ruled that the chapter 7 trustee had adequately pled a cause of action for substantive consolidation so as to survive a motion to dismiss. The court found that it had jurisdiction to consider the substantive consolidation of nondebtor entities with the Debtor and that it was well within the court's equitable powers to allow substantive consolidation of entities under appropriate circumstances, whether or not all of those entities are debtors in bankruptcy.

Acknowledging that the federal courts are split on the issue, the *S & G* court noted that, among the circuit courts of appeal, only the Ninth Circuit—in *In re Bonham*—has held that a court may order substantive consolidation of debtor and nondebtor entities. Other circuit courts, however, have implicitly acknowledged a bankruptcy court's authority to consolidate debtor and nondebtor entities. Moreover, the *S & G* court cited to bankruptcy-court rulings in Florida and Georgia (and elsewhere) that have expressly recognized a bankruptcy court's ability to substantively consolidate a debtor with a nondebtor.

Like the Ninth Circuit in *Bonham*, the court in *S & G* relied on the precode U.S. Supreme Court ruling in *Sampsell v. Imperial Paper and Color Corp.* for the proposition that "equality of distribution" is the core of bankruptcy jurisprudence from which the theory of substantive consolidation emanates. In *Sampsell*, the bankruptcy referee had decided that the debtor formed a nondebtor corporation simply to continue the debtor's previously unincorporated business and that prepetition transfers made to this "sham" corporation were fraudulent. The bankruptcy court in *Sampsell* ordered the corporation to be liquidated and the assets transferred to the debtor's bankruptcy estate. Notably, however, this de facto consolidation of estates was not an issue before the Supreme Court, which granted certiorari to

decide only the issue of the priority of a creditor's claim as to the liquidated assets.

The *S & G* court distinguished seemingly adverse case law, noting that some courts have viewed the application of substantive consolidation to nondebtors as an impermissible use of the court's equitable power to exercise jurisdiction over nondebtors without express statutory authority. In the *S & G* court's view, such holdings mistakenly "conflat[e] jurisdiction with power." In fact, the bankruptcy court clearly had jurisdiction to consider the substantive-consolidation issue because "the outcome of the proceeding could conceivably have an effect on the estate being administered in bankruptcy." According to the court, whether section 105 authorized the relief requested is a separate issue, and one that is not logically parallel to the jurisdictional question.

The *S & G* court then addressed the defendants' contention that it was in "conflict with the purposes of the Bankruptcy Code" to substantively consolidate nondebtors under section 105 when sections 303 and 548 of the Bankruptcy Code—as well as a veil-piercing theory under state law—were available to achieve the same effect. The court rejected this argument, holding that each doctrine is separate and distinct from substantive consolidation and should not be used as a replacement. First, compelling the trustee to file involuntary petitions against the defendants under section 303, which requires that the target entity be insolvent, would "defeat the very purpose of substantive consolidation," which in this case was "to recover assets from a financially sound affiliated entity." Second, and similarly, the fraudulent-transfer requirements under section 548 invoke different legal principles and demand a showing of fraud or intent to hinder or delay creditors. Finally, unlike veil piercing, substantive consolidation does not require a finding that the nondebtor entities are alter egos of the debtor. In sum, the court concluded, substantive consolidation is simply a remedy in addition to, rather than an alternative for, involuntary bankruptcy petitions, avoidance of fraudulent transfers, and veil piercing.

OUTLOOK

Commentators critical of the practice of substantively consolidating debtor entities with nondebtors have objected to reliance on *Sampsell* to justify the remedy. According to some critics, the Supreme Court in *Sampsell* merely decided an issue of claim priority with regard to nondebtor assets that had been liquidated and added to the debtor's estate, and that the case should be viewed, at most, as a "tacit approval" of the substantive consolidation ordered by the bankruptcy court. Nevertheless, *S & G* describes *Sampsell* as "the seminal case on substantive consolidation."

