JONES DAY

RECENT DEVELOPMENTS IN BANKRUPTCY AND RESTRUCTURING

VOLUME 11 ▪ NO. 2 ▪ MARCH/APRIL 2012

IN THIS ISSUE

1 10th Anniversary Edition

2 Chapter 9 Descends Into the Sewer to Clean Up

7 Equitable Mootness and Arbitration: First Impressions in the Ninth Circuit

12 The Rationale Against Substantive Consolidation of Nondebtor Entities: Florida on the Front Line

15 In Brief: Rising to the *Stern* Challenge

16 No Equitable Tolling of Section 548 "Look-Back" Period

18 European Perspective: The West Lothian Question in Voluntary Arrangements

21 Newsworthy

22 Largest Public-Company Bankruptcy Filings Since 1980

23 The U.S. Federal Judiciary

10th ANNIVERSARY EDITION

Paul D. Leake, Practice Leader, Business Restructuring & Reorganization

Welcome to the 10th Anniversary Edition of the *Business Restructuring Review*. We launched this publication in April 2002 with an enduring commitment to keeping our readers apprised of important worldwide developments in corporate bankruptcy and related fields. Although much has changed in these areas during a decade fraught with financial, economic, political, and social volatility, our dedication to providing incisive, informative, and timely analysis of ongoing developments has not. We look forward to continuing to do so.

BUSINESS RESTRUCTURING REVIEW

10TH ANNIVERSARY

2002 — 2012

CHAPTER 9 DESCENDS INTO THE SEWER TO CLEAN UP

Joseph M. Witalec and Mark G. Douglas

One option available to many cities, towns, and other municipalities in the United States that are teetering on the brink of financial ruin in the aftermath of the Great Recession is chapter 9 of the Bankruptcy Code, a once obscure legal framework that allows an eligible municipality to "adjust" its debts by means of a "plan of adjustment" that is in many respects similar to the plan of reorganization a debtor can devise in a chapter 11 case. However, due to constitutional concerns rooted in the Tenth Amendment's preservation of each state's individual sovereignty over its internal affairs, the resemblance between chapter 9 and chapter 11 is limited.

The contrasts between chapter 9 and other chapters of the Bankruptcy Code were highlighted in a ruling recently handed down by the Alabama bankruptcy court presiding over the largest municipal bankruptcy in U.S. history. In *In re Jefferson County, Alabama*, 2012 WL 32921 (Bankr. N.D. Ala. Jan. 6, 2012), the court denied a state-court-appointed receiver's request to retain control of the debtor's sewer system, holding that the bankruptcy court had exclusive jurisdiction over the property and that the automatic stays imposed by sections 362 and 922 of the Bankruptcy Code precluded continuation of the receiver's stewardship. The bankruptcy court also refused to abstain from hearing the bankruptcy case or to modify the automatic stays. However, the court ruled that the stays did not preclude the continuation of payments to warrant holders from the sewer system's pledged revenue stream, net of any necessary operating costs.

MUNICIPAL BANKRUPTCY LAW

Ushered in during the Great Depression to fill a vacuum that previously existed in both federal and state law, federal municipal bankruptcy law suffered from a constitutional flaw that endures in certain respects to this day—the Tenth Amendment reserves to the states sovereignty over their internal affairs. This reservation of rights caused the U.S. Supreme Court to strike down the first federal municipal bankruptcy law as unconstitutional in 1936, and it accounts for the limited scope of chapter 9, as well as the severely restricted role the bankruptcy court plays in presiding over a chapter 9 case and in overseeing the affairs of a municipal debtor.

The present-day legislative scheme for municipal debt reorganizations was implemented in the aftermath of New York City's financial crisis and bailout by the New York State government in 1975, but chapter 9 has proved to be of limited utility thus far. Few cities or counties have filed for chapter 9 protection. The vast majority of chapter 9 filings have involved municipal instrumentalities, such as irrigation districts, public-utility districts, waste-removal districts, and health-care or hospital districts. In fact, according to the Administrative Office of the U.S. Courts, fewer than 650 municipal bankruptcy petitions have been filed in the more than 70 years since Congress established a federal mechanism for the resolution of municipal debts. Fewer than 300 chapter 9 cases have been filed since the current version of the Bankruptcy Code was enacted in 1978—although the volume of chapter 9 cases has increased somewhat in recent years. By contrast, there were 11,400 chapter 11 cases filed in 2011 alone.

CONSTITUTIONAL COMPROMISES

In an effort to mollify constitutional concerns associated with subjecting a state instrumentality to the jurisdiction and control of a federal court, section 903 of the Bankruptcy Code expressly reserves to the states the power to control municipalities that file for chapter 9 protection, with the caveat—and the significant limitation—that any state law (or judgment entered thereunder) prescribing a method of composition of indebtedness among a municipality's creditors is not binding on dissenters. In addition, section 904 provides that, unless the debtor consents or its plan of adjustment so provides, a federal bankruptcy court may not "interfere" with any of the debtor's "political or governmental powers," any of the debtor's property or revenues, or the debtor's use or enjoyment of its income-producing property. Thus, unlike a chapter 11 debtor, a municipal debtor is not restricted in its ability to use, sell, or lease its property (section 363 does not apply in a chapter 9 case), and the court may not become involved in the debtor's day-to-day operations. Also, unlike in a case under chapter 7, 11, 12, or 13 of the Bankruptcy Code, a municipal debtor's assets do not become part of a bankruptcy

estate upon the filing of a chapter 9 petition. Accordingly, section 902(1) of the Bankruptcy Code provides that " 'property of the estate', when used in a section that is made applicable in a case under [chapter 9] by section 103(e) or 901 of [the Bankruptcy Code], means property of the debtor."

Control of a municipal debtor under chapter 9 is not subject to defeasance in the form of a bankruptcy trustee (although state laws commonly provide a mechanism for transferring control of the affairs of a distressed municipality to an emergency manager or similar entity). A trustee, however, may be appointed to pursue avoidance actions (other than preferential transfers to or for the benefit of bondholders) on behalf of the estate if the debtor refuses to do so. A municipal debtor generally is not subject to the reporting requirements and other duties of a chapter 11 debtor.

The fireworks in the County's chapter 9 case are far from over. This is not surprising, given the large amount of money at stake, the provenance of the County's financial problems, and the precedential ramifications of the court's rulings.

A chapter 9 debtor enjoys many of the rights of a chapter 11 debtor in possession but is subject to fewer of the obligations. Pursuant to sections 103(f) and 901(a), many provisions elsewhere in the Bankruptcy Code are expressly made applicable to chapter 9 cases. These include, among others, provisions regarding the automatic stay (with certain exceptions); adequate protection; postpetition financing; executory contracts; administrative expenses; a bankruptcy trustee's "strong arm" and avoidance powers; financial contracts; the formation of official committees; and most, but not all, of the provisions governing vote solicitation, disclosure, and confirmation of a chapter 11 plan. The incorporated provisions do not include, among others, sections 542 and 543, which mandate turnover to the estate of any of the debtor's property held by third parties and custodians (respectively) on the bankruptcy petition date.

Chapter 9 also includes a separate automatic stay in section 922 of the Bankruptcy Code. Section 922(a) provides that, "in addition to the stay provided by section 362," the filing of a chapter 9 petition operates as a stay of:

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against an officer or inhabitant of the debtor that seeks to enforce a claim against the debtor; and

(2) the enforcement of a lien on or arising out of taxes or assessments owed to the debtor.

Section 922(b) provides that subsections (c), (d), (e), (f), and (g) of section 362 of the Bankruptcy Code "apply to a stay under subsection (a) of this section the same as such subsections apply to a stay under section 362(a)." This means, among other things, that section 362(b)'s exclusions of certain designated acts from the scope of the automatic stay, including (pursuant to section 362(b)(4)) actions by a "governmental unit" to enforce its "police and regulatory powers," do not apply to a stay under section 922(a).

However, section 922(d) excludes certain acts from the scope of the stay under section 922(a) by providing that "[n]otwithstanding section 362 of this title and subsection (a) of this section, a petition filed under this chapter does not operate as a stay of application of pledged special revenues in a manner consistent with section 927 of this title to payment of indebtedness secured by such revenues."

Jefferson County

Perched in the foothills of the Appalachian Mountains, Jefferson County, Alabama (the "County"), is home to 660,000 residents and the state's largest city (Birmingham). Between 1997 and 2003, the County issued nearly $3.7 billion in "special revenue" warrants to finance the construction and repair of a sewer system. The warrants are backed by sewer-system revenues, but the obligations are not otherwise secured by the underlying sewer-infrastructure assets. The County chose this form of financing because in Alabama (and many other states), special-revenue warrants, unlike bonds, do not require voter approval. In addition, such warrants are not commonly tallied in computing debt limits imposed by states on municipalities, and like many

other states, Alabama does not generally allow a municipality to pledge its property to secure debt.

Owing to a combination of mismanagement, fraud, corruption, and market failures (including a failed combination of swap and interest-rate stabilization agreements), the County defaulted on the warrants and the governing indenture in February 2008. In September 2008, the indenture trustee (the "Indenture Trustee") and certain other parties sued the County and its commissioners in an Alabama federal district court seeking, among other things, the appointment of a receiver to take over the sewer system. The district court ruled in June 2009 that there was sufficient cause to appoint a receiver, but it abstained from doing so because the Johnson Act, 28 U.S.C. § 1342, provides that, under certain circumstances, a federal court shall not "enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public utility and made by a State administrative agency or a rate-making body of a State political subdivision."

