JONES DAY

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SOUTHERN DISTRICT OF NEW YORK BANKRUPTCY COURT RULES THAT AVOIDANCE POWERS APPLY EXTRATERRITORIALLY

Justin Morgan and Mark G. Douglas

Over the past 21 years, two U.S. district court judges in the Southern District of New York have held that the avoidance powers conferred on a bankruptcy trustee or chapter 11 debtor-in-possession under the Bankruptcy Code do not apply to pre-bankruptcy transfers made by a debtor outside the United States. However, a U.S. bankruptcy court judge in the same district recently reached the opposite conclusion in *Weisfelner v. Blavatnik (In re Lyondell)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016). In *Lyondell*, bankruptcy judge Robert E. Gerber refused to dismiss a claim seeking avoidance of a fraudulent transfer under section 548 of the Bankruptcy Code on the ground that the challenged transfer occurred outside the U.S. According to Judge Gerber, Congress could not have intended to exclude extraterritorial transfers from avoidance under section 548 while explicitly defining property of the bankruptcy estate under section 541 of the Bankruptcy Code to include all of the debtor's property "wherever located and by whomever held."

THE PRESUMPTION AGAINST EXTRATERRITORIALITY

"It is a longstanding principle of American law 'that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.' " *EEOC v. Arabian American Oil Co.*, 499 U.S. 244, 248 (1991) (quoting *Foley Bros. v. Filardo*, 336 U.S. 281, 285 (1949)). This "presumption against extraterritoriality" is a judicially developed rule of statutory construction whereby federal law is presumed not to apply to conduct or property outside the United States "unless a contrary intent appears." *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247, 255 (2010). In *Smith v. United States*, 507 U.S. 197, 204 n.5 (1993), the U.S. Supreme Court explained that this presumption is at least partially "the common-sense notion that Congress generally legislates with domestic concerns in mind." The presumption also "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord." *Arabian American*, 499 U.S. at 248 (citing *McCulloch v. Sociedad Nacional de Marineros de Honduras*, 372 U.S. 10, 20–22 (1963)).

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Contrary intent is shown through "clear evidence," either in the statutory text or the "legislative purpose underlying it." *Id.* at 204. However, a law need not explicitly state that "this law applies abroad" to have extraterritorial effect, and context is relevant to infer the statute's meaning. *Morrison*, 561 U.S. at 255.

Courts generally perform a two-step inquiry in determining whether to apply the presumption against extraterritoriality. First, the court must determine whether the presumption applies by "identifying the conduct proscribed or regulated by the particular legislation in question" and by considering whether that conduct "occurred outside of the borders of the U.S." *See Societe Generale plc v. Maxwell Commc'n Corp. plc (In re Maxwell Commc'n Corp. plc)*, 186 B.R. 807, 816 (S.D.N.Y. 1995), *aff'd on other grounds*, 93 F.3d 1036 (2d Cir. 1996). Second, if the presumption is implicated, the court must examine lawmakers' intent to determine whether Congress "intended to extend the coverage of the relevant statute to such extraterritorial conduct." *Id.*

Most courts have adopted a flexible approach in determining whether a transaction is extraterritorial. Many apply a "center of gravity" test, whereby the court examines the facts of the case to ascertain whether they have a center of gravity outside the U.S. *See, e.g., French v. Liebmann (In re French)*, 440 F.3d 145, 149 (4th Cir. 2006), *cert. denied*, 549 U.S. 815 (2006); *In re Florsheim Group Inc.*, 336 B.R. 126, 130 (Bankr. N.D. Ill. 2005). This analysis may involve consideration of "all component events of the transfer[]," *Maxwell*, 186 B.R. at 816, such as "whether the participants, acts, targets, and effects involved in the transaction at issue are primarily foreign or primarily domestic." *French*, 440 F.3d at 150.

EXTRATERRITORIAL OPERATION OF U.S. BANKRUPTCY LAWS?

In certain respects, U.S. bankruptcy law has explicitly applied extraterritorially for more than 60 years. In 1952, due to confusion about the scope of a debtor's property to be administered by a bankruptcy trustee under the Bankruptcy Act of 1898, Congress inserted the phrase "wherever located" into section 70a of the Act "to make clear that a trustee in bankruptcy is vested with the title of the bankrupt in property which is located without, as well as within, the United States." H.R. Rep. No. 82-2320, at 15 (1952), *reprinted in* 1952 U.S.C.C.A.N. 1960, 1976; *see also* Pub. L. No. 82-456, 66 Stat. 420 (July 7, 1952). This language was preserved in section 541(a) of the Bankruptcy Code (enacted in 1978), which provides that the bankruptcy estate includes the debtor's property "wherever located and by whomever held." Similarly, 28 U.S.C. § 1334(e) gives federal district courts—and, by jurisdictional grant pursuant to 28 U.S.C. § 157(a), bankruptcy courts within each district—exclusive jurisdiction of all property of the debtor and its estate, "wherever located."

Many courts have concluded that, because the automatic stay in section 362(a) of the Bankruptcy Code expressly prohibits, among other things, acts to obtain possession of "property of the estate," the stay bars creditor collection efforts with respect to estate property located both within and outside the U.S. *See, e.g., Milbank v. Philips Lighting Elecs. N. Am. (In re Elcoteq, Inc.)*, 521 B.R. 189 (Bankr. N.D. Tex. 2014); *In re Nakash*, 190 B.R. 763 (Bankr. S.D.N.Y. 1996).

However, the provisions of the Bankruptcy Code permitting avoidance of preferential or fraudulent transfers of property and allowing recovery of the property—*e.g.*, sections 547, 548, and 550—do not expressly refer to "property of the estate." Furthermore, some courts, noting that section 541(a)(3) of the Bankruptcy Code provides that any "interest in property that the trustee *recovers* under section . . . 550" is part of the estate, have concluded that fraudulently transferred property is not estate property *unless and until* it is recovered by the trustee. *See, e.g., FDIC v. Hirsch (In re Colonial Realty Co.)*, 980 F.2d 125 (2d Cir. 1992); *accord Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013). *But see Am. Nat'l Bank of Austin v. MortgageAmerica Corp. (In re MortgageAmerica Corp.),* 714 F.2d 1266, 1277 (5th Cir. 1983) ("[p]roperty fraudulently conveyed and recoverable under the Texas Fraudulent Transfers Act remains, despite the purported transfer, property of the estate within the meaning of section 541(a)(1)").