Interestingly, although the *S & G* court refers to the defendants' *Butner* argument, *Butner* itself is not cited anywhere (let alone discussed) in the *S & G* decision. Instead, the court relies on *Sampsell* without even attempting to resolve the tension presented by the Supreme Court's later decision in *Butner*. As such, *S & G* leaves to future courts the task of reconciling *Sampsell* and *Butner* with respect to consolidating debtor and nondebtor entities.

Kapila v. S & G Fin. Servs., LLC (In re S & G Fin. Servs. of S. Fla., Inc.), 2011 WL 96741 (Bankr. S.D. Fla. Jan. 11, 2011).

Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245 (11th Cir. 1991).

Drabkin v. Midland Ross Corp. (In re Auto-Train Corp., Inc.), 810 F.2d 270 (D.C. Cir. 1987).

Union Savings Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.), 860 F.2d 515 (2d Cir. 1988).

In re Owens Corning, 419 F.3d 195 (3d Cir. 2005).

Kurt A. Mayr, *Back to* Butner's *Basic Rule—the Fundamental Flaw of Nondebtor Substantive Consolidation*, 16 Norton J. Bankr. L. & Prac., 77 (Feb. 2007).

Butner v. U.S., 440 U.S. 48 (1979).

Sampsell v. Imperial Paper and Color Corp., 313 U.S. 215 (1941).

Bonham v. Compton (In re Bonham), 229 F.3d 750 (9th Cir. 2000).

Christopher J. Predko, *Substantive Consolidation Involving Non-Debtors: Conceptual and Jurisdictional Difficulties in Bankruptcy*, 41 Wayne L.R. 1741 (1994).

IN RE LETT: PRESERVING APR PLAN CONFIRMATION OBJECTIONS ON APPEAL

Daniel T. Moss and Mark G. Douglas

Earlier this year, the United States Court of Appeals for the Eleventh Circuit decided in *In re Lett* that objections to a bankruptcy court's approval of a cram-down chapter 11 plan on the basis of noncompliance with the "absolute priority rule" may be raised for the first time on appeal. The Eleventh Circuit ruled that "[a] bankruptcy court has an independent obligation to ensure that a proposed plan complies with [the] absolute priority rule before 'cramming' that plan down upon dissenting creditor classes," whether or not stakeholders "formally" object on that basis.

LETT HISTORY

The debtor, an individual, filed for chapter 11 protection in Alabama in 2004, in part to address a judgment lien on all of his property held by the Alabama Department of Economic and Community Affairs ("ADECA"). In total, ADECA claimed the debtor owed approximately $3 million. The debtor proposed four different chapter 11 plans, each of which proposed to pay ADECA very little. Each plan bifurcated the debt to ADECA into a secured claim and an unsecured claim. As to the secured portion of the claim, the last of the four plans proposed to pay $235,615 in installments of $12,616 beginning roughly five years after confirmation. For the unsecured portion of the claim, the plan proposed to pay approximately $20,000 in two annual installments, after payment of all secured claims. Other unsecured claims were classified separately, and claimants were scheduled to receive a distribution equal to one percent of their claims in a single installment six months after confirmation. Further, the plan proposed that, as of the plan's effective date, "all property of the Estate shall revest in the Reorganized Debtor, all free and clear of all claims, liens, encumbrances and other interests of creditors."

Although ADECA voted to reject the proposed plan, at least one impaired class of creditors voted to accept it. At the confirmation hearing, the debtor's counsel asserted that the plan complied with the cram-down provisions in the Bankruptcy Code, including the "absolute priority rule" codified in section 1129(b)(2)(B), which dictates that, unless senior class members are paid in full, no holder of any junior claim or interest shall "receive or retain under the plan on account of such junior claim or interest any property." ADECA presented a number of objections—none of which, however, addressed the plan's noncompliance with the absolute priority rule. Ultimately, the bankruptcy court confirmed the plan, ruling, among other things, that the plan "met the absolute priority requirements embodied in § 1129(b)(2)."