The most compelling takeaway from *Jefferson County* is arguably the ruling's reaffirmation of the hegemony (albeit temporary and limited) of federal bankruptcy courts over the assets of a chapter 9 debtor—once a chapter 9 petition is filed, the bankruptcy court has exclusive jurisdiction over all of a municipal debtor's property, wherever located (and by whomever held).

In August 2009, the Indenture Trustee asked an Alabama state court to appoint a receiver for the sewer system. The state court granted partial summary judgment in favor of the trustee in September 2010, appointing John S. Young, Jr., LLC, as receiver (the "Receiver") for the sewer system and entering a judgment against the County for more than $500 million, to be paid solely from revenues identified in the indenture. Among other things, the state court's order provides that the Receiver is forbidden, without some future "express order of [the Alabama court,] to sell or otherwise dispose" of the sewer system or any part of it. It also does not alter the ownership and title to the sewer-system properties. Finally, the order specifies that "the Receiver and the Receiver Affiliates are not and shall not be considered public officials or public employees for any purpose."

After taking over the sewer system, the Receiver: (i) began to develop a plan for rate increases and increased efficiencies designed to make the County's obligations under the indenture sustainable; and (ii) facilitated negotiations among the County, the Indenture Trustee, and other stakeholders that ultimately resulted in a settlement in principle. On September 16, 2011, County commissioners voted to accept a restructuring agreement that, with the approval of the state legislature (among others), would have allowed the County to shed about $1 billion in debt and lower the interest rate on roughly $2 billion of new, 40-year debt that would have been issued to replace the existing debt.

The settlement was never finalized. Instead, the County filed a petition for relief under chapter 9 on November 9, 2011, in the Alabama bankruptcy court. The County's chapter 9 case involves more than $4 billion in debt, dwarfing the $1.7 billion bankruptcy of Orange County, California, in 1994, which had been the largest municipal bankruptcy case on record. More than three-quarters of the County's total debt has arisen in connection with the sewer system.

Immediately after the chapter 9 filing, the Indenture Trustee, the Receiver, and various other parties filed an emergency motion seeking an order of the bankruptcy court: (i) abstaining from taking any action to interfere with the Alabama state-court receivership case for the sewer system; (ii) determining that the automatic stays imposed by sections 362 and 922 do not apply to the receivership case or the Receiver; (iii) directing that the Receiver is entitled to continue in that capacity; and (iv) if the court were to determine that the automatic stays apply, modifying the stays to allow for continuation of the receivership case.

THE BANKRUPTCY COURT'S RULINGS

Whose Property Is It Anyway?

At the outset, the court examined the competing property interests asserted by the Receiver and the County in the sewer system and its revenue stream. The court concluded that, under applicable law (here, Alabama state law),

a receiver has no interest in property under its supervision other than control and possession on behalf of the appointing court. Nor, the court explained, does the appointing court have any interest in the property other than holding such property *in custodia legis*. According to the court, these limitations were very clearly spelled out in the receivership order, which was nothing more than "an order giving a private creditor a contracted for and statutory remedy to enforce portions of the indentures and warrants designed to protect interests of the warrant holders."

Because legal title and ownership of the sewer system resided with the County, the bankruptcy court concluded that, upon the filing of the County's chapter 9 petition, 28 U.S.C. § 1334(e)(1) gave it exclusive jurisdiction "of all of the property, wherever located, of the debtor," thereby divesting the state court of jurisdiction over the sewer system. Moreover, the court emphasized, the automatic stays in sections 362 and 922 of the Bankruptcy Code thereafter precluded any actions by the Receiver or the Indenture Trustee impacting the County's rights in the sewer system.

The court rejected the Receiver's argument that the omission of turnover under section 543 from the list of provisions applicable in chapter 9 exempts the receivership case from the scope of the stays. According to the court, "Since no creditor had possession of any of the County's property comprising the sewer system, this makes the state court's possession of it via the Receiver not the equivalent of a creditor possessing property of a debtor." In other words, the court explained, the County had "no need of [section 543]." Moreover, the court emphasized, the absence of sections 542 and 543 from chapter 9 does not in any way impact the *in rem* jurisdiction of a bankruptcy court over a chapter 9 debtor's property, nor does it somehow make the stays of sections 362 and 922 inapplicable to creditor actions affecting that property.

No Police-Power Exception

The court also ruled that the Receiver and the Indenture Trustee could not rely on the "police and regulatory powers" exception to the automatic stay set forth in section 362(b)(4) of the Bankruptcy Code. As described above, by operation of section 922(b), that exception does not apply with respect to the stay automatically arising under section 922(a). Furthermore, the court explained, neither the Indenture Trustee nor the Receiver is a "governmental unit" within the meaning of the provision, and the Indenture Trustee's actions, including its request for the appointment of a receiver, "are those of a private party, not Alabama, seeking to enforce a contract."

Special Revenues Protected

The court then assessed the effect of section 922(d), which, as noted, exempts from the automatic stays the application of "pledged special revenues" to a debt secured by such revenues. The County contended that the term "pledged" in this context refers only to "special revenues" (defined in section 902(2)) that are actually in the possession of the Indenture Trustee on the bankruptcy petition date, as distinguished from postpetition revenues.

The court carefully examined the meaning of "pledge" in both common and legal usage, as well as the legislative history underpinning section 922(d). It concluded that the provision refers to pledged funds in the possession of a creditor on the petition date as well as the future revenue stream. According to the court, excerpts from the legislative history of amendments to the Bankruptcy Code in 1988 (which, among other things, added subsection (d) to section 922), indicate that sections 922(d) and 928 (regarding the postpetition effect of a security interest) were intended to preserve creditors' liens on municipal special revenues that might otherwise be avoided by operation of section 552(a). However, the court acknowledged that, pursuant to section 928(b), liens on special revenues are subject to the "necessary operating expenses" of the assets from which they are derived. The court left for another day the determination of the amount of necessary operating expenses that could be used from the pledged revenues to run the sewer system, and the parties are currently litigating that issue in front of the court.

Abstention/Stay Relief Unwarranted

Finally, the court ruled that no basis existed for it either: (i) to abstain from presiding over either the County's chapter 9 case under section 305, which does not apply in chapter 9, or any particular controversy arising in connection with the case, pursuant to the mandatory or discretionary abstention provisions set forth in 28 U.S.C. § 1334(c); or (ii) to modify the automatic stays under section 362(a) or 922(a). Among other things, the court found that such relief was unwarranted,

given the fact that a new set of county commissioners had been elected who were not involved in the mismanagement, fraud, and corruption alleged to have plagued the sewer system and to have precipitated the financial crisis that propelled the County into bankruptcy. However, the bankruptcy court did not foreclose the possibility that it might grant such relief in the future under appropriate circumstances.

OUTLOOK

Jefferson County is an important ruling. For participants in municipal special-revenue financing transactions, the decision is significant because it confirms their right to an uninterrupted flow of pledged revenues after a municipal bankruptcy filing, subject to charges for necessary operating expenses. The most compelling takeaway from *Jefferson County*, however, is arguably the ruling's reaffirmation of the hegemony (albeit temporary and limited) of federal bankruptcy courts over the assets of a chapter 9 debtor—once a chapter 9 petition is filed, the bankruptcy court has exclusive jurisdiction over all of a municipal debtor's property, wherever located (and by whomever held). That jurisdiction supplants any jurisdiction previously asserted by other courts and (unless specified otherwise in the Bankruptcy Code) precludes creditors from acting against the debtor or its property.

Jefferson County also illustrates some important distinctions between chapter 9 and other chapters of the Bankruptcy Code premised upon the differences between municipal debtors and other kinds of debtors. For example, the court's denial of the bid by the Receiver and the Indenture Trustee to retain control of the sewer system reaffirms the mandate underpinning chapter 9 that a municipal debtor have exclusive control of its assets during the bankruptcy case (as provided in section 904). In addition, the ruling shines a spotlight on the supplemental stay in section 922—relief that is not automatically available in other bankruptcy cases (although it could conceivably be granted under certain circumstances in the court's discretion).

Another noteworthy difference between chapter 9 and other chapters of the Bankruptcy Code cases highlighted in *Jefferson County* is (as noted previously) the absence of a bankruptcy estate in chapter 9. The court was very careful to characterize the sewer-system assets as property of the debtor, rather than its bankruptcy estate. This distinction is also rooted in the constitutional compromises embodied in chapter 9. If a bankruptcy estate were established in chapter 9, the court and other stakeholders would, by virtue of various provisions in the Bankruptcy Code, be in a position to exert constitutionally impermissible control over a municipal debtor's assets.

The fireworks in the County's chapter 9 case are far from over. This is not surprising, given the large amount of money at stake, the provenance of the County's financial problems, and the precedential ramifications of the court's rulings. On February 29, 2012, the bankruptcy court certified a direct appeal of the ruling in *Jefferson County* to the Eleventh Circuit Court of Appeals, concluding, among other things, that the decision "involves a matter of public importance" with respect to which there is no controlling Eleventh Circuit precedent. On March 4, 2012, despite objections by the Indenture Trustee and certain other creditors, the bankruptcy court ruled that the County is eligible to be a chapter 9 debtor under Alabama's limited chapter 9 authorization statute. Among other things, the court determined that the sewer-system warrants issued by the County qualified as "debt" for purposes of chapter 9. Bank creditors have also asked the bankruptcy court to certify a direct appeal of this ruling to the Eleventh Circuit. In addition, the bankruptcy court has scheduled a hearing in April to determine the appropriate amount of "necessary operating expenses" that the County can deduct from the sewer system's special-revenue stream that is payable to the holders of the County's warrants. Stay tuned for further developments.