Two U.S. district court judges in the Southern District of New York have cited *Colonial Realty* as support for their holdings that the Bankruptcy Code's avoidance and recovery provisions do not apply extraterritorially. In *In re Maxwell Commc'n Corp. plc*, 186 B.R. 807 (S.D.N.Y. 1995), district judge Shira A. Scheindlin ruled that Congress did not clearly express its intention, in statutory language or elsewhere, for section 547 of the Bankruptcy Code to empower a trustee to avoid foreign preferential transfers.

In *S.I.P.C. v. Bernard L. Madoff Inv. Sec. LLC*, 513 B.R. 222 (S.D.N.Y. 2014), district judge Jed S. Rakoff addressed the extraterritorial effect of section 550, which authorizes the trustee to

recover property (or its value) after a transfer of the property has been avoided. In ruling that section 550 does not apply extraterritorially, Judge Rakoff wrote:

> Under the logic of *Colonial Realty*, whether "property of the estate" includes property "wherever located" is irrelevant to the instant inquiry: fraudulently transferred property becomes property of the estate only after it has been recovered by the Trustee, so section 541 cannot supply any extraterritorial authority that the avoidance and recovery provisions lack on their own.

513 B.R. at 230; *accord Barclay v. Swiss Fin. Corp. Ltd. (In re Bankr. Estate of Midland Euro Exch. Inc.)*, 347 B.R. 708 (Bankr. C.D. Cal. 2006). Under the reasoning of the courts in *Maxwell* and *Madoff*, the language of section 541(a)(3) makes clear that Congress could not have intended the trustee's avoidance powers to apply extraterritorially, even though section 541 also clearly shows that lawmakers intended property of the estate to be defined broadly.

The bankruptcy court in *Lyondell* ruled to the contrary.

LYONDELL

Lyondell Chemical Company ("LCC") was the target of a failed leveraged buyout ("LBO") in December 2007. The purchaser was Basell AF S.C.A. ("Basell"), a Luxembourg company. In connection with the LBO, LCC incurred $21 billion in secured debt. Of the loan proceeds, $12.5 billion was distributed to LCC's stockholders and nearly $1 billion was paid in fees, expenses, and other transaction costs. Basell made distributions to its own stockholders—including BI S.à.r.l., another Luxembourg company, which owned 99.99 percent of Basell's capital stock—prior to the transaction. The payments included a €100 million distribution two weeks before the LBO closed.

LCC filed for chapter 11 protection in the Southern District of New York in January 2009. Five adversary proceedings were filed in connection with the chapter 11 cases against LCC's old shareholders, Basell, Basell's principals, BI S.à.r.l., LCC's officers and directors, and certain other defendants challenging the LBO transactions under a variety of legal theories, including breach of fiduciary duty; intentional and constructive fraudulent transfer; unlawful dividend; and a host of additional bases for recovery under state law, the Bankruptcy Code, and the laws of Luxembourg.

Certain of the claims were premised on the €100 million distribution Basell made to its shareholders in December 2007, two weeks prior to the LBO transaction. The trustee of a litigation trust created pursuant to LCC's chapter 11 plan alleged, among other things, that the distribution was avoidable as a fraudulent transfer under section 548 of the Bankruptcy Code, and he sought recovery of the €100 million transfer under section 550. The defendants moved to dismiss, arguing, among other things, that sections 548 and 550 do not apply extraterritorially.

THE BANKRUPTCY COURT'S RULING

Bankruptcy judge Gerber first examined whether the conduct at issue was sufficiently foreign to require the application of the presumption against extraterritoriality. He concluded that, for purposes of the motion to dismiss, the complaint adequately alleged that the center of gravity of the distribution was outside the U.S. because, among other things, it alleged that the transfer occurred between two Luxembourg companies.

Next, Judge Gerber searched for clear evidence that Congress intended section 548 of the Bankruptcy Code to apply outside the U.S. No court, he explained, has found such clear evidence in the text of section 548 itself. Even so, he noted, the presumption against extraterritoriality does not require such an explicit stamp on each statutory provision. Instead, the presumption can be rebutted by unequivocal evidence from the context of the statute that Congress intended for it to apply extraterritorially.

For guidance on this issue, Judge Gerber looked to the Fourth Circuit's ruling in *French*, where the court held that Congress expressed an intent for section 548 to apply extraterritorially by adopting parallel language in sections 548 and 541(a):

> Section 541 defines "property of the estate" as, *inter alia*, all "interests of the debtor in property." . . . In turn, [section] 548 allows the avoidance of certain transfers of such "interest[s] of the debtor in property." . . . By incorporating the language of [section] 541 to define what property a trustee may recover under his avoidance powers, [section] 548 plainly allows a trustee to avoid any transfer of property that *would have been* "property of the estate" prior to the transfer in question as defined by [section] 541 even if that property is not "property of the estate" *now*.

French, 440 F.3d at 152. Thus, contrary to *Maxwell* and *Madoff*, the Fourth Circuit concluded that it makes no difference whether unrecovered property which has been fraudulently transferred is property of the estate.

Persuaded by the reasoning in *French*, Judge Gerber distinguished the case before him from *Colonial Realty*. In *Colonial Realty*, he explained, the Second Circuit recognized that sections 541(a)(1) and (a)(3) "were speaking as of different times." Specifically, section 541(a)(1) "speaks of property of the estate 'as of the commencement of the case'; whereas section 541(a)(3) speaks of property that enters the estate at a later time, when it is recovered under section 550." The judge wrote, "That plainly correct observation by the Second Circuit falls far short of holding that property not in the estate as of the commencement of the case cannot be brought into the estate because it is in a foreign locale."

The ruling is a positive development for parties challenging extraterritorial transfers of a U.S. debtor's assets. However, its practical limitations were evident even in *Lyondell*, where the court also held that the complaint failed to establish that the court could exercise personal jurisdiction over certain of the foreign defendant-transferees.

On the basis of these and other similar authorities (see Lawrence Westerbrook, *Avoidance of Pre-Bankruptcy Transactions in Multinational Bankruptcy Cases*, 42 TEXAS INT'L L.J. 899 (Summer 2007)), Judge Gerber held that Congress could not have intended for property anywhere in the world to enter the bankruptcy estate once recovered pursuant to the avoidance powers while simultaneously not intending for such powers to reach anywhere in the world. This conclusion, he wrote, rests on the necessity "to protect the *in rem* jurisdiction of the bankruptcy courts over assets that Congress has declared become property of the estate when recovered under section 541(a)(3)."

