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FIRST (POST-) IMPRESSIONS: INSIDER DISTRIBUTION VIOLATES ABSOLUTE PRIORITY RULE, AND COMPETITION IS ESSENTIAL ELEMENT OF NEW VALUE COROLLARY

Paul D. Leake and Mark G. Douglas

Until 2013, no circuit court of appeals had weighed in on the implications of the U.S. Supreme Court's pronouncement in the *203 North LaSalle* case that property retained by a junior stakeholder under a cram-down chapter 11 plan in exchange for new value "without benefit of market valuation" violates the "absolute priority rule." *See Bank of Amer. Nat'l Trust & Savings Ass'n v. 203 North LaSalle Street P'ship*, 526 U.S. 434 (1999), *reversing Matter of 203 North LaSalle Street P'ship*, 126 F.3d 955 (7th Cir. 1997).

That changed when the Seventh Circuit Court of Appeals recently handed down its ruling in *In the Matter of Castleton Plaza, LP*, 2013 BL 40570 (7th Cir. Feb. 14, 2012). The court reversed a bankruptcy court ruling that a proposed plan under which an "insider" of the debtor would receive 100 percent of the equity in the reorganized company in exchange for a cash contribution passed muster under the absolute priority rule despite less than full payment of senior creditors. As a matter of first impression, the Seventh Circuit ruled that: (i) a distribution under the plan of new equity to the insider (the sole former shareholder's spouse) conferred a benefit on the former shareholder; and (ii) the sufficiency of the "new value" proffered by the insider had not been tested by competition and thus violated the absolute priority rule.

CRAM-DOWN AND THE "FAIR AND EQUITABLE" REQUIREMENT

If a class of creditors or shareholders votes to reject a chapter 11 plan, it can be confirmed only if the plan satisfies the "cram-down" requirements of section 1129(b) of the Bankruptcy Code. Among those requirements is the mandate that a plan be "fair and equitable" with respect to dissenting classes of creditors and shareholders.

Section 1129(b)(2)(B) of the Bankruptcy Code provides that a plan is "fair and equitable" with respect to a dissenting impaired class of unsecured claims if the creditors in the class receive or retain property of a value equal to the allowed amount of their claims or, failing that, in cases not involving an individual debtor, if no creditor of lesser priority, or no equity holder, receives or retains any distribution under the plan "on account of" its junior claim or interest. This requirement is sometimes referred to as the "absolute priority rule."

Three principal areas of controversy have arisen concerning the absolute priority rule. The first concerns the legitimacy, as a strategy to broker plan confirmation, of senior-class "gifting" under a chapter 11 plan to a junior class of creditors in cases where an intervening class is not being paid in full. The genesis of the second is 2005 amendments to the Bankruptcy Code that ignited a dispute as to whether the absolute priority rule continues to apply in individual chapter 11 cases. The third involves what is commonly referred to as the "new value" exception or corollary to the absolute priority rule. The *Castleton Plaza* decision focuses on the new value debate.

HISTORY OF THE ABSOLUTE PRIORITY RULE

The U.S. Supreme Court first formally articulated the absolute priority rule, originally referred to as the "fixed principle," in *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482 (1913), a case involving the equity receivership of a railroad. According to this precept, stockholders could not receive any distribution in a reorganization case unless creditor claims were first paid in full. The Supreme Court continued to apply this principle in equity-receivership cases throughout the early 20th century, emphasizing that it should be strictly applied.

In 1934, Congress amended the former Bankruptcy Act to introduce the words "fair and equitable" to the bankruptcy lexicon. Section 77B(f) of the Act provided that a plan of reorganization could be confirmed only if the bankruptcy judge was satisfied that the plan was "fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible."

The provenance of this restriction was the "fixed principle." As later expressed by the Supreme Court in *203 North LaSalle*, "The reason for such a limitation was the danger inherent in any reorganization plan proposed by a debtor, then and now, that the plan will simply turn out to be too good a deal for the debtor's owners." The "fair and equitable" requirement endured as part of chapter X of the former Bankruptcy Act when Congress passed the Chandler Act in 1938. As applied, the absolute priority rule prohibited any distribution to the holders of junior interests if senior creditors were not paid in full. This was so even if senior creditors agreed to the arrangement.

Congress partially codified the absolute priority rule into section 1129 of the Bankruptcy Code in 1978. Unlike prior law, however, the rule now applies only if a senior class deprived of payment in full does not vote to accept the plan. Thus, under the Bankruptcy Code, the absolute priority rule would be an obstacle to confirmation only if a class of senior creditors is "impaired" by, for example, receiving less than full payment under a chapter 11 plan; the senior class votes to reject the plan; and the plan provides for some distribution to junior creditors or interest holders.

THE NEW VALUE EXCEPTION

In 1939, the Supreme Court made explicit the connection between old equity-receivership cases and bankruptcy practice by holding in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), that under section 77B(f) of the former Bankruptcy Act, the requirement that a plan of reorganization be "fair and equitable" meant application of the absolute priority rule. In *Case*, the debtor's existing shareholders sought to retain an ownership interest in the company, even though senior creditors were not to be paid in full. The shareholders argued that retention of their interests was important to the company's future success, given their familiarity with business operations and the advantages of continuity in management. The Supreme Court ruled that continued shareholder participation in the ownership of an insolvent company may be acceptable under certain circumstances.

From this pronouncement evolved the controversial "new value" corollary or exception to the absolute priority rule.

Under the new value exception, a junior stakeholder (e.g., a shareholder) may retain an equity interest under a chapter 11 plan over the objection of a senior impaired-creditor class, provided that the junior stakeholder contributes new capital to the restructured enterprise. According to some courts, that contributed capital must be: (i) new; (ii) substantial; (iii) necessary for the success of the plan; (iv) reasonably equivalent to the value retained; and (v) in the form of money or money's worth.

In *In re Bonner Mall Partnership*, 2 F.3d 899 (9th Cir. 1993), *motion to vacate denied, case dismissed sub nom. U.S. Bancorp Mortg. Co. v. Bonner Mall Partnership*, 513 U.S. 18 (1994), the Ninth Circuit held that "if a proposed plan satisfies all of these [five] requirements, i.e. the new value exception, it will not violate section 1129(b)(2)(B)(ii) of the Code and the absolute priority rule." Such a plan, the court wrote, "will not give old equity property 'on account of' prior interests, but instead will allow the former owners to participate in the reorganized debtor on account of a substantial, necessary, and fair new value contribution."

Some courts have concluded that the new value exception did not survive the enactment of the Bankruptcy Code in 1978 because, among other things, the concept is not explicitly referred to in section 1129(b)(2) or elsewhere in the statute.

Since the enactment of the Bankruptcy Code, the U.S. Supreme Court has only obliquely addressed the legitimacy of the new value exception. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), the court held that, even if the new value exception survived the enactment of the Bankruptcy Code in 1978, the new value requirement could not be satisfied by promised future contributions of labor. The U.S. Supreme Court was similarly reluctant to tackle the issue head-on in the other two cases to date in which it had an opportunity to do so. In 1994, the court declined to vacate on appeal the Ninth Circuit's *Bonner Mall* opinion, and in 1999, it similarly declined to overrule the Seventh Circuit's interpretation of the corollary in *203 North LaSalle*. Instead, in the *203 North Lasalle* case, the court held that one or two of the five elements of the new value corollary could not be satisfied when old equity retains the *exclusive* right to contribute the new value—i.e., without a market test of the new value.

"It is enough to say, assuming a new value corollary," the court wrote in *203 North LaSalle*, "that plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of § 1129(b)(2)(B)(ii)." According to the court, the absolute priority rule is violated if a plan provides for "vesting equity in the reorganized business in the Debtor's partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan."