A version of this article was published in the March 7, 2012, edition of Bankruptcy Law360*. It has been reprinted here with permission.*

EQUITABLE MOOTNESS AND ARBITRATION: FIRST IMPRESSIONS IN THE NINTH CIRCUIT

Paul D. Leake, Peter J. Benvenutti, and Mark G. Douglas

2012 is shaping up as a year of bankruptcy first impressions for the Ninth Circuit. The court of appeals sailed into uncharted bankruptcy waters twice already this year in the same chapter 11 case. On January 24, the court ruled in *In re Thorpe Insulation Co.*, 2012 WL 178998 (9th Cir. Jan. 24, 2012) ("*Thorpe I*"), that an appeal by certain nonsettling asbestos insurers of an order confirming a chapter 11 plan was not equitably moot because, among other things, the plan had not been "substantially consummated" under the court's novel construction of that statutory term. Less than a week later, the Ninth Circuit ruled in *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.*, 2012 WL 255231 (9th Cir. Jan. 30, 2012) ("*Thorpe II*"), that a bankruptcy court has discretion in a core proceeding to decline to enforce an otherwise valid and applicable arbitration provision if arbitration would conflict with the underlying purposes of the Bankruptcy Code.

MOOTNESS

"Mootness" is a doctrine that precludes a reviewing court from reaching the underlying merits of a controversy. In federal courts, an appeal can be either constitutionally or equitably moot. Constitutional mootness is derived from Article III of the U.S. Constitution, which limits the jurisdiction of federal courts to actual cases or controversies and, in furtherance of the goal of conserving judicial resources, precludes adjudication of cases that are hypothetical or merely advisory. In contrast, "equitable mootness" bars adjudication of an appeal when a comprehensive change of circumstances occurs such that it would be inequitable for a reviewing court to address the merits of the appeal.

In bankruptcy cases, equitable mootness is often invoked in an effort to preclude appellate review of an order confirming a chapter 11 plan. Protecting legitimate expectations of innocent stakeholders and the difficulty of "unscrambling the eggs" are issues that a court considers when confronted with any challenge to a plan-confirmation order, whether such challenge involves a request to revoke the order outright under Bankruptcy Code § 1144 (providing for revocation of a confirmation order within 180 days of entry upon a showing of procurement by fraud) or some form of collateral attack. Courts sometimes reject the challenge (if in the form of an appeal of the confirmation order) as equitably moot because it is simply too late or too difficult to undo transactions consummated under the plan.

A court will dismiss an appeal from a confirmation order as equitably moot if effective relief, even if arguably possible, would be inequitable under the circumstances, given the difficulty of restoring the *status quo ante* and the impact on all parties involved. The threshold inquiry in applying the equitable mootness doctrine is ordinarily whether a chapter 11 plan has been "substantially consummated." Section 1101(2) of the Bankruptcy Code provides that substantial consummation occurs when substantially all property transfers proposed by the plan have been completed, the reorganized debtor or its successor has assumed control of the debtor's business and property, and plan distributions have commenced.

Several circuit courts of appeal have formally adopted the doctrine of equitable mootness in considering whether to hear appeals of plan-confirmation orders. For example, in *Search Market Direct, Inc. v. Jubber (In re Paige)*, 584 F.3d 1327 (10th Cir. 2009), the Tenth Circuit considered six factors in determining whether the doctrine should moot appellate review of a confirmation order: (1) whether the appellant sought and/or obtained a stay pending appeal; (2) whether the plan has been substantially consummated; (3) whether the rights of innocent third parties would be adversely affected by reversal of the confirmation order; (4) whether the public-policy need for reliance on the confirmed bankruptcy plan—and the need for creditors generally to be able to rely on bankruptcy-court decisions—would be undermined by reversal of the confirmation order; (5) the likely impact upon a successful reorganization of the debtor if the appellant's challenge is successful; and (6) whether, on the basis of a brief examination of the merits of the appeal, the appellant's challenge is legally meritorious or equitably compelling. Substantially similar tests have been adopted by the Second, Third, and Fifth Circuits. *See In re Chateaugay Corp.*, 10 F.3d 944 (2d Cir. 1993); *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180 (3d Cir. 2001); *TNB Fin., Inc. v. James F. Parker Interests (In re Grimland, Inc.)*, 243 F.3d 228 (5th Cir. 2001). As discussed herein, the Ninth Circuit joined this group with its ruling in *Thorpe I*.

ARBITRATION OF DISPUTES IN BANKRUPTCY

Whether a contractual arbitration clause will be enforced by the bankruptcy courts in accordance with the Federal Arbitration Act (the "FAA") has been the focus of debate in bankruptcy and appellate courts for decades. The FAA provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

In *Shearson/Am. Exp. Inc. v. McMahon*, 482 U.S. 220 (1987), the U.S. Supreme Court ruled that the FAA's mandate may be overridden if a party opposing arbitration can demonstrate that "Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." According to the Court, such congressional intent can be discerned in one of three ways: (i) the text of the statute; (ii) the statute's legislative history; or (iii) "an inherent conflict between arbitration and the statute's underlying purposes."

Guided by this mandate, in the past, the consensus among most courts addressing the issue had been that a bankruptcy court can adjudicate a dispute otherwise subject to binding arbitration if the dispute falls within the court's "core" jurisdiction, but in all other cases it must defer to arbitration. However, the approach adopted by most circuit courts that have considered the issue is more nuanced. Rulings from the Second, Third, Fourth, Fifth, and Eleventh Circuits stand for the proposition that arbitration is the favored means of resolving disputes—even some that fall within the bankruptcy court's core jurisdiction. In these circuits, the focus of the inquiry has shifted from an analysis of core versus noncore to determining: (i) whether a dispute is core; and (ii) if so, whether referral of the dispute to arbitration would conflict with the underlying purposes of the Bankruptcy Code. *See Whiting-Turner Contracting Co. v. Elec. Mach. Enters., Inc. (In re Elec. Mach. Enters., Inc.)*, 479 F.3d 791 (11th Cir. 2007); *MBNA America Bank, N.A. v. Hill*, 436 F.3d 104 (2d Cir. 2006); *Mintze v. American General Financial Services, Inc. (In re Mintze)*, 434 F.3d 222 (3d Cir. 2006); *Phillips v. Congelton, L.L.C. (In re White Mountain Mining Co.)*, 403 F.3d 164 (4th Cir. 2005); *Ins. Co. of N. Am. v. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.)*, 118 F.3d 1056 (5th Cir. 1997).

A matter falls within a bankruptcy court's "core" jurisdiction if it either invokes a substantive right created by federal bankruptcy law or could not exist outside a bankruptcy case. In contrast, "noncore" matters generally involve disputes that have only a tenuous relationship to a bankruptcy case and would in all likelihood have been litigated elsewhere but for the debtor's bankruptcy filing. If a dispute is core, a bankruptcy court can adjudicate it, subject to appeal (although the Supreme Court's recent ruling in *Stern v. Marshall*, 132 S. Ct. 56 (2011), means that certain kinds of core proceedings identified in 28 U.S.C. § 157(b)(2) cannot, as a matter of constitutional law, be adjudicated finally by a bankruptcy court). The court may also hear certain noncore disputes, provided they are "related" to the bankruptcy case, but must submit proposed findings of fact and conclusions of law to the district court for approval, unless the litigants agree otherwise.

In *Thorpe II*, the Ninth Circuit joined its sister circuits in holding that even core proceedings must be referred to arbitration unless referral of the dispute would inherently conflict with the underlying purposes of the Bankruptcy Code.

THORPE INSULATION

Thorpe Insulation Company is a California company that distributed, installed, and repaired asbestos insulation products between 1948 and 1972. Since the late 1970s, the company and its affiliates (collectively, "Thorpe") have faced approximately 12,000 claims and lawsuits for personal injury or wrongful death based on asbestos exposure. Over the years, Thorpe purchased insurance policies with many different companies covering claims for injuries caused by asbestos exposure. Beginning in 1978, Thorpe's insurers handled the defense of the asbestos suits and paid more than $180 million defending and indemnifying Thorpe, after which the insurers took the position that the policies' aggregate coverage limits were exhausted.

In 1985, Thorpe and one of its insurers, Continental Insurance Company ("Continental"), entered into a "Wellington Agreement," a comprehensive coverage and claims-handling agreement between a number of asbestos producers and their insurers. The Wellington Agreement provided for arbitration of any coverage dispute, an eventuality that was realized after Continental notified Thorpe in 1998 that its policy coverage was exhausted. An arbitrator ruled in Continental's favor, and the parties entered into a settlement agreement in

April 2003 (the "Settlement Agreement"). In that agreement, Thorpe warranted that: (i) it would not assign any cause of action connected with the coverage dispute or any claim under the insurance policies, which were the subject of releases elsewhere in the agreement; and (ii) it would "not in any way voluntarily assist any other person or entity in the establishment of any claim . . . against [Continental] . . . arising out of . . . the matters released." Notably, the Settlement Agreement also provided that disputes under it were subject to arbitration.

As asbestos claims and litigation multiplied, Thorpe began negotiating, and ultimately reached settlements, with several insurance companies (other than Continental) with a view toward using a bankruptcy filing as a way to manage its mounting liabilities. As part of those settlements, the insurers agreed to assign their contribution, indemnity, and subrogation rights against Thorpe's other insurers (including Continental) to an asbestos trust to be established after Thorpe filed for bankruptcy. Thorpe also began collaborating with asbestos claimants to begin structuring an asbestos trust to be established in Thorpe's contemplated bankruptcy.

Continental claimed that Thorpe's activities breached certain warranties in the Settlement Agreement. It accordingly demanded that the dispute be submitted to an arbitrator, who scheduled a hearing for October 16, 2007.