OUTLOOK

Although Judge Gerber did not address the issue, he apparently did not see himself as bound by the rulings in *Maxwell* and *Madoff*. This is consistent with the majority approach that bankruptcy courts are not bound by decisions of a single district court judge (or even two district court judges) in a multi-judge district. Thus, *Lyondell* stakes out new territory in the Southern District of New York on the extraterritorial reach of the Bankruptcy Code's avoidance powers.

The ruling is a positive development for parties challenging extraterritorial transfers of a U.S. debtor's assets. However, its practical limitations were evident even in *Lyondell*, where the court also held that the complaint failed to establish that the court could exercise personal jurisdiction over certain of the foreign defendant-transferees. Even if the Bankruptcy Code's avoidance powers apply extraterritorially on their face, lack of personal jurisdiction over a transferee would significantly complicate efforts to enforce them.

Judge Gerber is not the only bankruptcy judge in the Southern District of New York to consider cross-border issues recently in connection with avoidance actions. For example, in *Hosking v. TPG Capital Mgmt., L.P. (In re Hellas Telecomms. (Luxembourg) II SCA)*, 535 B.R. 543 (Bankr. S.D.N.Y. 2015), bankruptcy judge Martin Glenn ruled that, in a chapter 15 case, even though U.K. law governed actual fraudulent transfer claims asserted by the liquidators of a foreign debtor, a U.S. bankruptcy court has jurisdiction to adjudicate the claims applying U.K. law.

FIRST IMPRESSIONS: THE SIXTH CIRCUIT WEIGHS IN ON ARTIFICIAL IMPAIRMENT UNDER A CHAPTER 11 PLAN

Ben Rosenblum and Mark G. Douglas

One of the prerequisites to confirmation of any chapter 11 plan is that at least one "impaired" class of creditors must vote in favor of the plan. This requirement reflects the basic (but not universally accepted) principle that a plan may not be imposed on a dissident body of stakeholders of which no class has given approval. However, it is sometimes an invitation to creative machinations designed to muster the requisite votes for confirmation of the plan.

"Strategic" classification can entail, among other things, "manufacturing" an impaired class even though the impairment is immaterial. For example, the plan could pay creditor claims nearly, but not entirely, in full or modify the rights of the creditors in the class in some incidental way—in either case, with such minimal effect that creditors are still willing to vote to accept the plan despite slight impairment of their claims. Sometimes referred to as "artificial impairment," this practice is controversial.

So much so, in fact, that there is a split among the federal circuit courts of appeal concerning its legitimacy. In *Village Green I, GP v. Federal National Mortgage Association (In re Village Green I, GP)*, 2016 BL 20874 (6th Cir. Jan. 27, 2016), the Sixth Circuit weighed in on this debate as a matter of first impression. It joined the Fifth and Ninth Circuits in ruling that artificial impairment does not preclude a plan from satisfying the impaired class acceptance requirement, but instead is relevant in determining whether the debtor has proposed a chapter 11 plan in good faith.

IMPAIRMENT

Only impaired classes of creditors are entitled to vote on a chapter 11 plan. Holders of claims that are not impaired by a plan are deemed to accept it. Section 1124 of the Bankruptcy Code provides that a class of claims is impaired under a plan unless the plan provides the following treatment for each claimant in the class: (1) "leaves unaltered the legal, equitable, and contractual rights" to which the claimant is entitled; or (2) cures any defaults (with limited exceptions), reinstates the maturity and other terms of the obligation, and compensates the claimant for resulting losses.

Section 1124 is derived from section 107 of chapter X of the former Bankruptcy Act of 1898 (repealed in 1978), which provided that "creditors" or "any class thereof" would be "affected" for purposes of a plan—and therefore entitled to vote—"only if their or its interest shall be materially and adversely affected thereby." The legislative history indicates that when section 1124 was enacted as part of the present-day Bankruptcy Code in 1978, floor leaders for the final version of the bill stated that the provision "defines the new concept of 'impairment' of claims or interests; the concept differs significantly from the concept of 'materially and adversely affected' under the Bankruptcy Act." 124 Cong. Rec. H11,103 (daily ed. Sept. 28, 1978); 124 Cong. Rec. S17,419–17,420 (daily ed. Oct. 6, 1978).

Section 1124 originally included a third option for rendering a claim unimpaired—by providing the claimant with cash equal to the allowed amount of its claim. In *In re New Valley Corp.*, 168 B.R. 73 (Bankr. D.N.J. 1994), the court ruled that a solvent debtor's chapter 11 plan which paid unsecured claims in full in cash, but without postpetition interest, did not impair the claims. Due to the perceived unfairness of *New Valley*, Congress removed the "cash out" option from section 1124 in 1994.

IMPAIRED CLASS ACCEPTANCE AS A CONDITION TO CRAMDOWN

Even if all impaired classes of creditors do not vote to accept a chapter 11 plan, the plan may still be confirmed under the Bankruptcy Code's nonconsensual, or "cramdown," provisions. Among those is the requirement in section 1129(a)(10) for at least one impaired class to vote to accept the plan (without counting insider votes).

This requirement operates as one of several statutory gatekeepers to cramdown. Although there is some disagreement on this point, section 1129(a)(10) is supposedly premised on the policy that, before compelling creditors to bear the consequences associated with cramdown, at least one class whose members are not being paid in full (or whose claims are otherwise impaired) should be willing to go along with the chapter 11 plan. *Compare In re Windsor on the River Assocs., Ltd.*, 7 F.3d 127, 131 (8th Cir. 1993) (interpreting legislative history to suggest that the purpose of section 1129(a)(10) "is to provide some indicia of support by affected creditors and prevent confirmation where such support is lacking") *with* Final Report and Recommendations of the American Bankruptcy Institute Commission to Study the

Reform of Chapter 11 (December 8, 2014) (the "ABI Commission Report") p. 258 (recommending removal of section 1129(a)(10) from the Bankruptcy Code and stating that "[a]lthough some courts and commentators suggest that section 1129(a)(10) was intended to ensure that a plan had some creditor support, neither the legislative history nor the Bankruptcy Code indicate[s] such a purpose") (citations omitted).

ARTIFICIAL IMPAIRMENT

Courts disagree whether section 1129(a)(10) draws a distinction between "artificial" and "economically driven" impairment. For example, in *Windsor*, the Eighth Circuit ruled that "a claim is not impaired [for purposes of section 1129(a)(10)] if the alteration of the rights in question arises solely from the debtor's exercise of discretion." According to this approach, section 1129(a)(10) recognizes impairment only to the extent that it is caused by economic "need."