ADECA appealed the confirmation order to the district court. There, ADECA argued for the first time that the absolute priority rule was not satisfied because: (i) the plan proposed payments to the class of general unsecured creditors without paying ADECA's senior unsecured claim in full; and (ii) the plan called for the debtor to retain property interests without paying unsecured creditors in full. The debtor countered that the appeal was moot because the plan had been "substantially consummated" and because ADECA did not seek a stay pending appeal.

The district court held that the appeal was not moot under the substantial consummation standard because only secured creditors had received payments under the plan. Even so, the court dismissed the appeal because ADECA failed to object at the confirmation hearing on the basis that the plan violated the absolute priority rule. The district court ruled that ADECA was foreclosed from raising that issue for the first time on appeal. ADECA appealed to the Eleventh Circuit.

THE ELEVENTH CIRCUIT'S RULING

The Eleventh Circuit vacated the district court's decision and remanded the case below for a hearing on the merits. Among other things, the court held that ADECA's objections regarding noncompliance with the absolute priority rule could be raised for the first time on appeal. In reaching this conclusion, the Eleventh Circuit addressed the "civil plain error rule," under which an appellate court will consider an issue not raised below if it involves a pure question of law and if refusal to consider it would result in a miscarriage of justice. The Eleventh Circuit faulted the district court's determination that the rule precluded appellate review of the bankruptcy court's order on the absolute priority rule because, according to the district

court, no miscarriage of justice would result from its declining to hear ADECA's absolute-priority-rule arguments.

The Eleventh Circuit ruled as it did not because of any miscarriage of justice, but because "the application of the absolute priority rule in a Chapter 11 cram down proceeding sufficiently places the matter before the bankruptcy court so as to preserve the issue for appeal." Pointedly, the Eleventh Circuit held that "[a]n impaired creditor in a dissenting class need not formally object on such ground in the bankruptcy court in order to appeal an improperly confirmed cram down plan."

Under *Lett* and a 1994 Ninth Circuit case, *In re Perez*, in which the court reached the same conclusion, a party in interest's failure to raise a specific objection based upon noncompliance with the absolute priority rule in connection with confirmation of a cram-down chapter 11 plan does not preclude appellate review of the confirmation order on that basis. Even so, stakeholders in other circuits would be well advised not to rely on *Lett* and *Perez* as a safety net—other appellate courts faced with a party's failure to interpose such an objection may not be so generous.

The court recognized the inherent protections built into the Bankruptcy Code's cram-down requirements, which serve to protect dissenting impaired creditors. These protections, the court reasoned, prevent a debtor from isolating claims for unfair treatment or from putting the interests of equity holders ahead of the interests of creditors. The Eleventh Circuit further observed that "[i]mportantly, the Bankruptcy Code envisions a bankruptcy court exercising an independent duty to ensure that the strictures of § 1129(b) are met with regard to dissenting classes of creditors in a Chapter 11 cram down." This duty exists, the court emphasized, even in the absence of objections regarding compliance with the cram-down requirements.

According to the Eleventh Circuit, the record plainly showed that the bankruptcy court "fully understood this independent obligation" and addressed the absolute priority rule in confirming the plan despite ADECA's failure to object by specifically requiring the debtor to proffer evidence that the plan conformed to the absolute priority rule. Even if the court ultimately erred as a matter of law on the merits, the Eleventh Circuit wrote, "it cannot be said that it did not *reach* the merits or that the court did not contemplate its duties under § 1129(b)."

Recognizing the potentially expansive reading of its analysis in other situations, the Eleventh Circuit limited its holding, observing that "the requirements of § 1129(b) in a cram down proceeding sufficiently present the absolute priority rule in the bankruptcy court as to preserve the issue for review and obviate the civil plain error rule in this narrow context." Although a creditor who fails to object at a confirmation hearing "may waive many arguments," the court wrote, "such a creditor should presume that the bankruptcy court will complete its statutorily mandated duties—and, relatedly, for the appellate courts to hear challenges when the court errs as a matter of law concerning the absolute priority rule."