In *Castleton Plaza*, the Seventh Circuit addressed two of the issues that have arisen in connection with new value plans. Specifically, the court examined whether the absolute priority rule precludes proposed plan distributions to insiders and whether the absence of competition to test the adequacy of new value is fatal to confirmation of a chapter 11 plan under the new value exception.

CASTLETON PLAZA

Castleton Plaza, LP ("Castleton") owns a shopping center in Indiana. George Broadbent holds 98 percent of Castleton's equity directly and the remaining 2 percent indirectly. The shopping-center property is encumbered by a lien securing approximately $10 million owed to EL-SNPR Notes Holdings ("EL-SNPR"). After defaulting on the loan in September 2010, Castleton filed for chapter 11 protection in Indiana early in 2011.

In its chapter 11 plan, Castleton proposed to treat EL-SNPR's claims by: (i) replacing the original $10 million secured note with a secured note in the principal amount of $8.2 million maturing in 30 years at a significantly reduced rate of interest and with none of the original covenants; (ii) paying $300,000 in cash to EL-SNPR on the effective date of the plan; and (iii) classifying the remaining debt to EL-SNPR as an unsecured deficiency claim that would share *pari passu* in the 15 percent cash distribution (over five years) to general unsecured creditors. Although George Broadbent was nominally to receive nothing under the plan, the plan provided that George's wife, Mary Clare Broadbent, was to receive 100 percent of the equity in the reorganized Castleton in exchange for an investment in the reorganized debtor of $75,000 in cash.

Mary Clare is the sole stockholder of the Broadbent Co., Inc. ("BC"), which runs Castleton under a management contract and pays chief executive officer George Broadbent $500,000 annually. Castleton's proposed chapter 11 plan provided that the BC management agreement would be assumed.

At this juncture, the ramifications of this approach, if adopted by other courts, are unclear. At the very least, it may open the door for enhanced creditor recoveries by subjecting the adequacy of new value contributions to the market—to the extent there is one. In addition, it is not clear exactly what it means to expose the equity to a competitive process. What affirmative measures does a debtor need to take in order to satisfy the requirement? Is there a requirement to make such a showing in the absence of an absolute priority objection?

Claiming that Castleton's assets were undervalued in the plan, EL-SNPR offered $600,000 for the equity and promised to pay other creditors in full. Castleton rejected the proposal but submitted an amended plan in which Mary Clare's investment in the reorganized company was increased from $75,000 to $375,000 in exchange for all of the reorganized equity. EL-SNPR requested that the court condition confirmation of the plan on a competitive bidding process for the equity. The court denied the motion and confirmed the plan, holding that competition was not necessary because Mary Clare was not the existing equity holder, and thus, the plan did not implicate the absolute priority rule. However, the bankruptcy court certified a direct appeal of the confirmation order to the Seventh Circuit, which accepted the appeal "because no court of appeals has addressed, after *203 North LaSalle*, whether competition is essential when a plan of reorganization gives an insider an option to purchase equity in exchange for new value."

THE SEVENTH CIRCUIT'S RULING

A three-judge panel of the Seventh Circuit reversed. It faulted the bankruptcy court's determination that competition for Castleton's equity was unnecessary because Mary Clare was not an existing equity holder, and consequently, section 1129(b)(2)(B)(ii) did not apply. According to the Seventh Circuit, the Supreme Court devised the competition requirement in *203 North LaSalle* to "curtail evasion of the absolute-priority rule," and "[a] new-value plan bestowing equity on an investor's spouse can be just as effective at evading the absolute-priority rule as a new-value plan bestowing equity on the original investor."

A family member of a corporate manager, the Seventh Circuit explained, is an "insider" of the debtor under section 101(31)(B)(vi) of the Bankruptcy Code. The Seventh Circuit wrote that "[i]t follows that plans giving insiders preferential access to investment opportunities in the reorganized debtor should be subject to the same opportunity for competition as plans in which existing claim-holders put up the new money." According to the court, George Broadbent would clearly receive value from the equity that Mary Clare was to receive under the plan in the form of: (i) continuation of his salary as CEO of BC; and (ii) an increase in the family's wealth.

Because the value of Castleton's equity was not tested by competitive bidding, the Seventh Circuit ruled that the chapter 11 plan violated the absolute priority rule:

> Competition helps prevent the funneling of value from lenders to insiders, no matter who proposes the plan or when. An impaired lender who objects to any plan that leaves insiders holding equity is entitled to the benefit of competition. If, as Castleton and the Broadbents insist, their plan offers creditors the best deal, then they will prevail in the auction. But if, as EL-SNPR believes, the bankruptcy judge has underestimated the value of Castleton's real estate, wiped out too much of the secured claim, and set the remaining loan's terms at below-market rates, then someone will pay more than $375,000 (perhaps a lot more) for the equity in the reorganized firm.

OUTLOOK

The Seventh Circuit is not the only court of appeals post-*203 North LaSalle* to consider the impact of the Supreme Court's decision in connection with the absolute priority rule. In *Dish Network Corp. v. DBSD North America, Inc. (In re DBSD North*

America, Inc.), 634 F.3d 79 (2d Cir. 2011), the Second Circuit rejected senior-class gifting as inconsistent with the absolute priority rule. In ruling that a plan proposing to give existing owners shares and warrants despite less than full payment of a senior class violated the absolute priority rule, the court wrote, "Given that the Supreme Court [in *203 North LaSalle* and *Ahlers*] has hesitated to allow old owners to receive new ownership interests even when contributing new value, it is doubtful the Court would allow old owners to receive new ownership without contributing any new value, as in this case."

In *Alabama Dept. of Economic & Community Affairs v. Ball Healthcare-Dallas, LLC (In re Lett)*, 632 F.3d 1216 (11th Cir. 2011), the Eleventh Circuit discussed *203 North LaSalle* in ruling that objections to a bankruptcy court's approval of a cram-down chapter 11 plan on the basis of noncompliance with the absolute priority rule may be raised for the first time on appeal. However, after noting the existence of the new value exception, the court specifically declined any "further discussion of this exception to the absolute priority rule, as it is not at issue in this case."

The Third Circuit could have considered the issue in *In re Armstrong World Industries, Inc.*, 432 F.3d 507 (3d Cir. 2005), but the parties never raised it, opting instead to rely on other "equitable considerations to allow an exception to the absolute priority rule" that would justify the distribution of warrants under a plan to existing equity holders despite less than full payment to a senior class. In an earlier ruling, *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000), the Third Circuit construed *203 North LaSalle* in rejecting a challenge to a plan on the basis that releases of affiliates of junior equity allowed the equity holders to receive or retain property "on account of" their junior interests violated the absolute priority rule.

Finally, in *Carrieri v. Jobs.Com Inc.*, 393 F.3d 508 (5th Cir. 2004), the Fifth Circuit cited *203 North LaSalle* in affirming lower court rulings that shares of stock (with a redemption provision) and warrants (with a repurchase provision) are properly characterized as "equity securities" instead of "claims," such that the absolute priority rule precluded any distribution under a plan to the shareholders absent payment in full of creditor claims.

In *Castleton Plaza*, the Seventh Circuit broke new ground by explicitly expanding the scope of the absolute priority rule to preclude plan distributions to parties closely affiliated with members of a junior class and by expressly applying *203 North LaSalle*'s mandate that the adequacy of proposed new value be subject to competition.

Several lower courts previously have addressed the competition element of the new value exception. For example, in *H.G. Roebuck & Son, Inc. v. Alter Communications, Inc.*, 2011 BL 147642 (D. Md. June 3, 2011), the court ruled that a "new value" chapter 11 plan without any market valuation of equity to be retained by existing shareholders and without any opportunity for a competing plan violated the absolute priority rule, consistent with *203 North LaSalle*. *See also In re RTJJ, Inc.*, 2013 BL 31910 (Bankr. W.D.N.C. Feb. 6, 2013).