Many courts have applied *Windsor* to deny confirmation of a chapter 11 plan impairing the *de minimis* claims of some creditors for the purpose of contriving a class to accept the plan. *See, e.g.*, *In re Combustion Engineering, Inc.*, 391 F.3d 190, 243–44 (3d Cir. 2003); *In re All Land Investments, LLC*, 468 B.R. 676, 690 (Bankr. D. Del. 2012); *In re Daly*, 167 B.R. 734, 737 (Bankr. D. Mass. 1994); *see also In re Deming Hospitality, LLC*, 2013 BL 93045, *6 (Bankr. D.N.M. Apr. 5, 2013) (stating that "[i]f there is no economic justification for failing to pay Class 6 in full after confirmation rather than the proposed 75%, then the impairment of the class likely would be 'artificial' and impermissible"); *In re Swartville, LLC*, 2012 BL 211034, *2 (Bankr. E.D.N.C. Aug. 17, 2012) ("artificial impairment" refers to a scenario where a debtor "deliberately impairs a de minimis claim solely for the purpose of achieving a forced confirmation over the objection of a creditor"). These courts have reasoned that allowing manipulation of this kind undermines the policy of consensual reorganization expressed in section 1129(a)(10).

Other courts, including the Fifth and Ninth Circuits, have concluded that artificial impairment does not violate section 1129(a)(10). In *L & J Anaheim Assocs. v. Kawasaki Leasing Intl., Inc. (In re L & J Anaheim Assocs.)*, 995 F.2d 940 (9th Cir. 1993), the Ninth Circuit ruled that section 1129(a)(10) does not distinguish between discretionary and economically driven impairment. According to the court, "[T]he plain language of section 1124 says that a creditor's claim is 'impaired' unless its rights are left 'unaltered' by the plan," and "[t]here is no suggestion here that only alterations of a particular kind or degree can constitute impairment." *Accord In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213 (Bankr. D.N.J. 2000); *In re Duval Manor Assocs.*, 191 B.R. 622 (Bankr. E.D. Pa. 1996). In *Western Real Estate Equities, LLC v. Village at Camp Bowie I, LP (In re Village at Camp Bowie I, LP)*, 710 F.3d 239, 245 (5th Cir. 2013), the Fifth Circuit joined the Ninth Circuit in holding that section 1129(a)(10) "does not distinguish between discretionary and economically-driven impairment" and that "any alteration of a creditor's rights, no matter how minor, constitutes impairment" (citations and internal quotation marks omitted).

However, most courts taking this approach have concluded that artificial impairment *is* relevant to the issue of whether the debtor proposed its chapter 11 plan in good faith. Section 1129(a)(3) of the Bankruptcy Code provides that a plan may be confirmed only if "proposed in good faith and not by any means forbidden by law." Even if artificial impairment is not impermissible per se, these courts have held, proposing a contrived impaired class may constitute bad faith. *See Camp Bowie*, 710 F.3d at 247; *FNMA v. Village Green I, GP*, 483 B.R. 807 (W.D. Tenn. 2012) (refusing to reject artificial impairment outright but holding that, under either section 1129(a)(3) or 1129(a)(10), the debtor must demonstrate some economic justification for delaying payment to *de minimis* creditors); *In re The Beare Co.*, 177 B.R. 886 (Bankr. W.D. Tenn. 1994).

The Sixth Circuit had an opportunity to examine the concept of artificial impairment in *Village Green*.

VILLAGE GREEN

Village Green I, GP (the "debtor") purchased an apartment complex in Memphis, Tennessee, in 2005 with secured financing provided by the Federal National Mortgage Association ("FNMA"). FNMA commenced a foreclosure proceeding after the debtor defaulted on the mortgage in December 2009. The debtor filed for chapter 11 protection in April 2010 in the Western District of Tennessee to halt the foreclosure proceeding.

At the time of the bankruptcy filing, the apartment complex—the debtor's only asset—was valued at $5.4 million. FNMA was owed $8.6 million. Apart from FNMA, the debtor's only creditors were its former accountant and lawyer, who were owed approximately $740 and $1,600, respectively, on an unsecured basis.

NEWSWORTHY

Corinne Ball (New York), Bruce Bennett (Los Angeles), David G. Heiman (Cleveland), Paul D. Leake (New York), and ***Ben Larkin (London)*** were designated as "Leading Figures" in Restructuring & Insolvency by *Who's Who Legal* 2016.

Erin N. Brady (Los Angeles) and ***Timothy Hoffmann (Chicago)*** were named to the "40 under 40" for 2016 by *Global Restructuring Review*.

Scott J. Greenberg (New York), Christopher Lovrien (Los Angeles), Erin N. Brady (Los Angeles), Richard L. Wynne (Los Angeles), Michael J. Cohen (New York), and ***Genna L. Ghaul (New York)*** represented clothing retailer American Apparel, Inc., in connection with its chapter 11 case before the U.S. Bankruptcy Court for the District of Delaware. On January 27, 2016, the court confirmed a pre-negotiated chapter 11 plan under which the company emerged from bankruptcy on February 5 as a private company after swapping $230 million in debt for equity with bondholders. Confirmation and implementation of the pre-negotiated plan (which is rare in a retail case) preserved the manufacturing and retail operations of one of the largest U.S. clothing manufacturers, as well as the iconic American Apparel brand, and saved nearly 9,000 jobs.

Kevyn D. Orr (Washington) was the keynote speaker at *The Bond Buyer*'s National Outlook 2016 Conference in New York City on January 26.

Richard L. Wynne (Los Angeles), Bennett Spiegel (Los Angeles), Lori Sinanyan (Los Angeles), Monika Wiener (Los Angeles), Aaron Gober-Sims (Cleveland), and ***T. Daniel Reynolds (Cleveland)*** represented Beverly Hills-based film and television studio Relativity Media in connection with its chapter 11 case before the U.S. Bankruptcy Court for the Southern District of New York. In October 2015, after commencing chapter 11 cases intending to sell substantially all of its assets, Relativity completed a sale of only its television assets. The studio then reorganized around its film and other business units, culminating in a February 8, 2016, order confirming its chapter 11 plan of reorganization, subject to certain confirmatory order findings. On March 12, 2016, Relativity filed documentation evidencing $100 million in required financing and an executed agreement with Trigger Street Productions and Dana Brunetti, Kevin Spacey's producing partner, to lead Relativity's film division. The bankruptcy court confirmed Relativity's chapter 11 plan on March 18, 2016.