In a concurring opinion, one judge specifically stated that he joined with his colleagues

> only because [the] decision to dispense with the contemporaneous objection rule in appeals from bankruptcy court . . . is strictly limited by the unique nature of the bankruptcy court's duty to inquire into and review the cram down provisions of a Chapter 11 plan for purposes of enforcing the absolute priority rule.

LOOKING FORWARD

Under *Lett* and a 1994 Ninth Circuit case, *In re Perez*, in which the court reached the same conclusion, a party in interest's failure to raise a specific objection based upon noncompliance with the absolute priority rule in connection with confirmation of a cram-down chapter 11 plan does not preclude appellate review of the confirmation order on that basis. Even so, stakeholders in other circuits would be well advised not to rely on *Lett* and *Perez* as a safety net—other appellate courts faced with a party's failure to interpose such an objection may not be so generous.

The Eleventh Circuit's conclusion that cram-down chapter 11 plan objections based upon the absolute priority rule should be singled out for special treatment is somewhat difficult to explain. Other confirmation requirements in section 1129, such as the proscription of "unfair discrimination" in section 1129(b)(1), the requirement in section 1129(a)(3) that the plan be "proposed in good faith and not by any means forbidden by law," and the "best interests of creditors" test set forth in section 1129(a)(7), are arguably as fundamentally important as the absolute priority rule. Moreover, the bankruptcy court also has a duty to determine that any cram-down chapter 11 plan complies with those requirements.

Finally, from a strategic perspective, it is significant that *Lett* identifies substantial consummation as a barrier to raising an objection on appeal. For this reason, plan proponents intent upon minimizing the possibility of a successful challenge to a confirmation order should consider structuring the plan so that substantial consummation occurs as soon as possible after entry of the confirmation order. This can be done by structuring the plan transactions such that many of them are completed on or shortly after the plan effective date and, in addition, by seeking a waiver (or at least a reduction) of the automatic 14-day stay imposed under Rule 3020(e) of the Federal Rules of Bankruptcy Procedure.

Alabama Dept. of Econ. & Comm. Affairs v. Lett (In re Lett), 632 F.3d 1216 (11th Cir. 2011).

Everett v. Perez (In re Perez), 30 F.3d 1209 (9th Cir. 1994).

SECTION 503(b) NOT EXCLUSIVE AUTHORITY FOR PAYMENT OF CREDITOR FEES AND EXPENSES IN CHAPTER 11

Nancy J. Lu

Section 503(b) of the Bankruptcy Code delineates categories of claims that are entitled to elevated priority as "administrative expenses." Under section 503(b)(3)(D), administrative expenses include "actual, necessary expenses" incurred by a creditor, indenture trustee, equity holder, or unofficial committee "in making a substantial contribution" in a chapter 11 case. In addition, section 503(b)(4) provides that administrative priority can be conferred by the court upon claims for "reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable" under section 503(b)(3).

These provisions codify long-standing practice and reflect the recognition that a creditor which incurs costs in acting for the benefit of the entire bankruptcy estate rather than its own parochial interests should be compensated by the estate for its trouble. However, because the estate (and thus effectively other creditors) are footing the bill, the standard applied in determining whether a creditor's expense qualifies is a rigorous one. Courts narrowly construe what constitutes a "substantial contribution" to a chapter 11 case, what kinds of qualifying creditor expenses are "necessary," and what qualifies as "reasonable" professional compensation.