According to *203 North LaSalle* and *Castleton Plaza*, competition means: (i) a competitive bidding process for new equity to be distributed under a chapter 11 plan; or (ii) the opportunity for other stakeholders to propose a competing plan (presumably by termination of exclusivity if it has not already expired). At this juncture, the ramifications of this approach, if adopted by other courts, are unclear. At the very least, it may open the door for enhanced creditor recoveries by subjecting the adequacy of new value contributions to the market—to the extent there is one. In addition, it is not clear exactly what it means to expose the equity to a competitive process. What affirmative measures does a debtor need to take in order to satisfy the requirement? Is there a requirement to make such a showing in the absence of an absolute priority objection?

A bankruptcy court in the Seventh Circuit has already applied *Castleton Plaza* to preclude confirmation of a new value plan providing for distribution of new equity to an insider without competition. *See In re GAC Storage Lansing, LLC*, 2013 BL 53422 (Bankr. N.D. Ill. Feb. 27, 2013) ("In light of the *Castleton* decision, the Court determines that the absolute priority rule applies, despite the fact that Schwartz is not a direct owner or investor. The Debtor's Plan proposes to give Schwartz, an insider of the Debtor, preferential access to an investment opportunity in the Reorganized Debtor and is therefore subject to competitive bidding, as the holding in *Castleton* instructs."), *vacating and superseding In re GAC Storage Lansing, LLC*, 2013 BL 8095 (Bankr. N.D. Ill. Jan. 10, 2013).

NEWSWORTHY

Corinne Ball (New York) received the 2013 Leadership Award for Outstanding Achievements in Restructuring, Turnaround, and Reorganization at the 7th Annual *M&A Advisor* Turnaround Awards in Palm Beach, Florida, on March 6.

Richard L. Wynne (Los Angeles) participated in a panel discussion entitled "Legal Restructuring—Financial Institution Failures: Challenges and Lessons Learned" at the 2013 Wharton Restructuring and Distressed Investing Conference in Philadelphia on February 22.

Tobias S. Keller (San Francisco) gave a presentation on March 25 entitled "Over-Encumbered Property, Mortgages and Liens: The Section 1111(b) Election (Consumer Practitioners Beware)" at the Bay Area Bankruptcy Forum in San Francisco.

Jones Day was recognized at the 2013 *M&A Advisor* Turnaround Awards for the following: (i) Chapter 11 Reorganization of the Year—Over $250mm (for Lehman Brothers Holdings); (ii) Energy Deal of the Year (for the acquisition of the majority interest in Navigator Holdings by WL Ross); and (iii) Financial Services Deal of the Year (for the reorganization of Lehman Brothers Holdings).

Amy Edgy Ferber (Atlanta) participated in a panel discussion entitled "With Misery Comes Opportunity—The Top Five Dying Industry Sectors of 2013" at the 2013 *M&A Advisor* Distressed Investing Summit in Palm Beach, Florida, on March 6.

On February 28, *IFLR* held its annual Asia Awards in Hong Kong. Jones Day won the Deal of the Year Award in the Restructuring of the Year category for the Firm's representation of PT Arpeni Pratama Ocean Line in connection with its case under chapter 15 of the Bankruptcy Code, wherein the U.S. Bankruptcy Court for the Southern District of New York recognized PT Arpeni's Indonesian insolvency proceeding and extended comity to PT Arpeni's restructuring plan. It was the first time that a U.S. bankruptcy court recognized an Indonesian insolvency proceeding under chapter 15. The Jones Day team consisted of **Pedro A. Jimenez (New York)** and **Joseph E. Bauerschmidt (Singapore)**.

Brett J. Berlin (Atlanta) was selected for a two-year term as an inaugural member of the 20-person "Bench and Bar" liaison committee for the U.S. Bankruptcy Court for the Northern District of Georgia.

In March, a series of articles published in the *New Business Law Journal* in 2011 that discussed the Japanese bankruptcy proceedings of Spansion Japan, written by attorneys at Oh-Ebashi LPC & Partners as Japanese debtor's counsel and by **Pedro A. Jimenez (New York)** and **Kaoru Umino (Tokyo)** as U.S. debtor's counsel, was awarded the Restructuring and Reorganization Fellowship Support Prize by Japan's Foundation for Dispute Resolution Research. Pedro and Kaoru wrote the fourth installment of the series, entitled "Japanese Creditors in U.S. Bankruptcy Proceedings: Lessons from Spansion Japan."

Michael Rutstein (London), **Bruce Bennett (Los Angeles)**, **Laurent Assaya (Paris)**, **Corinne Ball (New York)**, **Paul D. Leake (New York)**, **David G. Heiman (Cleveland)**, **Heather Lennox (New York and Cleveland)**, and **Richard L. Wynne (Los Angeles)** were designated "Leaders in their Field" in the area of Restructuring/Insolvency and Bankruptcy by *Chambers Global* 2013.

NEWSWORTHY *(continued)*

Jeffrey B. Ellman (Atlanta) was appointed to the board of directors of the Southeastern Bankruptcy Law Institute.

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 February/March 2013 issue of *Pratt's Journal of Bankruptcy Law*.

Philip J. Hoser (Sydney) was named a "Leading Individual" in the field of Restructuring & Insolvency by *The Legal 500 Asia Pacific* 2013.

Christopher M. Healey (Columbus) was designated an Ohio Rising Star for 2013 by *Super Lawyers*.

Tobias S. Keller (San Francisco) conducted a seminar on January 23 at Stanford Law School entitled "Governance Issues Arising in the Zone of Insolvency and under the United States Bankruptcy Code."

Yuichiro Mori (Tokyo) was recommended as "a key figure in the business restructuring and reorganisation group" in *The Legal 500 Asia Pacific* 2013. He was also recommended in the field of Dispute Resolution.

Corinne Ball (New York) participated in a panel discussion on March 22 at an American College of Bankruptcy seminar at Boston College Law School entitled "The Auto Bankruptcies: Checking the Rearview Mirror."

Philip J. Hoser (Sydney) was recommended as a "Leader in his Field" in *Chambers Global* 2013 for the practice area of Dispute Resolution.

Laurent Assaya (Paris), **Michael Rutstein (London)**, **Bruce Bennett (Los Angeles)**, **Corinne Ball (New York)**, **David G. Heiman (Cleveland)**, **Heather Lennox (New York and Cleveland)**, **Paul D. Leake (New York)**, and **Richard L. Wynne (Los Angeles)** were recommended as "Leaders in their Field" in *Chambers Global* 2013 for the practice area of Restructuring/Insolvency.

Lisa G. Laukitis (New York) was named a *Law360* Rising Star for 2013 in the practice area of Bankruptcy. She was featured in the March 15, 2013, edition of *Law360*.

Philip J. Hoser (Sydney) was named a "Leader in his Field" in the practice area of Restructuring/Insolvency and Bankruptcy in *Chambers Asia-Pacific* 2013.

An article written by **Jeffrey B. Ellman (Atlanta)** and **Mark G. Douglas (New York)** entitled "Putting the Stockton Bankruptcy in Perspective" was published in the January 18, 2013, edition of *Bankruptcy Law360*.

COMITY IN CHAPTER 15—AND ITS LIMITS

Pedro A. Jimenez and Laird E. Nelson

A pair of rulings recently handed down by Delaware and New York bankruptcy courts have contributed to the ongoing debate about the role of "comity" (the recognition that one sovereign nation extends within its territory to the legislative, executive, or judicial acts of another sovereign, with due regard for the rights of its own citizens) in cross-border bankruptcy cases under chapter 15 of the U.S. Bankruptcy Code. Recourse to chapter 15 generally, and the utilization of section 363 of the Bankruptcy Code in chapter 15, can be especially valuable in cases where the representative of a foreign debtor wants to monetize assets located in the U.S. and the foreign insolvency scheme involved does not provide for "free and clear" sales or may be limited in jurisdiction. However, these tools are not without limits.