Richard L. Wynne (Los Angeles) gave a presentation on "Recent Trends of Bankruptcy in the Entertainment Industry" on March 11, 2016, at the Fortieth Annual UCLA Entertainment Symposium in Los Angeles.

On March 1, 2016, in Mexico City, ***Pedro A. Jimenez (Miami and New York)*** chaired a panel discussion entitled "Where Are We?" at the INSOL International Mexico City One Day Seminar on International Cross-border Insolvency and Restructuring. The program provided a comparative look at the experience in Mexico and the United States over the past 15 years with the UNCITRAL Model Law on Cross-Border Insolvency.

Erin N. Brady (Los Angeles) participated in a panel discussion on March 11, 2016, entitled "Everything-Must-Go Sale: The Ins and Outs of Retail Bankruptcies" at the ABI's 2016 Bankruptcy Battleground West conference in Los Angeles.

Laurent Assaya (Paris), Hugo Cosquer (Paris), and ***Jacques-Albert Weil (Paris)*** conducted a WebEx presentation on February 24, 2016, entitled "French Restructuring & Insolvency Proceedings."

Thomas A. Howley (Houston), Heather Lennox (Cleveland and New York), and ***Kevyn D. Orr (Washington)*** gave a presentation entitled "Chapter 9 Case Study—Detroit—From the perspective of the client: Managing politics, the press and the process" at the 5th Circuit Bankruptcy Bench-Bar Conference on February 25, 2016, in New Orleans.

Olaf Benning (Munich) conducted a WebEx presentation on March 22, 2016, regarding "German Restructuring & Insolvency Proceedings."

On January 27, 2016, ***Kevyn D. Orr (Washington)*** gave a presentation entitled "Lessons Learned on the Restructuring of Detroit" at the CFA's Asset-Based Capital Conference in Las Vegas.

On March 15, 2016, ***Bruce Bennett (Los Angeles)*** gave a presentation entitled "Valuation in Municipal Restructurings: The Constitutional, Legal and Practical Issues" at the 22nd Annual VALCON CLE Conference in Las Vegas.

Sidney P. Levinson (Los Angeles) was inducted into the American College of Bankruptcy on March 18, 2016, in Washington, D.C.

The debtor's proposed chapter 11 plan classified FNMA's secured claim into one class, while creating two separate classes of unsecured claims. The first class of unsecured claims contained FNMA's deficiency claim (approximately $3.2 million). The other unsecured class contained the claims of the lawyer and the accountant, which totaled approximately $2,340.

Under the plan, FNMA was to receive deferred cash payments in respect of its $5.4 million secured claim for 10 years, secured by a mortgage on the property with slightly modified terms. At the expiration of the 10-year period, FNMA would receive a balloon payment from the proceeds of a mortgage refinancing. With respect to FNMA's unsecured deficiency claim, the plan proposed to pay FNMA deferred cash payments for 10 years, with any remaining balance to be paid from the proceeds of the mortgage refinancing. The separately classified unsecured claims of the lawyer and the accountant were to be paid in full, but in two equal installments 30 and 60 days after the plan's effective date.

Prior to voting on the plan, FNMA offered to acquire the claims of the lawyer and the accountant at 100 cents on the dollar, payable immediately. The lawyer and the accountant rejected the offer.

FNMA voted to reject the plan with respect to its secured and unsecured claims. The lawyer and the accountant voted in favor of the plan.

The bankruptcy court confirmed the plan. Among other things, the court ruled that: (i) the class consisting of the lawyer and accountant claims was impaired due to the 60-day payment delay; and (ii) because that impaired class voted in favor of the plan, the plan satisfied section 1129(a)(10).

FNMA appealed to the district court, which vacated the confirmation order and remanded the case below for a determination whether the debtor proposed the chapter 11 plan in good faith. The bankruptcy court found that the plan was proposed in good faith, reasoning that the debtor was "economically justified in rationing every dollar" under the plan. However, after the district court again vacated and remanded the ruling, the bankruptcy court ultimately lifted the automatic stay to permit FNMA to continue its foreclosure proceeding and, *sua sponte*, dismissed the debtor's chapter 11 case. The district court affirmed those rulings, and the debtor appealed to the Sixth Circuit.

THE SIXTH CIRCUIT'S RULING

Even though the rulings below involved relief from the automatic stay and dismissal of the debtor's chapter 11 case, the Sixth Circuit addressed two different, albeit related, issues on appeal: (i) whether the lawyer and accountant class was impaired for purposes of section 1129(a)(10); and (ii) whether the debtor proposed its chapter 11 plan in good faith, as required by section 1129(a)(3).

Addressing the first issue, the Sixth Circuit joined the Fifth and Ninth Circuits in holding that "Section 1124(1) by its terms asks only whether a plan would alter a claimant's interests, not whether the debtor had bad motives in seeking to alter them." Instead, the court wrote, the debtor's motives "are expressly the business of § 1129(a)(3)." According to the Sixth Circuit, because section 1129(a)(3) expressly requires an inquiry into the debtor's motives in proposing a plan, "there is no reason to graft that inquiry onto the plain terms of § 1124(1)."

The Sixth Circuit faulted the bankruptcy court's good faith finding. In concluding that the debtor's chapter 11 plan was feasible, the Sixth Circuit explained, the bankruptcy court found that the debtor would have more than sufficient cash on the effective date to pay off its minor unsecured claims immediately. Moreover, the Sixth Circuit wrote, the fact that the lawyer and the accountant were closely allied with the debtor "compounds the appearance that impairment of their claims had more to do with circumventing the purposes of § 1129(a)(10) than with rationing dollars." The purported rationale underpinning good faith evaporated completely, the court noted, when the accountant and the lawyer rejected FNMA's offer to pay their claims in full immediately.

Remarking that "the minor claims' impairment was transparently an artifice to circumvent the purposes of § 1129(a)(10)," the Sixth Circuit affirmed the district court's rulings.

OUTLOOK

With *Village Green*, three circuits have now staked out the position rejecting any distinction between economically driven and artificial impairment for purposes of section 1129(a)(10). Under this view, if one or more claims are impaired in accordance with the plain meaning of section 1124, regardless of whether the claims are "materially or adversely affected"—a concept from prior law that was rejected in enacting section 1124—a class

containing the claims which votes in favor of a plan can satisfy the impaired class acceptance requirement for confirmation of a cramdown chapter 11 plan. Artificial impairment under these authorities, however, is relevant in assessing whether a debtor has proposed its plan in good faith.