Speculation has occasionally arisen concerning whether a creditor's reimbursement of such expenses from estate assets is authorized elsewhere in the Bankruptcy Code. One focus of inquiry is section 363(b) of the Bankruptcy Code. Under section 363(b), a debtor in possession may use, sell, or lease property of the estate outside the ordinary course of business upon a court finding that the requested use, sale, or lease of estate property represents an exercise of sound business judgment. Another is the court's general equitable powers in section 105(a). Section 105(a) authorizes the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code.

Certain other potential sources of authority for creditor expense reimbursement from estate assets—sections 1129(a)(4), 1123(b)(3), and 1123(b)(6)—were examined by the bankruptcy court overseeing the chapter 11 cases of Adelphia Communications Corp. and its affiliates. In *In re Adelphia Commc'ns Corp.*, the court ruled that professional fees and expenses incurred by a creditor may be paid by the estate if such costs are reasonable and expressly made payable as part of a chapter 11 plan, even if incurred solely to increase the creditor's personal recovery without benefit to the estate. The court also held, however, that that payment of fees is inappropriate where such fees were incurred to advance interests unrelated to claim recovery or for activities that were destructive to the estate.

ADELPHIA

Adelphia Communications Corp. ("Adelphia") was the fifth-largest operator of cable television systems in the U.S. prior to its chapter 11 filing in 2002 in New York. In 2005, Adelphia entered into an agreement to sell substantially all of its assets to Time Warner New York Cable LLC and Comcast Corporation for $12.5 billion in cash and certain other consideration. The agreement required that the sale be implemented through a chapter 11 plan by a specified date. Intercreditor disputes, however, stalled the plan-confirmation process and jeopardized the consummation of the sale. Consequently, Adelphia proposed to restructure the sale under section 363 and filed a "motion in aid of confirmation" to establish a framework to resolve intercreditor disputes.

After lengthy negotiations, creditors entered into a settlement agreement (the "Global Settlement Agreement") that was incorporated into a chapter 11 plan later confirmed by the bankruptcy court. Among other things, the Global Settlement Agreement provided that the estate would bear all reasonable fees and expenses incurred in connection with Adelphia's chapter 11 case (the "Fee Provision"), including fees incurred by the settling parties in connection with intercreditor litigation. Fourteen ad hoc committees and individual creditors sought reimbursement of their legal fees and professional expenses under the Fee Provision. The Office of the U.S. Trustee objected.

THE BANKRUPTCY COURT'S RULING

The court began with a textual analysis of whether the Bankruptcy Code permits enforcement of the Fee Provision. The court explained that, while sections 503(b)(3)(D) and 503(b)(4) expressly authorize reimbursement of nonfiduciary creditor or equity security holders' fees if certain requirements are met, the provisions do not explicitly provide that they are the exclusive means by which fees of this character may be reimbursed by a debtor's estate. The court found telling that the list of administrative expenses that may be paid under section 503(b) is preceded by the word "including," which the Bankruptcy Code defines as "not limiting" under section 102(3). As such, the court reasoned that it was free to examine whether other provisions of the Bankruptcy Code might authorize the Fee Provision.

The official creditors' committee argued that section 1129(a)(4) provides the necessary authorization. Section 1129(a)(4) provides that:

> Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

The court agreed to a point, finding that section 1129(a)(4) "contemplates" that there may be other payments reimbursable by the estate for "something," but that the " 'something' might or might not be for individual creditors' legal fees. . . . [a]nd if they were, they might or might not be for fees that would be capable of being requested, without any debtor assent, under section 503(b)." Otherwise, the court reasoned, there would be no need to state the "reasonableness" standard in both provisions. However, the court determined that section 1129(a)(4) "suggests, though it does not compel the conclusion, that there might be other payments by the debtor, 'for costs and expenses in or in connection with the case,' beyond those expressly permitted by section 503(b)."