Thorpe filed for chapter 11 protection on October 15, 2007, in California. At the time of the bankruptcy filing, Thorpe estimated that 2,000 asbestos cases were pending against it and that many more were likely to be filed in the future. In May 2008, Thorpe, its official creditors' committee, and the appointed legal representative for holders of future asbestos-related claims jointly proposed a chapter 11 plan contemplating: (i) the creation of a trust under section 524(g) of the Bankruptcy Code to handle asbestos claims; (ii) settlements with various insurance companies providing for more than $600 million in cash and securities to fund the trust; (iii) assignment by Thorpe of its rights in asbestos insurance policies to the trust; and (iv) the issuance of channeling injunctions barring the assertion of any asbestos-related claims (including indemnity claims) against various protected parties, including settling insurers.

The plan also stated that it was "asbestos neutral" because it preserved all "asbestos insurance defenses." However, certain defenses, including the right to object to Thorpe's assignment of its insurance-policy rights, were expressly precluded by the plan. Finally, the plan allowed asbestos claimants to assert their claims against either the trust or, with the trustees' permission, non-settling insurers ("NSIs").

Continental filed a proof of claim in Thorpe's bankruptcy case for damages arising from breach of the Settlement Agreement. It also moved to compel arbitration. The bankruptcy court denied the motion to compel in October 2008 and disallowed Continental's claim. The court determined that the allowance or disallowance of the claim was within its core jurisdiction pursuant to 28 U.S.C. § 157(b)(2). Acknowledging the "strong federal policy in favor of . . . arbitration," the court explained that, in core matters, it had "discretion in an appropriate case not to send it to arbitration." In the case before it, the court wrote that "the arguments that [Continental] wish[es] to advance are inextricably intertwined with the issues that the Court will have to address in connection with confirmation of [a chapter 11 plan]."

Continental appealed to the district court, which affirmed denial of the motion to compel arbitration, ruling that the bankruptcy court's findings "support the conclusion that arbitration of the claims would conflict with the underlying purposes of the Bankruptcy Code." However, the district court remanded the order denying Continental's claim to the bankruptcy court for additional findings. On remand, Continental refused to argue the issues and renewed its motion to compel arbitration, which the bankruptcy court denied and the district court affirmed on appeal. Continental appealed to the Ninth Circuit.

The bankruptcy court confirmed Thorpe's chapter 11 plan in February 2010. In doing so, the court held that, because the plan was insurance neutral, the NSIs lacked standing to object to many aspects of it. The court also ruled that the plan preempted the NSIs' state-law contract rights prohibiting assignment of Thorpe's rights under the insurance policies to the asbestos trust. Certain NSIs (including Continental) appealed the confirmation order, which was affirmed by the district court, with minor modifications, in September 2010. The plan became effective on October 22, 2010, after the Ninth Circuit denied the NSIs' emergency motion for a stay

pending appeal but granted an expedited hearing on the merits. Thorpe immediately began implementing the chapter 11 plan, and the trust commenced processing claims and making distributions. In February 2011, Thorpe asked the Ninth Circuit to dismiss the appeal on the basis of mootness.

THE NINTH CIRCUIT'S RULINGS

Equitable Mootness

The Ninth Circuit reversed the lower courts' rulings on equitable mootness and standing but affirmed the preemption rulings with respect to assignment of insurance rights. According to the Ninth Circuit: (i) the NSIs had standing to object to the plan and appeal the confirmation order because the plan had "the potential substantially to impact [the NSIs] economically" and was not insurance neutral, thereby providing the NSIs with party-in-interest, or "bankruptcy," standing under section 1109(b) of the Bankruptcy Code; and (ii) the NSIs had both "constitutional" standing under Article III of the U.S. Constitution and "zone of interests," or "prudential," standing because: (a) the plan affected the NSIs' contractual rights, financial interests, and (potentially) litigation rights; and (b) as Thorpe's insurers, the NSIs were within the "zone of interests" protected by section 1109(b).

Acknowledging that "[w]e have not yet expressly articulated a comprehensive test" for equitable mootness, the Ninth Circuit "endorse[d] a test similar to those framed" by sister circuits that have adopted a mootness standard:

> We will look first at whether a stay was sought, for absent that a party has not fully pursued its rights. If a stay was sought and not gained, we then will look to whether substantial consummation of the plan has occurred. Next, we will look to the effect a remedy may have on third parties not before the court. Finally, we will look at whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court.

Applying that standard, the court ruled that the NSIs' appeal of the plan-confirmation order was not equitably moot. First, the Ninth Circuit noted, this was not a case where the NSIs sat on their rights—they sought (and were refused) stays by the bankruptcy and district courts, the Ninth Circuit, and circuit justice Anthony Kennedy. Second, the court concluded that Thorpe's plan had not yet been substantially consummated because only $135 million (of $600 million) in settlement proceeds had been transferred by settling insurers to the trust. Third, the Ninth Circuit concluded that modification of the plan would not "bear unduly on the innocent." It rejected the plan proponents' argument that "any changes made to the plan would be inequitable because asbestos claimants voted on the plan relying on the transactions it created, and any change would unfairly affect the bargain they received." The question, the court explained, is not whether it is possible to alter a plan so that no third-party interests are affected, "but whether it is possible to do so in a way that does not affect third party interests to such an extent that the change is inequitable." According to the Ninth Circuit, the plan expressly contemplates that it may be modified after confirmation with the consent of the trust advisory committee and the representative of future asbestos claimants, who, together with the bankruptcy court, can ensure that any changes to the plan after remand are made in a way that is equitable to the stakeholders concerned.

Finally, and "most importantly," the Ninth Circuit determined that the bankruptcy court on remand could devise an equitable remedy short of totally upsetting the plan or "tip[ping] over the § 524(g) apple cart." This could entail requiring the plan proponents to contribute more to the trust, amending the plan to clarify that the trust-distribution procedures are not binding on direct suits against the NSIs, modification of the trust-distribution procedures, or directing that the trust be placed under new governance if the bankruptcy court credited the NSIs' contentions that the trust administrators were biased.

Preemption

The Ninth Circuit agreed with the lower courts that Congress expressly preempted, in section 541(c) of the Bankruptcy Code, the NSIs' contractual prohibition on assignment of their insurance policies to the trust. That section provides that "an interest of the debtor in property becomes property of the estate . . . notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law . . . that restricts or conditions transfer of such interest by the debtor."

Significantly, the court distinguished its earlier decision in *PG&E Co., v. Cal. ex rel. Cal. Dep't of Toxic Substances Control*, 350 F.3d 932, 937 (9th Cir. 2003), which the NSIs argued held that a plan could expressly preempt nonbankruptcy law only insofar as it "relates to financial condition." The court construed *PG&E* as relying only on Bankruptcy Code §§ 1123(a) and 1142(a)—which provide general rules and requirements for chapter 11 plans—as opposed to the specific prohibition on transfer restrictions found in § 541(c). The court also held that implied preemption would likewise apply to render unenforceable the contractual anti-assignment provisions because such provisions would "stand as an obstacle to completion of a successful § 524(g) plan."

Arbitration

Shortly afterward, the same panel of Ninth Circuit judges ruled that the bankruptcy court did not abuse its discretion by denying Continental's motion to compel arbitration. At the outset, the court noted that "[n]either the text nor the legislative history of the Bankruptcy Code reflects a congressional intent to preclude arbitration in the bankruptcy setting." Given the absence of any manifestation of such intent, the Ninth Circuit explained, "[w]e ask . . . whether there is an inherent conflict between arbitration and the underlying purposes of the Bankruptcy Code."

Examining the issue as a matter of first impression, the Ninth Circuit concluded that the core/noncore distinction is relevant, but not dispositive:

> "[N]ot all core bankruptcy proceedings are premised on provisions of the Code that 'inherently conflict' with the [FAA]; nor would arbitration of such proceedings necessarily jeopardize the objectives of the Bankruptcy Code." . . . We join our sister circuits in holding that, even in a core proceeding, the *McMahon* standard must be met—that is, a bankruptcy court has discretion to decline to enforce an otherwise applicable arbitration provision only if arbitration would conflict with the underlying purposes of the Bankruptcy Code.

The Ninth Circuit ruled that compelling arbitration of the dispute between Thorpe and Continental would conflict with the underlying purposes of the Bankruptcy Code. The court agreed with the lower courts' determinations that the dispute was a core proceeding—Continental filed a proof of claim and Thorpe objected to the claim, so that allowance or disallowance of Continental's claim was core under 28 U.S.C. § 157(b)(2)(B). In addition, the court explained, because the claim "disputed or affected" assets in the section 524(g) trust and the rights of other creditors, its resolution directly impacted the administration of the bankruptcy estate and was also within the bankruptcy court's core jurisdiction under 28 U.S.C. § 157(b)(2)(A).

The Ninth Circuit rejected Continental's argument that its claim was "independent of Thorpe's bankruptcy" and thus did not conflict with the Bankruptcy Code. It agreed with the lower courts' conclusion that Thorpe's alleged breaches of the Settlement Agreement were "inextricably intertwined" with its chapter 11 cases and that the bankruptcy court therefore had discretion not to send the claim to arbitration:

> The purpose of § 524(g) is to consolidate a debtor's asbestos-related assets and liabilities into a single trust for the benefit of asbestos claimants. . . . Congress intended that the trust/injunction mechanism be "available for use by any asbestos company facing . . . overwhelming liability." . . . Congress tasked bankruptcy courts with ensuring that § 524(g)'s "high standards" are met and gave them authority to implement and supervise this unique procedure. . . . A claim based on a debtor's efforts to seek for itself and third parties the protections of § 524(g) implicates and tests the efficacy of the provision's underlying policies. Because Congress intended that the bankruptcy court oversee all aspects of a § 524(g) reorganization, only the bankruptcy court should decide whether the debtor's conduct in the bankruptcy gives rise to a claim for breach of contract. Arbitration in this case would conflict with congressional intent.