Interestingly, at the district court level, the debtor made two arguments that the Sixth Circuit did not consider on appeal. First, the debtor argued that elimination of the cash-out provision in section 1124 in 1994 had the effect of broadening the definition of impairment, thereby undermining the Eighth Circuit's rule in *Windsor* that artificial impairment and the debtor's "motives in creating the impaired class" are relevant for purposes of section 1129(a)(10). *See Village Green I, GP v. FNMA*, 523 B.R. 581, 591–92 (W.D. Tenn. 2014), *aff'd*, 2016 BL 20874 (6th Cir. Jan. 27, 2016). The district court rejected this argument, noting that the debtor "has not persuaded the Court that the 1994 amendments to § 1124 have any bearing on the issue of whether the plan impaired the de minimis claims without justification." *Id*.

Second, the district court downplayed the debtors' argument that artificial impairment essentially results in "single asset real estate cases [being] judged by a different standard than any other business Chapter 11 case." According to the district court, the debtor "must demonstrate some economic justification for delaying payment to the de minimis creditors," failing which, based on the totality of the circumstances, and thus not a generalized rule for single-asset real estate cases, the debtor will be found not to have proposed its plan in good faith. *Id*.

Finally, in the ABI Commission Report, the commissioners recommended that acceptance by at least one impaired class should not be required as a condition to confirmation of a chapter 11 plan and that section 1129(a)(10) should be removed from the Bankruptcy Code. The commissioners were skeptical of the policy considerations attributed to the provision, noting that, "given the variation in class composition and the different motives and objectives of creditors, a non-accepting class does not necessarily equate to lack of creditor support for the plan." ABI Commission Report p. 258. The commissioners debated the advantages and disadvantages of the "gating role served by section 1129(a)(10)," but ultimately determined that "the potential delay, cost, gamesmanship, and value destruction attendant to section 1129(a)(10) in all cases significantly outweighed its presumptive gating role." *Id*. at p. 261.

ENERGY FUTURE WINS ROUND TWO IN FIGHT TO SKIRT LIABILITY FOR MAKE-WHOLE PREMIUMS

Jonathan M. Fisher and Mark G. Douglas

In February 2016, Energy Future Holdings Corp. ("EF"), which obtained confirmation of a chapter 11 plan on December 3, 2015, prevailed at the district court level in related appeals brought by first- and second-lien noteholders of bankruptcy court orders disallowing the noteholders' claims for make-whole premiums allegedly due under their note indentures. The forum in this hotly contested and long-running dispute has now moved to the Third Circuit Court of Appeals.

ENFORCEABILITY OF MAKE-WHOLE PREMIUMS IN BANKRUPTCY

Restrictions on a borrower's ability to prepay secured debt are a common feature of bond indentures and credit agreements. Lenders often incorporate "no-call" provisions to prevent borrowers from refinancing or retiring debt prior to maturity. Alternatively, a loan agreement may allow prepayment at the borrower's option, but only upon payment of a "make-whole" premium. The purpose of such a provision is to compensate the lender for the loss of the remaining stream of interest payments it would have received if the borrower had paid off the debt at maturity.

Bankruptcy courts almost uniformly refuse to enforce no-call provisions against debtors, permitting debtors to repay outstanding debt despite such provisions. *See*, *e.g.*, *HSBC Bank USA, N.A. v. Calpine Corp.*, 2010 BL 380458 (S.D.N.Y. Sept. 14, 2010); *Cont'l Sec. Corp. v. Shenandoah Nursing Home P'ship*, 188 B.R. 205 (W.D. Va. 1995); *In re Vest Assocs.*, 217 B.R. 696 (Bankr. S.D.N.Y. 1998). Further, the majority of courts have disallowed a lender's claim for payment of a make-whole premium when the premium is not explicitly payable in the event of acceleration. Such courts find that acceleration due to the debtor's bankruptcy filing, and any subsequent repayment of the debt during the bankruptcy case as part of a chapter 11 plan or otherwise, is not voluntary and therefore does not trigger any make-whole premium obligations. *See*, *e.g.*, *Bank of New York Mellon v. GC Merchandise Mart, LLC (In re Denver Merchandise Mart, Inc.)*, 740 F.3d 1052 (5th Cir. 2014); *U.S. Bank Trust Nat'l Assoc. v. Am. Airlines, Inc. (In re AMR Corp.)*, 730 F.3d 88 (2d Cir. 2013); *In re MPM Silicones, LLC*, 2014 BL 250360 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, *U.S. Bank National Association v. Wilmington*

Savings Fund Society, FSB (In re MPM Silicones, LLC), 531 B.R. 321 (S.D.N.Y. 2015); *Premier Entm't Biloxi, LLC v. U.S. Bank Nat'l Ass'n (In re Premier Entm't Biloxi, LLC)*, 445 B.R. 582 (Bankr. S.D. Miss. 2010); *In re Solutia Inc.*, 379 B.R. 473, 488 (Bankr. S.D.N.Y. 2007). *But see In re School Specialty, Inc.*, 2013 BL 107127 (Bankr. D. Del. Apr. 22, 2013) (allowing claim for make-whole premium under New York law where loan agreement specifically provided for make-whole premium in event of "either prepayment or acceleration" and make-whole premium was not plainly disproportionate to lender's probable loss).

The courts are divided on the alternative argument that a lender should be entitled to contract damages (apart from a make-whole premium) for "dashed expectations" when its outstanding debt has been paid prior to its original maturity. *Compare Calpine*, 2010 BL 380458, at *6–7 (noteholders were not entitled to expectation damages because notes did not provide for payment of premiums upon acceleration, and claims for expectation damages violated prohibition against unmatured interest under section 502(b)(2)) *with Premier Entm't Biloxi*, 445 B.R. at 631 (although lenders were not entitled to secured claim for make-whole damages because indenture required prepayment penalties only if debtor repaid loan prior to maturity, and maturity was automatically accelerated due to bankruptcy filing, lenders were entitled to unsecured claim for dashed expectations).

ENERGY FUTURE

The Delaware bankruptcy court presiding over the chapter 11 cases of EF and its affiliates weighed in on this issue in a pair of rulings in 2015—*Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 527 B.R. 178 (Bankr. D. Del. 2015), and *Computershare Tr. Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 539 B.R. 723 (Bankr. D. Del. 2015), *motion for direct certification of appeal to Third Circuit denied*, No. 1:14-ap-50405 (Bankr. D. Del. Nov. 30, 2015).