Having determined that an award of fees and expenses in Adelphia's chapter 11 case might be appropriate, the court turned to sections 1123(b)(3) and 1123(b)(6) of the Bankruptcy Code. These sections provide, respectively, that a chapter 11 plan may provide for "the settlement or adjustment of any claim or interest belonging to the debtor or to the estate" and "include any other appropriate provision not inconsistent with the applicable provisions of" the Bankruptcy Code. In previously approving the Global Settlement Agreement (of which payment of the fees was an element) under Federal Rule of Bankruptcy Procedure 9019, the court expressly found that the settlement was one of those matters for which "a plan may . . . provide," under section 1123(b)(3). However, the court noted, it "did not then decide whether the payment of the Fees, since it was part of the settlement in the Plan, was likewise authorized under the settlement authority granted by section 1123(b)(3)." Acknowledging that "textual analysis would tend to suggest the possibility that it could be so authorized, under Code language that is fairly broad in that respect," the court concluded that it need not decide whether such payments could be authorized under section 1123(b)(3) (or Rule 9019) alone, "[i]n light of the remainder of its analysis."

Under the court's holding in *Adelphia*, creditor fees and expenses may be paid by the estate outside the confines of section 503(b) if the fee provision is an element of a confirmed chapter 11 plan, provided that such fees are reasonable, such that they relate to activities undertaken to maximize recovery on claims, rather than conduct that exceeds the bounds of normal negotiation and advocacy, or for activities that are abusive, irresponsible, or destructive to the estate.

The court then examined section 1123(b)(6), the "most potentially relevant provision of all." In this analysis, the court explained, it had to determine: (i) whether the Fee Provision was inconsistent with any applicable provisions of the Bankruptcy Code; and (ii) whether the provision was "appropriate." Having already concluded that section 503(b) is not the exclusive Bankruptcy Code provision for estate reimbursement of creditor fees, the court determined that the Fee Provision was inconsistent with neither section 503(b) nor any other provision of the Bankruptcy Code.

As to whether the Fee Provision was appropriate, the court noted that the word "appropriate" is ambiguous, not being defined in the Bankruptcy Code. Canvassing case law addressing permissible chapter 11 plan provisions in this context, the court observed that those decisions suggest that courts have rarely found plan provisions to be inappropriate within the meaning of section 1123(b)(6), except where the provision was inconsistent with the Bankruptcy Code, nonbankruptcy federal statutory law, or existing case law.

As a matter of public policy, the court noted that the wisdom of permitting reimbursement of nonfiduciary creditor fees under the circumstances is debatable. On the one hand, an estate's reimbursement of legal fees for intercreditor disputes might materially increase the cost of chapter 11 cases. This is particularly troubling, the court explained, in disputes involving distressed-debt investors that voluntarily participate in the chapter 11 process for profit. On the other hand, the ability to allocate value among creditors increases the ability of fiduciaries to settle controversies. Mindful of these opposing policy arguments, the court concluded that the Fee Provision was *not inappropriate* as a matter of public policy under section 1123(b)(6).

Finally, turning to whether the fees requested satisfied the reasonableness standard under section 1123(b)(6), the court held that fees incurred by a creditor solely to increase its recovery, in the absence of more, is not a sufficient basis for deeming a creditor's fees unreasonable. However, the court disallowed fees incurred by certain creditors whose behavior it deemed to be "outrageous" and beyond the bounds of ordinary negotiation and advocacy. As examples of "outrageous" conduct, the court cited moving to appoint a chapter 11 trustee, which would have effectively caused a default under Adelphia's debtor-in-possession financing facility and prevented consummation of the sale transaction; shorting certain bonds to cause a delay in the case; making inappropriate threats to Adelphia's board; and leaking information to the media to advance a bargaining position.

OUTLOOK

Under the court's holding in *Adelphia*, creditor fees and expenses may be paid by the estate outside the confines of section 503(b) if the fee provision is an element of a confirmed chapter 11 plan, provided that such fees are reasonable, such that they relate to activities undertaken to maximize recovery on claims, rather than conduct that exceeds the bounds of normal negotiation and advocacy, or for activities that are abusive, irresponsible, or destructive to the estate.