Coming down on the side of broad access, the court in *In re Elpida Memory, Inc.*, 2012 BL 302570 (Bankr. D. Del. Nov. 16, 2012), ruled that both the express language of chapter 15 and its legislative intent permit the representative of a foreign debtor to use chapter 15 and section 363 to sell assets located in the U.S. free and clear of all claims, liens, and other competing interests. By contrast, in *In re Fairfield Sentry Limited*, 2013 BL 8090 (Bankr. S.D.N.Y. Jan. 10, 2013), the court sounded a cautionary note, emphasizing the pre-eminent role of comity in chapter 15 and concluding that plenary review under section 363 of a sale transaction approved by a foreign tribunal was not appropriate.

ELPIDA

On February 27, 2012, Elpida Memory, Inc. ("Elpida"), a manufacturer of dynamic random-access, or DRAM, products, commenced reorganization proceedings under the Japanese Corporate Reorganization Act (*Kaisha Kosei Ho*) in a Japanese court. Thereafter, the foreign representatives of Elpida sought and obtained from the Delaware bankruptcy court an order recognizing the Japanese proceeding as a foreign "main proceeding" under chapter 15.

After an auction was conducted in Japan, Elpida's bankruptcy trustees determined that Micron Technology, Inc. ("Micron") would serve as the sponsor for Elpida's plan of reorganization. In connection with the sponsor agreement, the trustees also sought authority to enter into various technology transfer agreements between Elpida and Micron, as well as agreements with Rambus Inc. to sell certain Elpida patents and to continue to cross-license others (collectively, the "Agreements"). Each of the Agreements was approved by the Japanese court.

However, each of the Agreements contemplated a sale of Elpida property located in the U.S. Accordingly, Elpida's foreign representatives sought U.S. bankruptcy court approval under sections 363 and 1520 of the Bankruptcy Code of that portion of the Agreements involving the sale of U.S. assets. A group of Elpida's bondholders objected.

Although all parties agreed that section 363 was available to Elpida as a means of effecting a sale of U.S. assets, it was unclear how the provision should be applied and, in particular, what standard should be employed by the bankruptcy court in ruling on Elpida's request. Therefore, the court considered whether it should decide the issue on the basis of principles of comity (i.e., by deferring to the Japanese court's approval of the transaction) or instead independently review the sale transaction under the "business judgment" standard applied under section 363(b) to a proposed use, sale, or lease of property outside the ordinary course of business.

THE DELAWARE BANKRUPTCY COURT'S DECISION

The bankruptcy court began its analysis by looking to section 1520(a)'s plain meaning—the "default entrance" when interpreting a statute. This analysis, it determined, was straightforward: section 1520(a) unequivocally states that section 363 applies "to a transfer of an interest of the debtor in property that is within the territorial jurisdiction of the United States to the same extent that the section[] would apply to property of an estate." From this, the court concluded that, by extension, the standard applied to nonordinary-course transactions under section 363(b) must also apply in chapter 15 and that the foreign representatives bore the burden of demonstrating that the Agreements represented a sound exercise of business judgment.

The court also examined the legislative history of section 1520, observing that "[n]otwithstanding the Supreme Court's repeated admonition that courts are to interpret statutes according to their plain meaning, one could argue that in Chapter 15 cases plain meaning should be subservient to legislative history or more general principles of comity." Noting that section 1520 is adopted from Article 20 of the U.N. Commission on International Trade Law's Model Law on Cross-Border Insolvency (the "Model Law"), the court looked to the Model Law "as part of its interpretive task."

These rulings shed further light on the extent to which a foreign debtor (as well as its creditors) may rely on the provisions and protections of the Bankruptcy Code. Stakeholders in cross-border bankruptcy cases should benefit from the growing body of case law regarding this issue, particularly where the protections provided by the Bankruptcy Code are different from, and often greater than, those provided by the law of the foreign forum. However, the availability of U.S. courts (and relief under U.S. law) is not unlimited. Comity remains an important and vibrant principle, particularly where assets and interests are clearly centered in a foreign proceeding. Participants would be well advised to recognize the complicated interplay that exists in cross-border cases.

In the court's view, the Model Law has two essential purposes: (i) stopping actions against the debtor's assets in all jurisdictions; and (ii) preventing the debtor from transferring or disposing of assets without a court order. In order to achieve these ends, the court explained, Article 20 and the Model Law as a whole follow an *in rem* division of labor between the sovereigns—i.e., by giving domestic courts responsibility for the assets located within their borders and by imposing "the laws of the ancillary forum—not those of the foreign main proceedings—on the debtor with respect to transfers of assets located in such ancillary jurisdiction."

Lastly, the court examined the general precept that a U.S. court should grant comity to a recognized foreign representative in insolvency matters. Acknowledging that court rulings in chapter 15 cases routinely refer to this concept, the bankruptcy court in *Elpida* cautioned that "it is not the end all be all of the statute. To require this Court to defer in all instances to foreign court decision[s]," the court wrote, "would gut section 1520," which itself is mandatory.

Moreover, the court explained, the only two provisions in chapter 15 that specifically mention comity—sections 1507(b) and 1509(b)(3)—did not apply to the situation before it. Section 1507(b) was not relevant because Elpida's foreign representatives were not requesting "additional assistance" (e.g., an order preventing preferential or fraudulent transfers of a debtor's assets). Similarly, section 1509(b) was inapplicable because, in the court's view, the provision's direction that a bankruptcy court, post-recognition, "grant comity or cooperation to the foreign representative" does not require a U.S. court to grant comity to the *orders of the foreign court*.

Therefore, because principles of comity did not alter the court's interpretation of both the plain meaning and the legislative history of section 1520, the court ruled that section 363(b)'s business-judgment test controls.

SUBSEQUENT HISTORY—THE MERITS

On January 16, 2013, the Delaware bankruptcy court approved the Agreements, ruling that the asset sales satisfied the business-judgment standard under section 363(b). Although the court took judicial notice of the fact that the transactions at issue involved certain assets that were outside its jurisdiction, the court nonetheless subjected the Agreements to plenary review. It found that Elpida had demonstrated a sound business purpose, a fair sale price, fair and reasonable notice, and good faith on the part of the purchasers. Moreover, the court determined that, although (i) the transactions were not made public until after the Agreements were executed and (ii) much of the Japanese proceeding was conducted *ex parte* or under seal, leading to concerns about notice and transparency, the requirements of the Bankruptcy Code and due process were ultimately satisfied.

On January 30, 2013, certain Elpida bondholders filed a motion for reconsideration of the order approving the Agreements. The court denied the motion on February 15, 2013. On February 27, 2013, the Japanese court approved Elpida's reorganization plan, leaving recognition of the plan by the Delaware bankruptcy court as the last major hurdle for approval of the Micron deal.

FAIRFIELD SENTRY

Fairfield Sentry Limited ("Fairfield Sentry") was established for the purpose of allowing mainly non-U.S. persons and certain tax-exempt U.S. entities to invest with Bernard L. Madoff Investment Securities ("BLMIS"). Shortly after Madoff's Ponzi scheme came to light and BLMIS collapsed, Fairfield Sentry was placed into liquidation in a British Virgin Islands ("BVI") court. On July 22, 2010, a New York bankruptcy court issued an order recognizing the BVI proceeding as a foreign main proceeding under chapter 15.