Aligning itself with a number of Southern District of New York bankruptcy courts, the court granted partial summary judgment to the debtor-borrower in both cases, which involved claims for make-whole premiums asserted by first- and second-lien noteholders. The court ruled that, although the debtor repaid the bonds prior to maturity, make-whole premiums were not payable under the plain terms of the bond indentures because automatic acceleration of the debt triggered by the debtor's chapter 11 filing was not a "voluntary" repayment.

In the *Del. Trust Co.* case cited above, however, the court reserved judgment on the indenture trustee's request for relief from the automatic stay to revive the make-whole premium claim by decelerating the first-lien notes, as permitted under the terms of the indenture. The bankruptcy court subsequently denied that request in *Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 533 B.R. 106 (Bankr. D. Del. 2015). The court concluded that stay relief was unwarranted because the debtor's estate and its stakeholders would be greatly prejudiced by lifting the stay, and the harm to the first-lien noteholders did not substantially outweigh the harm to the debtor's estate. It also held that the noteholders were not entitled to expectation damages due to their inability to rescind the acceleration notice. The indenture trustee appealed the bankruptcy court's rulings disallowing the make-whole premium claim and denying relief from the automatic stay.

THE DISTRICT COURT'S RULINGS

Judge Richard Andrews of the U.S. District Court for the District of Delaware upheld both rulings. On February 9, 2016, he ruled from the bench that the first-lien noteholders were not entitled to a make-whole premium for substantially the same reasons articulated by the bankruptcy court.

In a separate decision issued on February 16, Judge Andrews affirmed the bankruptcy court's ruling denying relief from the automatic stay and disallowing any claim for damages arising from the inability to rescind acceleration of the first-lien notes. *See Del. Tr. Co. v. Energy Future Intermediate Holding Co. (In re Energy Future Holdings Corp.)*, 2016 BL 42871 (D. Del. Feb. 16, 2016).

On appeal to the district court, the indenture trustee argued that the bankruptcy court had erred in ruling that, although the first-lien noteholders had the right under the indenture to rescind acceleration and be paid the make-whole premium, that right was stayed by the automatic stay and, as a result, the noteholders' claim for the make-whole premium, or for damages due to frustration of the right to rescind, must be disallowed.

Judge Andrews, however, did not fault the bankruptcy court for barring the indenture trustee from pursuing the contractual right to rescind. According to the judge, the indenture trustee's arguments "appear to be little more than an effort to evade clear precedent that a bankruptcy stay prevents specific enforcement of such contractual rights" (citing *AMR Corp.*, 730 F.3d at 102; *In re Chemtura Corp.*, 439 B.R. 561, 604 (Bankr. S.D.N.Y. 2010)).

Addressing the damages claim, the court ruled that the bankruptcy court correctly concluded that the first-lien indenture does not expressly provide for damages for breach of the right to rescission, "thereby disallowing a secured claim for damages" under section 506(b) of the Bankruptcy Code. Judge Andrews explained that, although some courts have permitted parties to pursue unsecured claims for breach of no-call provisions in bond indentures, he was more persuaded by contrary rulings (citing *MPM Silicones* and *Calpine*).

In light of Judge Andrews' rulings with respect to the first-lien notes and in anticipation of similar decisions in a related appeal filed on behalf of EF's second-lien noteholders, the indenture trustee for the second-lien noteholders waived oral argument in the related appeal and requested that it be decided solely on the basis of the pleadings.

Judge Andrews' rulings in the *Del. Trust* case were appealed to the Third Circuit on February 17, 2016.

CHAPTER 15 RECOGNITION DENIED DUE TO COMI MANIPULATION SCHEME TO EVADE U.K. JUDGMENT

Pedro A. Jimenez and Mark G. Douglas

More than a decade after the enactment of chapter 15 of the Bankruptcy Code, issues pertaining to recognition of a foreign debtor's bankruptcy or insolvency proceeding under chapter 15 have, in large part, shifted from the purely procedural inquiry (such as the foreign debtor's center of main interests, or "COMI") to more substantive challenges regarding the limits, if any, that chapter 15 places on U.S. bankruptcy courts. But as demonstrated by the recent ruling in *In re Creative Finance Ltd. (In Liquidation)*, 2016 BL 8825 (Bankr. S.D.N.Y. Jan. 13, 2016), U.S. bankruptcy courts continue to closely scrutinize the manner and place of the foreign insolvency proceeding to ensure that it complies with the prerequisites for recognition under chapter 15. In *Creative Finance*, the U.S. Bankruptcy Court for the Southern District of New York denied recognition of a British Virgin Islands ("BVI") liquidation commenced as part of a scheme to avoid paying a U.K. judgment. The court ruled that the debtors' foreign representative failed to demonstrate that the debtors' COMI was in the BVI—either at the time of the filing of the liquidation or because of the liquidator's post-filing activities—or even that the debtors had an establishment in the BVI. Moreover, in so ruling, the court emphasized that "[f]rom beginning to end, . . . [the] tactics [of the debtors' principal] were a paradigmatic example of bad faith, and the [BVI] Liquidator's actions—and inaction—facilitated them."

PROCEDURES AND RECOGNITION UNDER CHAPTER 15

Under chapter 15, the representative of a foreign debtor may file in a U.S. bankruptcy court a petition seeking "recognition" of a "foreign proceeding." "Foreign representative" is defined in section 101(24) of the Bankruptcy Code as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding."

"Foreign proceeding" is defined in section 101(23) of the Bankruptcy Code as:

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

More than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries. Chapter 15 therefore contemplates recognition in the U.S. of both a "main" proceeding—a case pending in the country where the debtor's COMI is located—and "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment."

Section 1517 of the Bankruptcy Code provides that, subject to section 1506, after notice and a hearing, "an order recognizing a foreign proceeding shall be entered" if the proceeding qualifies as a foreign main or nonmain proceeding, the foreign representative is "a person or body," and the petition itself complies with the evidentiary requirements set forth in section 1515. Section 1506 states that "[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

If a U.S. bankruptcy court recognizes a foreign main proceeding under chapter 15, section 1520(a)(1) of the Bankruptcy Code provides that actions against the foreign debtor or "property of the debtor that is within the territorial jurisdiction of the United States" are stayed under section 362—the Bankruptcy Code's "automatic stay."

Following recognition of a foreign main or nonmain proceeding, section 1507 states that the bankruptcy court may also provide "additional assistance" to a foreign representative. This can include injunctive relief or authority to distribute the proceeds of all or part of the debtor's U.S. assets. However, under section 1507(b), in granting such relief, the court must consider, "consistent with the principles of comity," whether such assistance will reasonably ensure, among other things, the just treatment of creditors and other stakeholders, the protection of U.S. creditors against prejudice and inconvenience in pursuing their claims in the foreign proceeding, and the prevention of fraudulent or preferential dispositions of the debtor's property.