Fees and expenses incurred in connection with intercreditor disputes are often substantial in complex chapter 11 cases. As a consequence, plan provisions relating to the payment of such fees and expenses often are heavily negotiated by the creditor groups involved. *Adelphia* provides authority for the position that creditor groups can contract pursuant to a settlement or a chapter 11 plan for payment of such fees and expenses out of the debtor's estate without satisfying the "substantial contribution" requirement under section 503(b).

In re Adelphia Commc'ns Corp., 441 B.R. 6 (Bankr. S.D.N.Y. 2010).

U.S. v. Energy Resources Co., 495 U.S. 545 (1990).

In re Mercado, 124 B.R. 799 (Bankr. C.D. Cal. 1991).

In re Trans World Airlines, Inc., 185 B.R. 302, 313 (Bankr. E.D. Mo. 1995).

IN BRIEF: CMBS CERTIFICATE HOLDERS LACK STANDING IN CHAPTER 11

In a ruling that has been described as "very important" and the "first decision of its kind," bankruptcy judge Shelley C. Chapman of the U.S. Bankruptcy Court for the Southern District of New York held on April 1, 2011, in *In re Innkeepers USA Trust*, 2011 WL 1206173 (Bankr. S.D.N.Y. April 1, 2011), that a certificate holder with a beneficial interest in a securitized trust established by the chapter 11 debtors' prepetition lenders was not a "party in interest" and therefore lacked standing to object to bidding procedures proposed by the debtors for the sale of their assets outside the ordinary course of business.

Prior to filing for chapter 11 protection in July 2010 in New York, Innkeepers USA Trust ("Innkeepers"), a real estate investment trust and a leading owner of upscale and extended-stay hotel properties throughout the U.S., borrowed more than $800 million from certain lenders under a fixed-rate mortgage loan collateralized by 45 of Innkeepers' hotel properties.

The lenders transferred their interests in the notes evidencing the loan to trusts, each of which was organized as a real estate mortgage investment conduit (a "REMIC")—an investment vehicle that holds mortgage loans and residential and commercial mortgage-backed securities ("CMBS") in trust and issues securities to investors in the secondary mortgage market in the form of certificates representing beneficial interests in those trusts. Appaloosa Investment L.P. I and certain other investment funds (collectively, "Appaloosa"), held approximately $263 million in face amount of trust certificates.

REMICs are governed by pooling and servicing agreements that spell out in detail the duties of the servicers that are responsible for administering the loans and allocating cash flows to different classes of certificate holders. Typically, upon an event of default under a mortgage loan held by the REMIC, the servicing agreement provides that the loan shall be transferred to and administered by a "special servicer" appointed to represent the interests of the certificate holders with respect to that loan.

Midland Loan Services ("Midland") acted as special servicer for the trusts in *Innkeepers*. Under the trust servicing agreements, certificate holders agreed to allow Midland to administer and service the loans in the certificate holders' collective best interests, including, where appropriate, to exercise remedies on behalf of the certificate holders. The servicing agreements also contained a standard "no action" clause prohibiting a certificate holder from instituting any suit, action, or proceeding under the servicing agreement or relating to the loan unless: (i) a certificate holder gives the trustee written notice of a default under the servicing agreement; and (ii) certificate holders holding at least 25 percent of the voting rights make a written request to the trustee to act, and the trustee neglects to do so for at least 60 days.

In January 2011, Innkeepers filed a motion for authority to sell substantially all of its assets under section 363(b) of the Bankruptcy Code and sought court approval of bidding procedures. Appaloosa objected to the proposed bidding procedures, claiming, among other things, that they were "an impediment to competitive bidding" and "improperly mandate[d] terms of a plan of reorganization." Innkeepers and Midland responded by arguing that, in its capacity as holder of interests in the trusts, Appaloosa had no standing to appear and be heard with respect to the motion.