Finally, the Ninth Circuit concluded that arbitration of a creditor's claim against a debtor, even if conducted expeditiously, "prevents the coordinated resolution of debtor-creditor rights and can delay the confirmation of a plan of reorganization." It accordingly ruled that arbitration of Continental's claim "would conflict with the purposes and policies of § 524(g) and the Bankruptcy Code as a whole."

OUTLOOK

The Ninth Circuit has addressed mootness in various contexts before, but *Thorpe I* represents a departure in that the court of appeals for the first time expressly adopted a standard for equitable mootness in connection with a challenge to an order confirming a chapter 11 plan. The articulation of such a standard adds some clarity to an issue that was previously uncertain. *Thorpe I* also supports the proposition that non-settling insurers in an asbestos bankruptcy case should have a seat at the table as parties in interest in the proceedings. The Ninth Circuit's analysis of "insurance neutrality" in *Thorpe I* is consistent with the Third Circuit's approach to the same issue in *In re Global Indus. Technologies, Inc.*, 645 F.3d 201 (3d Cir. 2011). Like the Third Circuit, the Ninth Circuit ruled that the chapter 11 plan was not "insurance neutral" because it could have a substantial economic effect on the non-settling insurers.

Thorpe I is hardly an unqualified victory for insurers in asbestos cases. Plan proponents now have much less incentive to propose "insurance neutral" plans, and insurers may find that they must litigate insurance-related issues in bankruptcy court and risk adverse bankruptcy-court decisions that will have preclusive effect in subsequent coverage litigation. In addition, the preemption decision with respect to the assignability of insurance policies eliminates, at least in the Ninth Circuit, one objection that insurers typically raise in opposing an asbestos plan.

The Ninth Circuit's interpretation of the term "substantial consummation" in *Thorpe I* represents a significant departure from existing case law, because it focused not on the transfer of property *from the bankruptcy estate* to the asbestos trust and reorganized debtor, but instead on future settlement payments to be made *by third parties* (the settling insurers) under existing settlement agreements, all of which had been transferred to the asbestos trust at or shortly after the plan's effective date in 2010. On April 3, 2012, the Ninth Circuit denied a petition for rehearing en banc, modifying its opinion slightly on this point.

Thorpe II, although also groundbreaking in the Ninth Circuit, is consistent with the approach applied by the majority of courts in determining whether to defer to an arbitrator to resolve a dispute involving a debtor in bankruptcy.

Jones Day represents the official creditors' committee in *In re Thorpe Insulation*.

THE RATIONALE AGAINST SUBSTANTIVE CONSOLIDATION OF NONDEBTOR ENTITIES: FLORIDA ON THE FRONT LINE

Dara R. Levinson

On January 10, 2012, a Florida bankruptcy court ruled in *In re Pearlman*, 462 B.R. 849 (Bankr. M.D. Fla. 2012), that substantive consolidation is purely a bankruptcy remedy and that it accordingly did not have the power to consolidate the estate of a debtor in bankruptcy with the assets and affairs of a nondebtor. In so ruling, the court staked out a position on a contentious issue that has created a widening rift among bankruptcy and appellate courts regarding the scope of a bankruptcy court's jurisdiction over nondebtor entities. The court's ruling is also contrary to a decision handed down by another Florida court less than a year previously in *Kapila v. S & G Fin. Servs., LLC (In re S & G Fin. Servs. of S. Fla., Inc.)*, 451 B.R. 573 (Bankr. S.D. Fla. 2011).

SUBSTANTIVE CONSOLIDATION

Substantive consolidation streamlines the administration of interrelated bankruptcies by, among other things, eliminating intercompany claims between related debtors and duplicative claims asserted against multiple consolidated debtors. The Bankruptcy Code does not expressly authorize the remedy, 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. Courts approving substantive consolidation typically authorize it under section 105(a) of the Bankruptcy Code, which provides that a court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. However, because forcing creditors of one entity to share equally with creditors of a less solvent debtor is not appropriate in many circumstances, courts generally hold that substantive consolidation is to be used sparingly and have labeled it an "extraordinary remedy."

Different standards have been employed by courts to determine the propriety of substantive consolidation. In *Eastgroup Properties v. Southern Motel Association, Ltd.*, 935 F.2d 245 (11th Cir. 1991), for example, the Eleventh Circuit Court of Appeals articulated a standard for substantive consolidation

requiring a showing that: (1) there is "substantial identity" between the entities to be consolidated; and (2) substantive consolidation "is necessary to avoid some harm or to realize some benefit."

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

(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.

SPLIT OF AUTHORITY

There is a split of authority as to whether a bankruptcy court has the power to substantively consolidate debtors with nondebtors. The majority rule, whose adherents include the Ninth Circuit Court of Appeals and lower courts in the Sixth, Tenth, and Eleventh Circuits, permits such a consolidation under appropriate circumstances, with the caveat that increased caution should be exercised in assessing the propriety of the remedy. These courts have held that they have the power to substantively consolidate debtor and nondebtor entities on the basis of: (i) section 105's broad grant of authority; (ii) a court's ability to assert personal and subject-matter jurisdiction over nondebtors; and (iii) the bankruptcy court's mandate to "ensure the equitable treatment of all creditors." Other courts hold otherwise, citing jurisdictional concerns and/or ruling that substantive consolidation should not be used to circumvent the involuntary bankruptcy petition requirements and procedures of the Bankruptcy Code.

Pearlman

Certain creditors of Louis J. Pearlman ("Pearlman"), a manager and producer of boy bands such as the Backstreet Boys and *NSYNC, filed involuntary chapter 7 cases against Pearlman and 10 affiliated entities (collectively, the "debtors") in 2007 in Florida, contending, among other things, that the debtors were the perpetrators of a massive Ponzi scheme. Later, after the cases were converted to chapter 11, a trustee appointed in the cases filed hundreds of adversary proceedings seeking to recover millions of dollars in transfers made by the debtors as part of the scheme to individuals, banks, law firms, and vendors.

In that litigation, the trustee alleged that one or more of the debtors made transfers to the defendants in repayment of the obligations of other Pearlman entities (both debtors and nondebtors). Because the payor-debtor entities arguably did not receive any value in exchange for these payments, the trustee argued, the transfers were constructive fraudulent transfers subject to avoidance under section 548(a)(1)(B) of the Bankruptcy Code. Certain defendants seeking to ward off liability for these "wrongful payor" claims moved to substantively consolidate the debtors' estates as well as the assets of certain Pearlman-related nondebtor entities.

In an earlier ruling, the bankruptcy court had held that substantive consolidation of the debtors' estates was appropriate because their financial affairs were "inextricably interwoven." In this ruling, the court then addressed whether the same remedy could be exercised to consolidate the nondebtor entities with the debtors.

THE BANKRUPTCY COURT'S DECISION

The court ruled that it could not consolidate the debtor and nondebtor entities, providing three bases for its decision. First, the bankruptcy court explained, section 105 gives bankruptcy courts the authority to do only what is necessary

or appropriate to accomplish the goals of the Bankruptcy Code; it is not a grant of "unfettered power." It is not within a court's section 105 powers, the court wrote, to "drag unwilling entities that never chose to file bankruptcy into a bankruptcy forum simply because it is expedient and will help one party or another."

Second, the court reasoned that allowing the substantive consolidation of debtors with nondebtor entities would "circumvent" the procedures laid out in the Bankruptcy Code for involuntary bankruptcies. Section 303 provides strict requirements for when and how an unwilling party can be placed into bankruptcy. "[F]orcing a non-debtor into bankruptcy via substantive consolidation," the court observed, "circumvents these strict requirements and is in contravention of" the Bankruptcy Code. The court concluded that it would be outside the scope of section 105's grant of authority for a bankruptcy court to circumvent such statutory provisions.

Finally, the court explained, state law already provides a remedy for parties who can establish that a nondebtor entity is an "alter ego" of a debtor. By "piercing the corporate veil," a court can disregard the separateness of related corporate entities under circumstances where the entities are "mere instrumentalities" of one another—a standard quite similar to the test applied for substantive consolidation. To pierce the corporate veil under Florida law, the court noted, a claimant must prove that: (1) the shareholder dominated and controlled the corporation to such a degree that the corporation did not have an independent existence and shareholders were the alter egos of the corporation; (2) the corporate form was used fraudulently or for an improper purpose; and (3) this fraudulent or improper use of the corporate form caused injury to the claimant. Although this showing is a difficult one to make in keeping with a "high regard for corporate ownership," the court wrote, the alter-ego remedy under state law is an "alternative to substantive consolidation that protects a non-debtor's corporate identity without usurping the protections of the Bankruptcy Code."

OUTLOOK

Pearlman is notable because of the limitations the bankruptcy court imposed on its powers under section 105 to assert jurisdiction over nondebtors. It is also noteworthy because the bankruptcy court in *S & G Financial* reached the exact opposite result less than a year earlier. In *S & G Financial*, 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 wrote 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." The *Pearlman* court rejected both of these rationales.

In *S & G Financial*, the court was dissatisfied with the alternatives (an involuntary petition under section 303 or a state-law veil-piercing suit). Requiring an involuntary petition instead of a motion for substantive consolidation, the court reasoned, would "defeat" the rationale for substantive consolidation: "to recover assets from a financially sound affiliated entity." In addition, the court distinguished between substantive consolidation and veil piercing, as the former does not require a finding that a nondebtor entity is an alter ego of the debtor.