Fairfield Sentry filed three customer claims in the U.S. liquidation proceeding commenced on behalf of BLMIS under the Securities Investor Protection Act ("SIPA"). Litigation in the proceeding resulted in a settlement whereby Fairfield Sentry's claims were allowed in the amount of $230 million. In 2010, following a competitive auction, Fairfield Sentry's foreign representative accepted an offer from Farnum Place, LLC, to purchase the claims for 32.125 percent of their allowed amount. In December 2010, shortly after the parties signed a trade confirmation (the "Trade Confirmation") (with the assistance of U.S. counsel), the pool of assets available for distribution to BLMIS customers was augmented by approximately $7.2 billion due to a separate settlement, leading to a sharp increase in the prices offered for claims against BLMIS.

By its terms, the Trade Confirmation was subject to: (i) approval by the BVI court; and (ii) an order of both the BVI court and the U.S. bankruptcy court approving the assignment of Fairfield Sentry's claims. The BVI court approved the Trade Confirmation and the claim assignment after a three-day evidentiary hearing. Approval was then sought from the New York bankruptcy court, which was faced with, among other things, the question of whether it was bound to review the assignment under section 363 to determine whether the transaction was in the best interests of Fairfield Sentry's estate.

THE NEW YORK BANKRUPTCY COURT'S DECISION

Noting that "[t]his is a pure and simple case of seller's remorse," the court concluded that plenary review of the claims assignment was not warranted under section 1520(a)(2) (which, as noted previously, makes section 363 applicable in chapter 15 cases) because the property was not "within the territorial jurisdiction of the United States."

The court considered whether this conclusion comports with chapter 15's "governing concept of comity." At the outset, it noted that the origin of chapter 15 rests in section 304 of the Bankruptcy Code (repealed in 2005) and the Model Law. Integral to both of those, the court explained, is the governing concept of comity. The primacy of that concept is demonstrated by its inclusion in the preamble of section 1507(b), as well as by chapter 15's deferential framework for international judicial cooperation.

The court determined that Fairfield Sentry's SIPA claims were "located" in the BVI and that the BVI court had the paramount interest in the sale of the claims, whereas the New York court lacked any meaningful interest at all. Under circumstances where U.S. interests are minimal, the court reasoned, comity dictates deference to the BVI court and its judgment. Simply put, the court wrote:

> Chapter 15 was not designed to permit parties to mix and match multiple countries' laws, which would lead to "haphazard, erratic, or piecemeal" adjudication of the distribution of assets . . . , as the administration and disbursement of *the same* assets would be handled by "different tribunals in different countries according to different laws."

Moreover, the court emphasized the extent to which such "inharmonious legal approaches" threaten the predictability of cross-border cases and the administration of the assets—exactly the outcome chapter 15 was designed to prevent.

OUTLOOK

Elpida builds on an earlier decision in *In re Qimonda AG*, 462 B.R. 165 (Bankr. E.D. Va. 2011), which likewise confirmed that foreign debtors may avail themselves of the protections of or remedies in the Bankruptcy Code. In that case, two U.S. patent licensees, Samsung and Elpida, whose licenses were repudiated under German law in Qimonda's German insolvency proceeding, asserted that they were entitled to the protections of section 365(n) of the Bankruptcy Code with respect to their licenses. The court held that the failure of German insolvency law to afford patent licensees the safeguards which they would enjoy under section 365(n) was "manifestly contrary" to the public policy of the U.S. and did not ensure that licensees of the debtor's U.S. patents were "sufficiently protected." According to the court, the failure to apply section 365(n) would "severely impinge" on an important statutory protection afforded to licensees of U.S. patents, and uncertainty attendant upon the exercise of German law would "slow the pace of innovation, to the detriment of the U.S. economy." The court accordingly denied the foreign representative's motion to strike section 365(n) from the recognition order and clarified that section 365(n) applies in the chapter 15 case with respect to the foreign debtor's U.S. patents.

By contrast, the court in *Fairfield Sentry* distanced itself from *Elpida*, noting that it "disagrees with the *Elpida* court's downplay of the role of comity in Chapter 15." Moreover, the *Fairfield Sentry* court emphasized, "*Elpida* is on entirely different footing from the instant case" due to the existence in *Elpida* of a modified recognition order that explicitly prohibited the foreign representative from selling Elpida's U.S. assets without bankruptcy court approval. In *Fairfield Sentry*, there was no such order from either the U.S. court or the BVI court—all that existed was "a similar but *gratuitous* approval requirement present in the Trade Confirmation."

These rulings shed further light on the extent to which a foreign debtor (as well as its creditors) may rely on the provisions and protections of the Bankruptcy Code. Stakeholders in cross-border bankruptcy cases should benefit from the growing body of case law regarding this issue, particularly where the protections provided by the Bankruptcy Code are different from, and often greater than, those provided by the law of the foreign forum. However, the availability of U.S. courts (and relief under U.S. law) is not unlimited. Comity remains an important and vibrant principle, particularly where assets and interests are clearly centered in a foreign proceeding. Participants would be well advised to recognize the complicated interplay that exists in cross-border cases.

EMPLOYER'S FAILURE TO ISSUE WARN NOTIFICATION EXCUSED DUE TO ABRUPT TERMINATION OF FINANCING

Robert W. Hamilton and Mark G. Douglas

Despite the increasing prominence of pre-packaged or prenegotiated chapter 11 cases in recent years, not every bankruptcy filing by or against a company is a carefully planned event orchestrated over a period of months or even years to achieve a workable reorganization, sale, or liquidation strategy. Sometimes, unanticipated circumstances precipitate a bankruptcy filing. If the debtor employs a substantial workforce that is dismissed (pre- or post-bankruptcy) because the debtor either ceases operating or significantly reduces the number of its employees, state and/or federal law other than the Bankruptcy Code may impose obligations on the debtor in connection with the workforce dismissals or plant closures.

A recent unpublished ruling by the Fifth Circuit Court of Appeals examines a debtor-employer's responsibilities under the federal Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 *et seq.* ("WARN"). In *Angles v. Flexible Flyer Liquidating Trust (In re Flexible Flyer Liquidating Trust)*, 2013 BL 35609 (5th Cir. Feb. 11, 2013), the court affirmed a bankruptcy court determination that a debtor-employer was not required to give a 60-day WARN notification to its employees because a sudden, unanticipated termination of financing which forced the company to file for bankruptcy protection satisfied WARN's notification exception for "unforeseeable business circumstances."

WARN

Enacted in 1988, WARN protects workers, their families, and communities by requiring most employers with 100 or more employees to provide notification 60 calendar days in advance of plant closings and mass layoffs. Twenty-nine U.S.C. § 2102(a) provides that:

> [a]n employer shall not order a plant closing or mass layoff until the end of a 60-day period after the employer serves written notice of such an order –

> (1) to each representative of the affected employees as of the time of the notice or, if there is no such representative at that time, to each affected employee.

Twenty-nine U.S.C. § 2101(a)(2) defines "plant closing" as:

> the permanent or temporary shutdown of a single site of employment, or one or more facilities or operating units within a single site of employment, if the shutdown results in an employment loss at the single site of employment during any 30-day period for 50 or more employees excluding any part-time employees.

"Mass layoff" is defined in 29 U.S.C. § 2101(a)(3) as a reduction in the workforce that is not the result of a plant closing and results in an employment loss at a single site of employment during any 30-day period of a specified percentage or aggregate number of employees.

Twenty-nine U.S.C. § 2101(a)(1) defines "employer" as "any business enterprise that employs – (A) 100 or more employees, excluding part-time employees; or (B) 100 or more employees who in the aggregate work at least 4,000 hours per week (exclusive of hours of overtime)." However, a court-fashioned "liquidating fiduciary" exception provides that a liquidating fiduciary in a bankruptcy case (e.g., a trustee or other estate representative) does not fit the definition of an employer for purposes of WARN. *See Official Comm. of Unsecured Creditors of United Healthcare Sys., Inc. v. United Healthcare Sys., Inc. (In re United Healthcare Sys., Inc.)*, 200 F.3d 170 (3d Cir. 1999); *Conn v. Dewey & LeBoeuf LLP (In re Dewey & LeBoeuf LLP)*, 2013 BL 39061 (Bankr. S.D.N.Y. Feb. 13, 2013).