Judge Chapman ruled against Appaloosa, emphasizing that Appaloosa is merely an "investor in a creditor" and is bound by the terms of the "no action" clause in the servicing agreement. According to the judge, her ruling is "based entirely on controlling law as well as the applicable language of the [servicing agreement]" and "to hold otherwise would, in the view of the Court, potentially cause chaos in the already-tumultuous CMBS market." Judge Chapman flatly rejected Appaloosa's argument that "shutting [it] out of the Bankruptcy Case inevitably will result in litigation in other venues, which ultimately may impede the implementation of a confirmable plan." She also rejected Appaloosa's contention that Midland was "hopelessly and impermissibly conflicted" and engaging in "self-enriching" behavior. If Appaloosa believed that to be the case, the judge wrote, "Midland is surely acting at its peril and is answerable to Appaloosa if Appaloosa pursues an action for breach of the servicing standard."

Judge Chapman concluded that Appaloosa had no privity or other relationship with Innkeepers that would confer standing on Appaloosa to be heard. Rather, she noted, in a securitization, the investors' relationship is with the special purpose vehicle holding the assets, and the right to payment comes from cash generated by the assets, not from the debtor as the originator of the assets itself. Judge Chapman explained that this comports with the Second Circuit's holding in *In re Refco Inc.*, 505 F.3d 109 (2d Cir. 2007), that a "creditor of a creditor is not a 'party in interest' within the meaning of section 1109(b) of the Bankruptcy Code."

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.

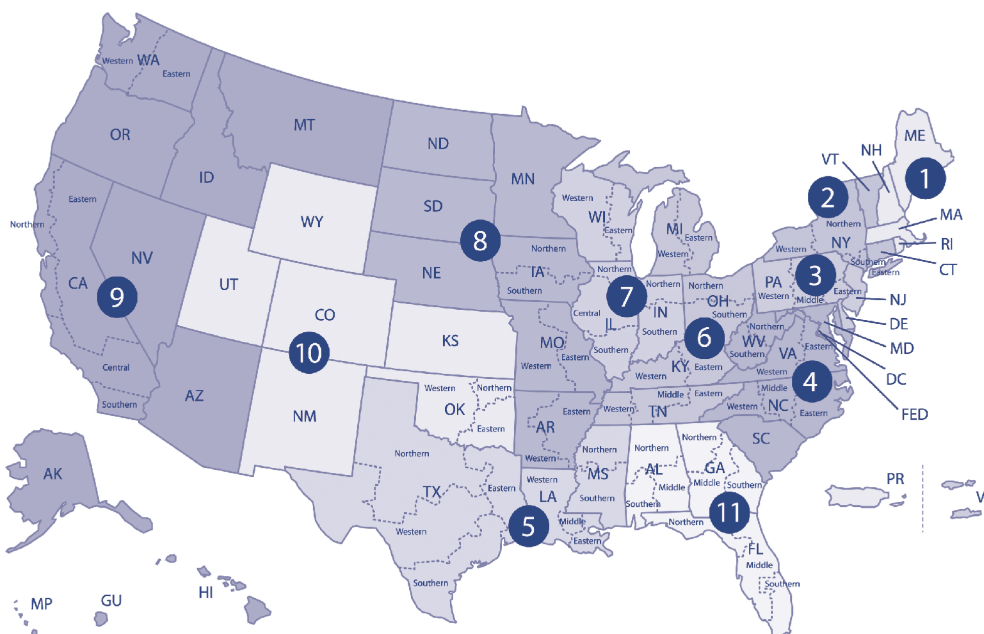
As stipulated by Article III of the Constitution, the Chief Justice and the eight associate Justices of the Supreme Court hear and decide cases involving important questions regarding the interpretation and fair application of the Constitution and federal law. A U.S. court of appeals sits in each of 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 United States. 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



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