The *Pearlman* court cited *S & G Financial,* but only in a footnote as an example of a case in which substantive consolidation of nondebtor entities was permitted. That sister bankruptcy courts in the same circuit are so at odds with respect to this issue highlights the wider controversy simmering in bankruptcy and appellate courts nationwide. As noted, among the circuit courts of appeal, only the Ninth Circuit has explicitly held that a bankruptcy court has the power to substantively consolidate debtor and nondebtor entities. No other circuit court has had occasion to rule on the issue. Conflicting rulings like *Pearlman* and *S & G Financial* suggest that appellate courts at the highest levels may soon be called upon to weigh in on this important issue.

IN BRIEF: RISING TO THE *STERN* CHALLENGE

Putting it mildly, the U.S. Supreme Court's ruling last year in *Stern v. Marshall*, 132 S. Ct. 56 (2011), cast a wrench into the day-to-day operation of U.S. bankruptcy courts scrambling to deal with a deluge of challenges—strategic or otherwise—to the scope of their "core" jurisdiction to issue final orders and judgments on a wide range of disputes. In *Stern*, the Court ruled that, to the extent that 28 U.S.C. § 157(b)(2)(C) purports to confer core jurisdiction on a bankruptcy court to finally adjudicate a state-law counterclaim against a creditor that filed a proof of claim, section 157(b)(2)(C) is constitutionally invalid. The ruling has already spawned hundreds of requests for removal, abstention, and withdrawal of reference, in addition to burdening district courts with requested rulings on a greater volume of proposed findings of fact and conclusions of law in cases deemed to be outside a bankruptcy court's core jurisdiction.

In an effort to alleviate the mayhem wrought by *Stern*, the U.S. District Court for the Southern District of New York issued an Amended Standing Order of Reference on January 31, 2012 (the "Amended Order"). The Amended Order provides as follows:

> If a bankruptcy judge or district judge determines that entry of a final order or judgment by a bankruptcy judge would not be consistent with Article III of the United States Constitution in a particular proceeding referred under this order and determined to be a core matter, the bankruptcy judge shall, unless otherwise ordered by the district court, hear the proceeding and submit proposed findings of fact and conclusions of law to the district court. The district court may treat any order of the bankruptcy court as proposed findings of fact and conclusions of law in the event the district court concludes that the bankruptcy judge could not have entered a final order or judgment consistent with Article III of the United States Constitution.

The Amended Order indicates that, in the view of the Southern District, *Stern* is not jurisdictional, but rather implicates the scope of bankruptcy courts' authority to issue final orders and judgments. It would also appear to discourage requests for reference withdrawal in favor of having disputes regarding final authority resolved by the district court after the underlying merits have already been litigated in the bankruptcy court.

At this juncture, the impact of the Amended Order is unclear, and it remains to be seen whether other districts will be guided by the Southern District in sorting out their own *Stern*-related problems. However, at least one Southern District judge has already cited to the Amended Order in denying a motion to withdraw the reference. *See Adelphia Recovery Trust v. FLP Group, Inc.*, 2012 WL 264180 (S.D.N.Y. Jan. 30, 2012) (Crotty, J.) (denying motion to withdraw reference with respect to adversary proceeding seeking avoidance of fraudulent transfers based on *Stern* and noting that, "[i]n accordance with [the new standing order], the Bankruptcy Court has the authority to issue proposed [findings] of fact and conclusions of law in this case").

Meanwhile, the Local Rules Committee for the U.S. Bankruptcy Court for the Southern District of New York recently proposed new Local Bankruptcy Rules in response to *Stern* that require litigants to state expressly whether or not they consent to entry of final judgments or orders by bankruptcy courts in core proceedings if the court is deemed to lack constitutional authority to enter a final judgment or order. The text of the proposed rules can be accessed at http://www.nysb.uscourts.gov/localrules2012.html (web site last visited on March 28, 2012). The proposed rules were posted for comment for a 30-day period that ended on March 22, 2012.

NO EQUITABLE TOLLING OF SECTION 548 "LOOK-BACK" PERIOD

Haben Goitom

In *Industrial Enterprises of America v. Burtis (In re Pitt Penn Holding Co., Inc.)*, 2012 WL 204095 (Bankr. D. Del. Jan. 24, 2012), a Delaware bankruptcy court held that the two-year statutory "look-back" period with respect to which a fraudulent transfer may be avoided pursuant to section 548 of the Bankruptcy Code cannot be "equitably tolled." Previously, the bankruptcy court had issued inconsistent orders in various adversary proceedings in the case providing that the two-year look-back period could be equitably tolled, allowing transfers that occurred outside that window of time to be avoided. *Pitt Penn* clarifies that, in the view of this Delaware bankruptcy court, the look-back period cannot be tolled for equitable reasons because it is "a substantive element of a § 548 cause of action" rather than a statute of limitations.

AVOIDANCE OF FRAUDULENT TRANSFERS AND OBLIGATIONS

Section 548(a) of the Bankruptcy Code allows a bankruptcy trustee or chapter 11 debtor in possession ("DIP") to avoid transfers of a debtor's property or obligations incurred by a debtor if the transaction involved was either actually or constructively fraudulent and if the transfer or obligation "was made or incurred on or within 2 years before the date of the filing of the petition."

Transfers may also be avoided under applicable state law by operation of section 544(b) of the Bankruptcy Code. Section 544(b) allows a DIP or trustee to "avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim" against the debtor. The primary advantage of this provision over section 548 is that many state fraudulent-transfer laws (in most jurisdictions, a version of the Uniform Fraudulent Transfer Act) provide for a longer statutory look-back period than the two-year period specified in section 548.

Section 546 of the Bankruptcy Code places other limitations on the ability of a trustee or DIP to commence avoidance actions. Section 546(a) provides in relevant part:

> An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of— (1) the later of— (A) 2 years after the entry of the order for relief; or (B) 1 year after the appointment or election of the first trustee . . . ; or (2) the time the case is closed or dismissed.

If a transfer is avoided, the trustee or DIP can recover the property transferred or its value from the transferee(s) (with certain exceptions) pursuant to section 550 of the Bankruptcy Code.

BACKGROUND

Pittsburgh-based Industrial Enterprises of America ("IEAM") was a seller of antifreeze and other automotive additives and chemicals until it went out of business in 2009 after two former IEAM senior executives engaged in a massive fraud that ultimately earned them lengthy jail sentences. IEAM filed for chapter 11 protection on May 1, 2009, in Delaware.

Nearly (but not quite) two years after the petition date, IEAM filed adversary proceedings against various defendants (the "Collyers") seeking to recover property fraudulently transferred by the company prior to its bankruptcy filing. The complaints assert various state- and federal-law claims as well as claims to recover property, pursuant to sections 544, 548, and 550 of the Bankruptcy Code. The Collyers moved to dismiss all of the claims. The court ruled in their favor with respect to the section 548 claims because the transfers occurred "several months outside of the look-back period," but it denied the motion to dismiss the remaining claims. In doing so, the court held that, regardless of when IEAM learned of the transfers or the fraudulent circumstances surrounding them, if the transfers occurred more than two years before IEAM's bankruptcy filing, IEAM could not bring the causes of action under section 548.

That ruling, however, was in direct conflict with the court's prior holdings in other adversary proceedings commenced by IEAM, where the court permitted equitable tolling of fraudulent-transfer actions. The bankruptcy court learned of its inconsistent holdings in connection with IEAM's motion to reconsider the court's order dismissing its section 548 claims against the Collyers.

THE BANKRUPTCY COURT'S DECISION

Apologizing to the parties for its oversight, the bankruptcy court brought "its prior inconsistent rulings into alignment." It ruled that "Section 548(a)'s two-year look-back period is a substantive element of a § 548 cause of action, and therefore cannot be equitably tolled."

IEAM argued that equitable tolling has often been applied by bankruptcy courts to allow a claim to be filed outside the statute of limitations, where some action has been taken on the part of the defendant to make the plaintiff unaware that the cause of action existed. IEAM also argued that equity should prevent the Collyers from benefiting from the statute of limitations when they concealed the fraudulent transfers.

Pitt Penn clarifies that even in a court of equity and despite colorable claims of concealment on the part of an avoidance-action defendant, there are limitations on the power of a bankruptcy court to invoke the doctrine of equitable tolling.

The court agreed that typically, statutes of limitations are equitably tolled to prevent "technical forfeitures that would unfairly thwart a trial on the merits, unless tolling would be 'inconsistent with the text of the relevant statute.'" However, the court explained, IEAM's argument fails because it does not address whether the two-year look-back period is a substantive element of a section 548 claim that, unlike a statute of limitations, cannot be equitably tolled.

STATUTES OF LIMITATIONS v. SECTION 548 LOOK-BACK PERIOD

Statutes of limitations, the court emphasized, are rules of procedure meant to "regulate secondary conduct," such as the filing of a suit, but should not affect the actions that gave rise to the suit. By contrast, although the text of section 548 creates a cause of action based on the transfer of a debtor's interest in property (the "primary conduct"), the provision does not "regulate" how far into the future the claim can be brought (the "secondary conduct"), which is what a statute of limitations does. According to the court, the two-year period in section 548 simply looks back from the petition date (when the cause of action accrued) to evaluate transfers that occurred during that window of time. The look-back period, the court wrote, is "baked-in to 'the actual *substance*'" of the cause of action, whereas a statute of limitations begins to run when the cause of action accrues, requiring a litigant to assert a claim within a certain time period.

Turning to an examination of section 546 for purposes of comparison, the court described section 546 as "a true statute of limitations," whereas the two-year time period in section 548 is a substantive element of a fraudulent-transfer claim that cannot be tolled.