The U.S. Department of Labor has prescribed regulations to implement WARN. Among other things, the regulations prescribe when an employer must give WARN notice, who the employer must notify, how the employer must give notice, and what information the notice must contain. *See* 20 C.F.R. § 639 *et seq.*

Twenty-nine U.S.C. § 2104(a) provides that an employer who fails to give WARN notice shall be liable to each aggrieved employee who suffers an employment loss as a result of such plant closing or mass layoff for, among other things, back pay for each day during the period of the violation. It also states that the employer's liability "shall be calculated for the period of the violation, up to a maximum of 60 days, but in no event for more than one-half the number of days the employee was employed by the employer."

In certain respects, *Flexible Flyer* is a cautionary tale. Employers confronting problems that may lead to workforce reductions, mass layoffs, or the shuttering of a business altogether should be aware of their obligations under WARN and comparable state laws. If WARN notification, even in an abridged form, is not possible due to unforeseen circumstances, management should be prepared to demonstrate not only that the events in question were unanticipated, but also that business decisions made during the period leading up to a plant closure or mass layoff were reasonable under the circumstances.

However, if an employer can prove that it shut down operations because either it was a "faltering company" or the shutdown was due to business circumstances "that were not reasonably foreseeable," it need not comply with WARN's 60-day notice provisions. Twenty-nine U.S.C. § 2102(b) provides as follows:

> (1) An employer may order the shutdown of a single site of employment before the conclusion of the 60-day period if as of the time that notice would have been required the employer was actively seeking capital or business which, if obtained, would have enabled the employer to avoid or postpone the shutdown and the employer reasonably and in good faith believed that giving the notice required would have precluded the employer from obtaining the needed capital or business.
>
> (2)(A) An employer may order a plant closing or mass layoff before the conclusion of the 60-day

> period if the closing or mass layoff is caused by business circumstances that were not reasonably foreseeable as of the time that notice would have been required.

* * * *

In addition, 29 U.S.C. § 2102(b)(2)(B) provides that "[n]o notice under [WARN] shall be required if the plant closing or mass layoff is due to any form of natural disaster, such as a flood, earthquake, or the drought currently ravaging the farmlands of the United States."

Even if the exceptions in 29 U.S.C. § 2102(b)(1) and (b)(2)(A) apply, an employer is not relieved of its obligation to notify employees altogether. When an employer ceases operating due to "not reasonably foreseeable" business circumstances or because it is a "faltering company," the employer can give less than 60 days' WARN notice, provided the notice contains certain "basic" information (*see* 20 C.F.R. § 639.7) and the reasons the employer could not provide the full 60 days' notice. *See* 29 U.S.C. § 2102(b)(3).

Twenty C.F.R. § 639.9(b)(1) states that closings and layoffs are not foreseeable when "caused by some sudden, dramatic, and unexpected action or condition outside the employer's control." The regulations also provide that, in assessing the foreseeability of business circumstances, the focus should be "on an employer's business judgment" and that an employer is required only to "exercise such commercially reasonable business judgment as would a similarly situated employer in predicting the demands of its particular market." *See* 20 C.F.R. § 639.9(b)(2).

Some states have enacted laws similar to WARN that impose enhanced employee-notification requirements. *See*, *e.g.*, New York State Worker Adjustment and Retraining Notification Act, N.Y. Lab. L. §§ 860–860-i; art. 25-A, pt. 921 (2009); Cal. Lab. Code § 1400–1408 (2003), 820 Ill. Comp. Stat. 65/*et seq.* (2005).

The Fifth Circuit addressed the unforeseeable-business-circumstances exception to the federal WARN notification requirement in *Flexible Flyer*.

FLEXIBLE FLYER

Private-equity fund Cerberus Capital Management Corp. ("Cerberus") formed FF Acquisition Corp., d.b.a. Flexible-Flyer ("Flexible Flyer") in 1997 to purchase the Flexible Flyer assets out of bankruptcy. At the time, Flexible Flyer manufactured swing sets, hobby horses, go-carts, utility vehicles, and fitness equipment, in addition to the iconic Flexible Flyer sled, sold by a variety of retailers, including Walmart, Toys "R" Us, Kmart, and Sam's Club.

Flexible Flyer never made a profit and constantly lost money. It was funded almost entirely by Cerberus, which infused Flexible Flyer with $85 million in capital. However, late in 2000, the company entered into a factoring arrangement with CIT Group Commercial Systems, LLC ("CIT"). Under the factoring agreement, CIT advanced funds equal to 80 percent of Flexible Flyer's receivables.

Each year, Cerberus informed Flexible Flyer that it would shut down the company if it did not become profitable within the coming year, but Cerberus never made good on the threat and continued to provide Flexible Flyer with capital. In 2005, Flexible Flyer experienced several financial reverses, including a product recall due to defective parts. The company notified its employees in April 2005 of possible layoffs in the affected division. Retailers also informed Flexible Flyer that they would be deferring purchases of millions of dollars' worth of products.

Management took steps to triage the damage and remained optimistic that the company could weather the storm, especially in light of a bankruptcy filing by Flexible Flyer's primary competitor in the U.S. swing-set market. In August 2005, Flexible Flyer consulted professionals to explore a range of options, including divestiture of unprofitable divisions and a bankruptcy filing.

Soon afterward, CIT reduced its credit line by cutting advances to 50 percent of receivables. Two weeks later, CIT informed Flexible Flyer that it would cease advancing credit altogether. After Cerberus refused a request for additional capital, Flexible Flyer filed for chapter 11 protection in Mississippi on September 9, 2005. That same day, the company informed its employees (by means of an abridged

WARN notification) that it would be terminating business operations, resulting in company-wide layoffs. Shortly afterward, Flexible Flyer sold substantially all of its assets, including the Flexible Flyer® trademark.

A group of more than 100 former employees filed an adversary proceeding in the bankruptcy court alleging that Flexible Flyer was liable under WARN for failing to give them the required 60-day layoff notice. The bankruptcy court ultimately determined that Flexible Flyer was excused from providing advance notice because it had demonstrated that the layoffs were the result of an unforeseeable business circumstance. The court also found that, under the circumstances, Flexible Flyer had provided WARN notification to its employees "at the earliest practical date that such a notice could be provided." The district court affirmed the ruling on appeal.

THE FIFTH CIRCUIT'S RULING

A three-judge panel of the Fifth Circuit affirmed the rulings below in an unpublished decision. Focusing on the foreseeability issue, the court explained that "where it only is possible that the business circumstance at issue may occur, such circumstances are not reasonably foreseeable." Rather, the court wrote, "it is the probability of occurrence that makes a business circumstance 'reasonably foreseeable' and thereby forecloses use of the [unforeseeable business circumstances] exception."

The Fifth Circuit did not fault the bankruptcy court's conclusion that the closing of Flexible Flyer's business was not reasonably foreseeable. All of the evidence, the Fifth Circuit stated, "shows that the focus of Flexible Flyer's management was on saving the company, not planning for an upcoming shutdown." The court also determined that the bankruptcy court committed no clear error in concluding that management's exercise of its business judgment to keep Flexible Flyer operating and its expectation that it would continue operations into the following year were "completely reasonable," despite the fact that "Flexible Flyer's financial condition was perilous for much of its eight-year existence." According to the Fifth Circuit, "[i]t was only when CIT and Cerberus both decided to cut off funding completely, and did so almost simultaneously without warning, that the shutdown became inevitable."

In affirming the rulings below, the Fifth Circuit observed that the case before it presented a "convincing example" of an event satisfying the unforeseeable-business-circumstances exception, consistent with the underlying purpose of WARN:

> [WARN] allows good faith, well-grounded hope, and reasonable expectations. Its regulations protect the employer's exercise of business judgment and are intended to encourage employers to take all reasonable actions to preserve the company and the jobs. Holding Flexible Flyer liable for a [WARN] violation on the facts found by the bankruptcy court would serve only to encourage employers to abandon companies even when there is some probability of some success.

OUTLOOK

In certain respects, *Flexible Flyer* is a cautionary tale. Employers confronting problems that may lead to workforce reductions, mass layoffs, or the shuttering of a business altogether should be aware of their obligations under WARN and comparable state laws. If WARN notification, even in an abridged form, is not possible due to unforeseen circumstances, management should be prepared to demonstrate not only that the events in question were unanticipated, but also that business decisions made during the period leading up to a plant closure or mass layoff were reasonable under the circumstances. According to the Fifth Circuit's analysis, the probability, rather than the possibility, of the occurrence of the business circumstance that forces the shutdown is the determinative factor.

Interestingly, although the bankruptcy court in *Flexible Flyer* also ruled that the company satisfied the "faltering company" exception in 29 U.S.C. § 2102(b)(1), the Fifth Circuit never reached the issue on appeal. Explaining that the bankruptcy court found the unforeseeable-business-circumstances exception to be "by far the most compelling," the court of appeals declined to express any views on this alternative exception to the WARN notification requirements.

The debtor in *Flexible Flyer* may also have been exempt from the 60-day WARN notification requirement as a liquidating fiduciary, especially given that the company never attempted to reorganize in chapter 11 instead of shutting down immediately upon the bankruptcy filing. However, the issue was apparently never raised in either the bankruptcy or appellate courts.

IN RE LOTHIAN OIL: NO TOLLING OF STATUTE OF LIMITATIONS FOR CHAPTER 11 PLAN REVOCATION

Laura L. Swanson and Mark G. Douglas

Confirmation of a chapter 11 plan providing for the reorganization or liquidation of a debtor is the culmination of the chapter 11 process. To promote the fundamental policy of finality in that process, the general rule is that a final confirmation order is inviolable. The absence of certainty that the transactions effectuated under a plan are valid and permanent would undermine chapter 11's fundamental purpose as a vehicle for rehabilitating ailing enterprises and providing debtors with a fresh start. The importance of finality in this context was the subject of a ruling recently handed down by the Fifth Circuit Court of Appeals. In *Anti-Lothian Bankr. Fraud Comm. v. Lothian Oil, Inc. (In re Lothian Oil, Inc.)*, 2013 BL 17873 (5th Cir. Jan. 23, 2013), the court ruled that the 180-day limitation period in section 1144 of the Bankruptcy Code for seeking revocation of a plan-confirmation order on the basis of fraud may not be tolled.

REVOCATION OF AN ORDER CONFIRMING A PLAN

A limited exception to the rule of finality of the confirmation of a chapter 11 plan can be found in section 1144 of the Bankruptcy Code. Section 1144 provides that, on the request of a party-in-interest made any time before 180 days after the entry of an order of confirmation, the bankruptcy court "may revoke such order if and only if such order was procured by fraud." If the court exercises its discretion to revoke a confirmation order, the statute further provides that the revocation order "shall—(1) contain such provisions as are necessary to protect any entity acquiring rights in good faith reliance on the order of confirmation; and (2) revoke the discharge of the debtor." Section 1144 is designed to restore the parties to their pre-confirmation positions, as long as the rights of third parties who relied on the plan in good faith are protected. The extreme difficulty of doing so in most cases means that revocation is generally regarded as a drastic remedy for the bankruptcy court to employ.

The court must specifically find that the order was procured by fraud before revoking a confirmation order. The fraud need not have been committed by the debtor or any other proponent of the plan. Fraud committed during a chapter 11 case that is unrelated to plan confirmation is not a basis for revocation—the bankruptcy court can implement other remedies designed to punish the malefactor or remedy any resulting harm, such as the entry of a judgment against the perpetrator. On its face, section 1144, unlike its predecessor provision under the former Bankruptcy Act, does not require the party seeking revocation to have been unaware of the fraud at the time the plan was confirmed.

A defense frequently invoked in connection with a revocation request is that the party seeking revocation knew or should have known of the fraud prior to confirmation. Unless the party in question is the plan proponent, who has affirmative duties of disclosure and good faith, such knowledge is not a bar to revocation under section 1144, although the party seeking revocation may be required to justify its failure to call the fraud to the court's attention when it occurred.

Section 1144 does not explain the meaning of "fraud." As a consequence, it has been left to the courts to fashion a definition. They have done so by looking to the traditional elements of fraud under common law and precedent construing section 1144, the revocation provisions under other chapters of the Bankruptcy Code, and their predecessors under the former Bankruptcy Act, all of which are similar enough to be informative in assessing the kind of conduct that can justify revocation of an order confirming a chapter 11 plan. Many courts construe "fraud" in section 1144 to mean "fraud on the court." In addition, most courts require a showing of actual fraudulent intent. The fraud can consist of either material misstatements or omissions in the face of a duty to disclose information.

Even if it finds that actionable fraud was committed, the bankruptcy court is not obligated to revoke a confirmation order. Section 1144 gives the court considerable discretion to fashion whatever remedy is appropriate under the circumstances to achieve an equitable outcome. If, for example, it is too late to remedy fraud, or if revoking a confirmation order and restoring the *status quo ante* would be impractical, the court may exercise its discretion to deny revocation in lieu of more effective and less disruptive remedies.

Importantly, the 180-day period specified in section 1144 is absolute. Unlike certain other deadlines contained in the Bankruptcy Code, it may not be extended by the court, even if fraud in procuring a confirmation order is not discovered until after the 180-day period expires. The Fifth Circuit reaffirmed the importance of strict compliance with these requirements in the service of finality in *Lothian Oil*.

LOTHIAN OIL

Lothian Oil, Inc. ("Lothian") filed for chapter 11 protection on June 13, 2007, in Texas. That same day, Lothian filed motions to approve settlement agreements with two creditors resolving lawsuits previously brought by Lothian to protect properties on which the creditor entities, both headed by a company called the Belridge Group ("Belridge"), were trying to foreclose. In response, an unofficial group of shareholders (the "ad hoc committee") tried to block approval of the settlements, claiming that the agreements amounted to fraudulent transfers because the properties were being surrendered to Belridge without appropriate compensation. The bankruptcy court approved the settlement agreements on June 16, 2007.

On June 10, 2008, the ad hoc committee filed a motion to set aside the settlement agreements under Rule 9024 of the Federal Rules of Bankruptcy Procedure. Rule 9024, with certain exceptions, makes Fed. R. Civ. P. 60 applicable in bankruptcy cases. Civil Rule 60 provides that the court may relieve a party from an order or judgment due to, among other things, "mistake, inadvertence, surprise, or excusable neglect," "newly discovered evidence," fraud, or "any other reason that justifies relief." A request for relief under Rule 9024 and Civil Rule 60 must be made no later than one year following entry of the challenged order or judgment. However, Rule 9024(3) makes an exception to the application of Civil Rule 60, providing that "a complaint to revoke an order confirming a plan may be filed only within the time allowed by § 1144 [of the Bankruptcy Code]."

On June 27, 2008, the bankruptcy court confirmed a chapter 11 plan for Lothian that incorporated both settlements with Belridge. However, the confirmation order preserved the ad hoc committee's right to request that the 2007 settlement orders be set aside under Rule 9024. Most ad hoc committee members subsequently resolved their objections to the settlements.