The court respectfully declined to follow contrary (but noncontrolling) precedent relied upon by IEAM. *See Official Committee of Unsecured Creditors v. Pardee (In re Stanwich Fin. Servs. Corp.)*, 291 B.R. 25 (Bankr. D. Conn. 2003). Instead, the bankruptcy court in *Pitt Penn* agreed with the reasoning articulated in *In re Maui Indus. Loan & Fin. Co.*, 454 B.R. 133 (Bankr. D. Haw. 2011), where the court similarly held that the two-year look-back period is a substantive element of section 548.

CONCLUSION

Pitt Penn clarifies that even in a court of equity and despite colorable claims of concealment on the part of an avoidance-action defendant, there are limitations on the power of a bankruptcy court to invoke the doctrine of equitable tolling. According to *Pitt Penn*, one such impediment is found in section 548, whose two-year look-back period cannot be equitably tolled because it is a substantive element of a fraudulent-transfer cause of action under federal bankruptcy law. Although this may appear to be a harsh result, especially when the facts regarding the defendants are particularly egregious, in some instances (like *Pitt Penn*), similar claims can be brought under state law that may provide for a longer look-back period or a "discovery rule" tolling an applicable statute of limitations. Such state-law claims, however, may not always be available.

Finally, the concept of equitable tolling should be distinguished from the statutory tolling provision of section 108 of the Bankruptcy Code. Section 108 expressly gives a trustee or DIP additional time to: (i) commence actions on behalf of the estate, provided that the applicable time period did not expire before the filing of the bankruptcy petition; and (ii) file pleadings, cure defaults, and perform other acts on behalf of the debtor.

EUROPEAN PERSPECTIVE: THE WEST LOTHIAN QUESTION IN VOLUNTARY ARRANGEMENTS

Michael Rutstein and Luke Johnson

THE ROLE OF DISINTERESTED CREDITORS IN THE APPROVAL PROCESS

As the question of Scottish independence resurfaces, the West Lothian question remains embedded, thorn-like, in the side of British politics and democracy 35 years after it was first posed: How is it that Scottish members of Parliament with no apparent interest in a matter applying only to England and Wales are entitled to vote on it?

An identical question arises with voluntary arrangements: Why should a creditor who is to be paid in full have the right to vote on a proposal that compromises the claims and rights of others? The increasing popularity of company voluntary arrangements ("CVAs") gives some urgency to the resolution of this question. In this article, we will look at whether CVAs can be used to differentiate between creditors and the legal issues that arise if they are used to do so. The issues discussed here apply equally to individual voluntary arrangements, but for the sake of convenience, we restrict our discussion to CVAs.

Unlike schemes of arrangement, where creditors must be divided into distinct classes to ensure sufficient protection of their divergent interests, CVAs require the support of only 75 percent in value of the total mass of creditors (and only 50 percent in value of the total mass of creditors unconnected with the debtor) to be passed (Rule 1.19 of the Insolvency Rules). Where a CVA proposes to treat a class of creditors differently from other classes, there is a clear danger that if the differentiated class holds under 25 percent of the voting rights, it will be powerless to prevent other creditors from approving the debtor's proposal.

The small number of provisions of the Insolvency Act 1986 and the associated Rules speak of creditors as a collective. Thus, the debtor's proposal and the notice of the creditors' meeting must be sent out to all creditors, and all of them must be invited to attend the meeting and vote on the proposal. There is no basis for excluding a category of creditors on the grounds that it has no interest in the proposal or that it has no economic interest in the debtor (as is the case with a "scheme of arrangement", a procedure under the Companies Act 1985 enabling a compromise or arrangement between a company and its creditors, its members or any class of them, subject to ratification by the court).

One may perhaps then have inferred that a CVA proposal must provide for all creditors to take the pain (or, if you prefer, the haircut), such that their treatment and recovery rate contemplated by the debtor's proposal must be the same. However, voluntary-arrangement practice soon established that a debtor's proposal could offer creditors a derisory return, or no return at all, and if the creditors voted for it, it was binding. It was a matter for creditor democracy to establish whether the creditors were prepared to accept a debtor's offer of compromise, however commercially repugnant its terms might be. It was then not too big a step for debtors to start differentiating between categories (or classes) of creditors in terms of treatment and recovery under a CVA.

The landmark case of *Re Cancol* [1996] 1 BCLC 100 established that a debtor could legitimately offer a different deal under a CVA to those landlords of premises it wished to continue to occupy for its future business and those whose premises it wished to vacate. This line of reasoning has been refined and, in more recent times, has been adopted with considerable success by retail chains overburdened by long-term, onerous, solvency-busting leases. These debtors have used CVAs as a way of retaining leases at profitable sites (perhaps on varied terms) and escaping from unprofitable sites by leaving landlords to claim a dividend calculated in accordance with a specified formula from a pot of money reserved for them. JJB Sports is one of the most high-profile companies to have used a CVA to this effect—and not once, but twice. There has, however, been no challenge made to any of these CVAs. If there had been a landlord disgruntled with differential treatment compared to non-landlord creditors, what could the poor fellow have done about it?

There are only two grounds of challenge: material irregularity and unfair prejudice. Although the terms of a CVA are ostensibly protected by section 6(a) of the Insolvency Act 1986, challenging them as unfairly prejudicial has proved difficult for creditors. As held in *Re a debtor* (No 101 of 1999),

the mere existence of differential treatment is not enough to support a finding that a dissentient creditor has been unfairly prejudiced. Further, even if a class of creditors would have been able to vote down a scheme of arrangement, that does not necessarily mean that a CVA proposal can, on the same facts, be successfully challenged as unfairly prejudicial.

In considering whether a CVA is unfairly prejudicial, the court will examine the dissenting creditor's position as against the other creditors (the "horizontal position"). However, it will also place substantial weight upon the return that the creditor might expect in a winding-up of the debtor (the "vertical position"). While the *Powerhouse* ruling (*Prudential Assurance v PRG Powerhouse*, 2007 EWHC 2170) confirms that a CVA will be unfair if the creditor would be in a worse position than in a winding-up, where this is not the case, the courts have been inclined to overlook an imbalance in the recoveries of creditors, swayed by the desire to let stand a CVA proposal approved by creditors.

Though utilitarianism may motivate the court to overlook an unevenness of treatment under a CVA, it is not hard to understand the court's reluctance when a CVA is approved by the weight of votes of those creditors who have nothing to lose by the CVA and who are in the happy position of saying: "It's not my money at risk, so why not vote yes?"

The court considered this very situation in *HMRC v Portsmouth City Football Club (in administration)* [2010] EWHC 2013, where Her Majesty's Revenue and Customs ("HMRC") objected to the participation in the vote of "football creditors" who, pursuant to Premier League and Football League rules, have to be paid in full under a CVA if the Premier League or Football League is to renew the membership of a football club that is subject to an insolvency procedure. Football creditors are creditors related to the football industry (*e.g.*, other clubs, if there are transfer fees outstanding; player salaries; and various football authorities and organisations). Whether you love or hate HMRC, it deserves a medal for its determination to overturn CVAs that it sees as disadvantageous to its interests, even though its history of success has—how shall we put it?—not been crowned with glory. Not one to give up without a jolly good fight, HMRC challenged the football club's CVA on both material irregularity and unfair-prejudice grounds.

By making an analogy between a CVA and a scheme of arrangement, HMRC initially invoked "material irregularity" as a means of challenging the football creditors' exercise of voting rights. However, Mr Justice Mann rejected this argument, ruling that, as the provisions for voting in CVAs do not require, or indeed allow for, separate classes of creditors, there could not be any irregularity. This decision makes clear that "irregularity" refers only to a digression from the statutory provisions and not a complaint of inherent unfairness.

Minority creditors are therefore left to interpose an unfair-prejudice argument if they wish to challenge the participation of West Lothian creditors in the yes vote. This line of argument was similarly rejected in *Portsmouth*, albeit on a factual basis. The judge held that the football creditors did in fact have an interest in the CVA's being approved. If the CVA were not approved and a liquidation followed, the court concluded, their contracts of employment would come to an end. In contrast, were the football clubs to continue operating after approval of the CVA, then the balance of the football creditors' existing contracts would be honoured.

COMPANY VOLUNTARY ARRANGEMENTS

If a UK company and its creditors can reach agreement on a plan to deal with the company's debts, an appropriate means of implementing such agreement may be a company voluntary arrangement ("CVA"), largely under the UK Insolvency Act 1986. Under this process, the debtor makes a proposal to its creditors to repay a certain percentage of their claims over a specified period of time. If more than 75 percent in value of the debtor's creditors taking part in the creditors' meeting to consider the proposal vote in favour of the proposal, then, subject to certain safeguards, the proposal becomes binding on all creditors, including those who voted against it (although secured creditors need to consent specifically to a CVA in order for it to be binding on them).

Notwithstanding his factual ruling vis-à-vis the football-creditor athletes, the judge did note that:

> [I]f it were the case that these creditors had no real interest in the CVA at all then there might be something in it. Why should those with no interest in the CVA at all, and who were being paid outside it, be entitled to force unwilling creditors into a CVA which is not approved by a requisite majority of that smaller class?

Interestingly, the judge did not apply this line of analysis to the non-employee football creditors, such as rival clubs owed transfer fees by the insolvent club.

Although the battle is lost, the war might yet be won by the launch of a separate campaign. HMRC has brought proceedings against the Premier League to challenge the validity of the football-creditor rule.

Although the West Lothian question has thus far arisen only in the idiosyncratic world of football insolvency, it is not inconceivable that West Lothian creditors may appear in a more typical commercial context—for example, where a creditor is able to recover in full outside a CVA (such as by way of a third-party guarantee that will not be discharged by the CVA). It is apparent that there is friction between the freedom which the Insolvency Act gives to a debtor to craft its proposal in whatever way it wishes (subject to certain safeguards) and what we might grandiosely call "the laws of natural justice". The authors' view is that the courts have correctly interpreted the statutory regime for voluntary arrangements. In applying English insolvency law, the courts appear to have resolved the West Lothian question in favour of the Scottish MPs. Whether that result was intended by the UK Parliament is another matter. In any case, we can see that the result, however commercially convenient, does lead to unfairness and an abuse of creditor democracy. The football-creditor rule also rankles. It is not hard to see the force of the argument that it breaches the golden rule of English insolvency law that all unsecured creditors must be treated equally. We await the outcome of HMRC's proceedings with great interest, in the hope that it will rule on the validity of the football-creditor rule once and for all and throw light on how to resolve the West Lothian question with respect to voluntary arrangements.

A version of this article was published in the Winter 2011 issue of Recovery. *It has been reprinted here with permission.*

NEWSWORTHY

Jones Day's Business Restructuring & Reorganization Practice was recognized as being among the finest worldwide in the field of Restructuring/Insolvency and Bankruptcy by *Chambers Global* 2012.

Corinne Ball (New York), ***Paul D. Leake (New York)***, ***David G. Heiman (Cleveland)***, ***Heather Lennox (New York*** and ***Cleveland)***, ***Volker Kammel (Frankfurt)***, ***Michael Rutstein (London)***, ***Richard L. Wynne (Los Angeles)***, and ***Laurent Assaya (Paris)*** were designated "Leaders in their Field" in the area of Restructuring/Insolvency and Bankruptcy by *Chambers Global 2012*.

Brad B. Erens (Chicago) and ***Mark A. Cody (Chicago)*** were named "Illinois Super Lawyers" for 2012.

Bennett L. Spiegel (Los Angeles) and ***Richard L. Wynne (Los Angeles)*** were named "Southern California Super Lawyers" for 2012.

Jeffrey B. Ellman (Atlanta) and ***Aldo L. LaFiandra (Atlanta)*** were named "Georgia Super Lawyers" for 2012.

Dan B. Prieto (Dallas) was designated a "Texas Rising Star" for 2012 in the field of Bankruptcy & Creditor/Debtor Rights by *Super Lawyers* magazine.

Philip J. Hoser (Sydney) was included in the 2012 edition of *Chambers Asia-Pacific* in the field of Restructuring/Insolvency. The directory also named him a "Leader in His Field" in the practice area of Restructuring/Insolvency and Bankruptcy.

Richard L. Wynne (Los Angeles) was a panelist at a program sponsored by the Turnaround Management Association entitled "Recent Cases and Developments Important to Private Equity and Hedge Funds" on March 8 in Los Angeles.

Corinne Ball (New York) spoke at a Practising Law Institute program on April 12 in New York entitled "Bankruptcy & Reorganizations 2012: Current Developments." The topic of her presentation was "Current Jurisdictional and Procedural Issues—*Stern v. Marshall et al.*"

Daniel P. Winikka (Dallas) was a panelist for a State Bar of Texas Bankruptcy Law Section webinar entitled "Recent Developments in Bankruptcy: Proposed U.S. Trustee Fee Guidelines and Trends in the Use of Enterprise Valuation" on February 29.

An article written by ***Charles M. Oellermann (Columbus)*** and ***Mark G. Douglas (New York)*** entitled "The Year in Bankruptcy, Part I" was published in the April 2012 edition of *Pratt's Journal of Bankruptcy Law*.

An article written by ***Joseph M. Witalec (Columbus)*** and ***Mark G. Douglas (New York)*** entitled "Is Ch. 9 the Next Chapter in the Municipal Saga?" was published in the February 6, 2012, issue of *Bankruptcy Law360*.

LARGEST PUBLIC-COMPANY BANKRUPTCY FILINGS SINCE 1980

Company	Filing Date	Industry	Assets
Lehman Brothers Holdings Inc.	09/15/2008	Investment Banking	$691 billion
Washington Mutual, Inc.	09/26/2008	Banking	$328 billion
WorldCom, Inc.	07/21/2002	Telecommunications	$104 billion
General Motors Corporation	06/01/2009	Automobiles	$91 billion
CIT Group Inc.	11/01/2009	Banking and Leasing	$80 billion
Enron Corp.	12/02/2001	Energy Trading	$66 billion
Conseco, Inc.	12/17/2002	Financial Services	$61 billion
MF Global Holdings Ltd.	10/31/2011	Commodities	$40.5 billion
Chrysler LLC	04/30/2009	Automobiles	$39 billion
Thornburg Mortgage, Inc.	05/01/2009	Mortgage Lending	$36.5 billion
Pacific Gas and Electric Company	04/06/2001	Utilities	$36 billion
Texaco, Inc.	04/12/1987	Oil and Gas	$35 billion
Financial Corp. of America	09/09/1988	Financial Services	$33.8 billion
Refco Inc.	10/17/2005	Brokerage	$33.3 billion
IndyMac Bancorp, Inc.	07/31/2008	Banking	$32.7 billion
Global Crossing, Ltd.	01/28/2002	Telecommunications	$30.1 billion
Bank of New England Corp.	01/07/1991	Banking	$29.7 billion
General Growth Properties, Inc.	04/16/2009	Real Estate	$29.6 billion
Lyondell Chemical Company	01/06/2009	Chemicals	$27.4 billion
Calpine Corporation	12/20/2005	Utilities	$27.2 billion
New Century Financial Corp.	04/02/2007	Financial Services	$26.1 billion
Colonial BancGroup, Inc.	08/25/2009	Banking	$25.8 billion
UAL Corporation	12/09/2002	Aviation	$25.2 billion
AMR Corporation	11/29/2011	Aviation	$25 billion
Delta Air Lines, Inc.	09/14/2005	Aviation	$21.9 billion
Adelphia Communications Corp.	06/25/2002	Cable Television	$21.5 billion
Capmark Financial Group, Inc.	10/25/2009	Financial Services	$20.6 billion
MCorp	03/31/1989	Banking	$20.2 billion
Mirant Corporation	07/14/2003	Energy	$19.4 billion
Ambac Financial Group, Inc.	11/08/2010	Financial Insurance	$18.9 billion

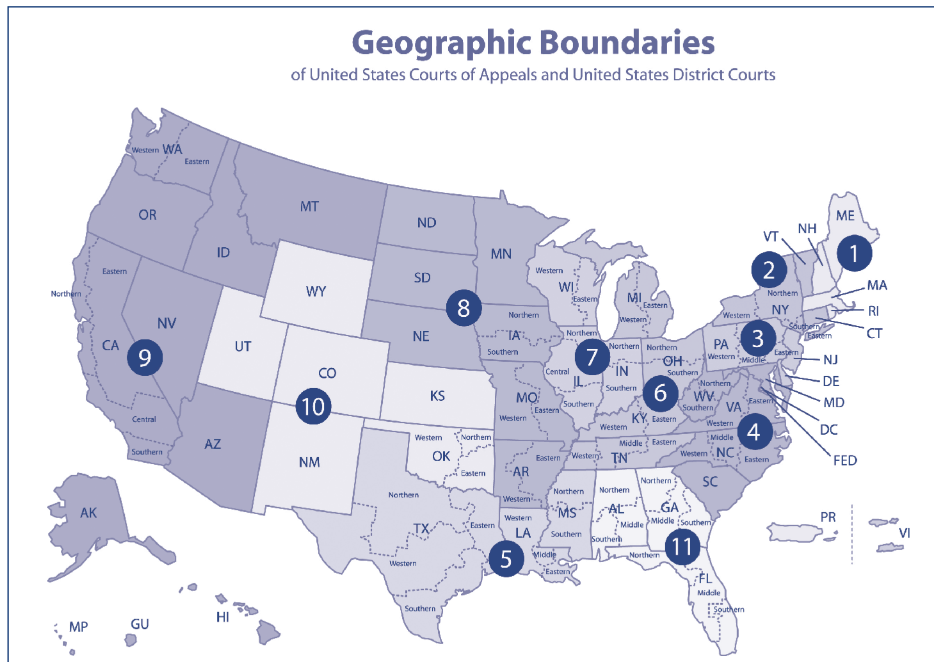
THE U.S. FEDERAL JUDICIARY

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.



BUSINESS RESTRUCTURING REVIEW

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

Executive Editor: Charles M. Oellermann
Managing Editor: Mark G. Douglas
Contributing Editor: Scott J. Friedman

If you would like to receive a complimentary subscription to *Business Restructuring Review*, send your name and address to:

Jones Day
222 East 41st Street
New York, New York
10017-6702
Attn.: Mark G. Douglas, Esq.

Alternatively, you may call (212) 326-3847 or contact us by email at mgdouglas@jonesday.com.

Three-ring binders are also available to readers of *Business Restructuring Review*. To obtain a binder free of charge, send an email message requesting one to mgdouglas@jonesday.com.

Business Restructuring Review provides general information that should not be viewed or utilized as legal advice to be applied to fact-specific situations.

JONES DAY HAS OFFICES IN:

ALKHOBAR
ATLANTA
BEIJING
BOSTON
BRUSSELS
CHICAGO
CLEVELAND
COLUMBUS
DALLAS
DUBAI
DÜSSELDORF
FRANKFURT
HONG KONG
HOUSTON
IRVINE
JEDDAH
LONDON
LOS ANGELES
MADRID
MEXICO CITY
MILAN
MOSCOW
MUNICH
NEW DELHI
NEW YORK
PARIS
PITTSBURGH
RIYADH
SAN DIEGO
SAN FRANCISCO
SÃO PAULO
SHANGHAI
SILICON VALLEY
SINGAPORE
SYDNEY
TAIPEI
TOKYO
WASHINGTON

© Jones Day 2012. All rights reserved.