On June 29, 2009, more than a year after confirmation, nonsettling members of the ad hoc committee and certain other parties challenged the 2007 settlement orders and requested that Lothian's chapter 11 plan be set aside under Rule 9024 due to recently discovered fraud. Although the bankruptcy court dismissed the request without prejudice, a substantially similar group of plaintiffs (the "Anti-Lothian Group") then filed a motion under Rule 9024 to "clarify or modify" the plan by setting aside the settlement orders and avoiding the payment of illicit fees.

The bankruptcy court held that the confirmation order was final, deeming the Anti-Lothian Group's motion to set aside the settlement orders an attempt to relitigate matters that were or should have been contested when the plan was first confirmed. The court ruled that the motion was barred by the 180-day limitation period for revoking a plan-confirmation order under section 1144. It also addressed the merits, finding that there was no mistake, inadvertence, fraud, or other cause shown to set aside the settlement orders.

The district court affirmed on appeal. According to the district court, not only is Rule 9024 expressly subject to the 180-day limitation in section 1144, but the Anti-Lothian Group's request to set aside the settlement was untimely filed under both section 1144 and Rule 9024.

THE FIFTH CIRCUIT'S RULING

A three-judge panel of the Fifth Circuit affirmed in an unpublished ruling. The Anti-Lothian Group argued that its motion was not an attempt to revoke the confirmed plan but merely sought a modification of the plan to undo fraudulent transfers and recover illicit fees paid by the estate. The appellant also claimed that, because the plan itself "made room" for the initial 9024 motion by the ad hoc committee, the current "attack" on the challenged transactions was merely in keeping with that carve-out. Finally, the Anti-Lothian Group contended that any delay in the filing could be excused by newly discovered evidence of certain conflicts of interest which tainted the settlements. The Fifth Circuit rejected each of these arguments.

At the outset, the court ruled that the Anti-Lothian Group lacked standing to seek modification of the plan. "Even if we accept the dubious proposition that the [motion] merely sought modification of the plan," the Fifth Circuit wrote, "only the plan's proponents or the debtor may modify a confirmed plan" under section 1127 of the Bankruptcy Code. Because the Anti-Lothian Group neither sought court permission to bring a derivative action on Lothian's behalf nor claimed that any such request would be futile, the Fifth Circuit held that the appellant "thus lacks the requisite standing to make a motion to modify the Confirmed Plan."

Lothian Oil illustrates the importance of the finality of an order confirming a chapter 11 plan, as well as the exacting scrutiny that courts will bring to bear on any attempt to attack a confirmation order outside the normal appellate process, regardless of how such a challenge is denominated.

The Fifth Circuit agreed with the lower courts' determinations that the Anti-Lothian Group's motion was untimely under both section 1144 and Rule 9024. It was critical of the Anti-Lothian Group's contention that the normal limitation period governing a challenge to a chapter 11 plan should be excused on the basis of recently acquired evidence of fraud. Even if the Anti-Lothian Group had put forth sufficient evidence of this "newness," which it did not, the Fifth Circuit concluded, any form of tolling is explicitly precluded by the text of both section 1144 and Rule 9024. According to the court, because those provisions explicitly treat fraud, "it would make little sense to toll the limitations period of rules designed to deal with fraud because fraud was present." Finally, the Fifth Circuit held that the carve-out in Lothian's chapter 11 plan applied only to the ad hoc committee's Rule 9024 motion.

OUTLOOK

Lothian Oil illustrates the importance of the finality of an order confirming a chapter 11 plan, as well as the exacting scrutiny that courts will bring to bear on any attempt to attack a confirmation order outside the normal appellate process, regardless of how such a challenge is denominated. The requirements of section 1144 are strictly construed. The message of *Lothian Oil* is aptly summed up by the Fifth Circuit's citation to the U.S. Supreme Court's ruling in *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), for the proposition that "[d]eadlines may lead to unwelcome results, but they prompt parties to act and they produce finality."

EUROPEAN PERSPECTIVE IN BRIEF

Europe has struggled mightily during the last several years to triage a long series of critical blows to the economies of the 27 countries that comprise the European Union, as well as the collective viability of eurozone economies. Here we provide a snapshot of some recent developments relating to insolvency and restructuring in the EU.

Spain—The capital structure of the Asset Management Company for Assets Arising from Bank Restructuring ("SAREB") established in late November 2012 by the Fund for Orderly Bank Restructuring (*Fondo de Reestructuración Ordenada Bancaria* ("FROB")) in connection with the Spanish banking sector's recapitalization and restructuring process has been completed. SAREB was created as a limited liability stock company for a term not to exceed 15 years. It is governed by the provisions of Law 9/2012 of November 14, 2012, on Restructuring and Resolution of Credit Entities ("Law 9/2012"); by Royal Decree 1559/2012 of November 15, 2012, which established the Legal System for Asset Management Companies; and by other private law regulations.

The exclusive purpose of SAREB is the ownership, management, and administration (whether direct or indirect), as well as the acquisition and sale, of distressed assets that have been transferred to it by: (i) financial institutions which required public assistance from FROB when Royal Decree 24/2012 on Restructuring and Resolution of Credit Entities (now repealed by Law 9/2012) entered into force; and (ii) institutions that require public funds, according to the Bank of Spain's judgment and independent analysis of the capital needs and the quality of the assets of the Spanish financial system (carried out within the framework of the Memorandum of Understanding on Financial-Sector Policy Conditionality executed by Spanish and European authorities on July 20, 2012).

SAREB will be managing total assets of more than €50 billion after acquiring the assets of Group 1 entities (i.e., banks that have already been nationalized: Bankia, Catalunya Bank, NCG Banco-Banco Gallego, and Banco de Valencia) for approximately €36.7 billion and the assets of Group 2 entities (i.e., banks that require public capital: BMN, Liberbank, Caja3, and CEISS) for approximately €14 billion, all according to parameters defined by restructuring plans approved by the European Commission on November 28, 2012.

Germany—On January 3, 2013, the German Ministry of Justice circulated draft legislation that would establish procedures to govern the coordination of insolvency proceedings of affiliated companies. Existing German law does not provide for a joint approach to such insolvencies but is instead structured to accommodate companies on an individual basis. Under current law, an insolvency petition must be filed in the court of the district where the center of a group member's economic activity is located. This often results in the involvement of multiple insolvency courts and the appointment of multiple officeholders to administer the insolvency proceedings of group members. As a result, it is frequently difficult to achieve the best results for stakeholders in cases where corporate functions serving the whole group have been allocated to a single group member before insolvency proceedings or where similar dependencies exist among group members. Close cooperation of group members following the filing of an insolvency petition may not be possible if different courts and officeholders are involved, although such cooperation may be desirable for economic reasons. The proposed legislation is intended to change this, consistent with broader EU legislative activity promoting closer cooperation between courts and officeholders in insolvency proceedings of group companies carrying on economic activity in different member states.

The German ministry's proposed legislation provides for a single insolvency court to have jurisdiction over all the members of the group. Which particular court shall have such jurisdiction depends on a number of factors, including: (i) a finding by the court that the petitioning group member is of sufficient significance to the group to warrant commencement of joint proceedings in the district where the center of that group member's economic activity is located; and (ii) the interests of creditors. The court presiding over joint proceedings may generally appoint a single insolvency administrator for all group members. The court may also appoint a joint creditors' committee. However, each group member's insolvency proceeding will be administered separately—the draft legislation does not provide for the substantive consolidation of group members' estates. In cases involving the appointment of multiple insolvency administrators, the court may appoint a coordinating administrator to harmonize the joint proceedings, including by means of a joint insolvency plan. Finally, in cases involving multiple insolvency courts and officeholders administering the proceedings of group members, the courts and officeholders will be obligated to exchange relevant information and to cooperate generally.

Other recent European developments can be tracked in Jones Day's *EuroResource*, available at http://www.jonesday.com/euroresource__march__2013.

BUSINESS RESTRUCTURING REVIEW

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