Foreign Main Proceeding—Center of Main Interests

The Bankruptcy Code does not define "center of main interests." However, section 1516(c) provides that, "[i]n the absence of evidence to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be" the debtor's COMI.

Various factors have been deemed relevant by courts in determining a debtor's COMI, including the location of the debtor's headquarters, managers, employees, investors, primary assets, or creditors, as well as which jurisdiction's law would apply to most disputes. *See In re SPhinX, Ltd.*, 351 B.R. 103, 117 (Bankr. S.D.N.Y. 2006), *aff'd*, 371 B.R. 10 (S.D.N.Y. 2007). In addition, courts have considered any relevant activities, including liquidation activities and administrative functions. *See Morning Mist Holdings Ltd. v. Krys (In re Fairfield Sentry Ltd.)*, 714 F.3d 127, 137 (2d Cir. 2013). Courts may also consider the situs of the debtor's "nerve center," including the location from which the debtor's "activities are directed and controlled, in determining a debtor's COMI." *Id*. at 138. "[R]egularity and ascertainability" by creditors are also important factors in the COMI analysis. *Id*.

In *Fairfield Sentry*, the Second Circuit ruled that the relevant time for assessing COMI is the chapter 15 petition date, rather than the date a foreign insolvency proceeding is commenced with respect to the debtor. The impact of the ruling is that, in cases where a foreign representative engages in significant pre-U.S. chapter 15 filing activities—such as operating or liquidating the debtor—in the jurisdiction where the foreign proceeding was commenced, COMI "can be found to have shifted from the foreign debtor's original principal place of business to the new locale." *Creative Finance*, 2016 BL 8825, *31. This can occur even if the activities take place in a "letterbox" jurisdiction where the debtor itself had few contacts and conducted no meaningful business. *Id*. (citing cases).

In *Fairfield Sentry*, the Second Circuit also noted concern about possible COMI "manipulation," ruling that a court "may look at the period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition to ensure that a debtor has not manipulated its COMI in bad faith." *Fairfield Sentry*, 714 F.3d at 138.

Foreign Nonmain Proceeding—Establishment

An "establishment" is defined in section 1502(2) as "any place of operations where the debtor carries out a nontransitory economic activity." Unlike with the determination of COMI, there is no statutory presumption regarding the determination of whether a foreign debtor has an establishment in any particular location. *See In re British Am. Ins. Co.*, 425 B.R. 884, 915 (Bankr. S.D. Fla. 2010). The debtor's foreign representative bears the burden of demonstrating that the debtor has an establishment in a particular jurisdiction. *Id*.

Abstention—Section 305

Section 305(a) of the Bankruptcy Code provides that a bankruptcy court can dismiss, or suspend, all proceedings in a bankruptcy case under any chapter if: (i) "the interests of creditors and the debtor would be better served by such dismissal or suspension;" or (ii) the court has granted a petition for recognition of a foreign proceeding under chapter 15, and "the purposes of chapter 15 . . . would be best served by such dismissal or suspension." Abstention under section 305 is with respect to the entire case and "reflects Congress's recognition that there may be situations where creditors and the debtor would be better served outside of bankruptcy," such as when recalcitrant creditors involved in an out-of-court restructuring file an involuntary bankruptcy petition to extract more favorable treatment from the debtor. COLLIER ON BANKRUPTCY ¶ 305.01[1] (16th ed. 2016). Because an order dismissing or suspending all proceedings in a case under section 305(a) may be reviewed on appeal only by a district court or a bankruptcy appellate panel, rather than a court of appeals or the U.S. Supreme Court (*see* 11 U.S.C. § 305(c)), section 305(a) dismissal is an "extraordinary remedy." *In re Kennedy*, 504 B.R. 815, 828 (Bankr. S.D. Miss. 2014); *see also Gelb v. United States (In re Gelb)*, 2013 BL 166941, *6 n.13 (B.A.P. 9th Cir. Mar. 29, 2013) (dismissal or suspension order under section 305(a) reviewable by bankruptcy appellate panel).

In *Creative Finance*, the bankruptcy court examined the chapter 15 recognition requirements and challenges to recognition based on the alleged bad faith of a pair of foreign debtors and their principal, as well as a foreign liquidator's inaction.

CREATIVE FINANCE

Creative Finance Ltd. and Cosmorex Ltd. (collectively, the "debtors"), each of which was organized under the laws of the BVI, were engaged in foreign exchange trading through accounts provided by third parties, such as Refco Capital Markets ("Refco"). The debtors conducted all or nearly all of their business through foreign exchange brokers located outside the BVI. The debtors' sole shareholder, Carlos Sevilleja ("Sevilleja"), and their sole director do not reside in the BVI, spending the bulk of their time in Spain or Dubai.

In 2011, Marex Financial Ltd. ("Marex") sued the debtors in the English High Court of Justice (the "English Court") for amounts allegedly due under trading contracts after Marex closed out currency positions when the Japanese yen plummeted in the wake of the catastrophic March 2011 tsunami and the ensuing nuclear disaster. The contracts included an English choice of law clause, and all of the underlying transactions that gave rise to the dispute occurred outside the BVI. The debtors' only physical presence in the BVI was through a registered agent and a post office box.

On July 19, 2013, the English Court circulated a proposed judgment awarding approximately $5 million to Marex. The draft judgment contained language restraining the parties from taking action in response to the judgment before formal pronouncement, on penalty of contempt of court. The English Court formally handed down the judgment on July 26, 2013, establishing August 8, 2013, as the deadline for the debtors to pay the amount due. The debtors never appealed the judgment.

Instead of paying or appealing the judgment, the debtors, directed by Sevilleja, transferred more than $9.5 million from their accounts in England to accounts in Gibraltar and Dubai. The transfers occurred after circulation of the draft judgment but before the payment deadline.

After the transfers, the debtors' only remaining material assets consisted of approximately $171 million in allowed unsecured claims in Refco's U.S. chapter 11 case. After the debtors received an interim distribution from the Refco estate in August 2013 in the amount of $1.7 million, those funds were also withdrawn from the debtors' English bank accounts.

On August 29, 2013, in an effort to enforce the English Court's judgment in the U.S. against future Refco claim distributions, Marex—the debtors' only noninsider creditor—sued the debtors in New York state court. The state court entered judgments against the debtors that domesticated the English Court's judgment in early November 2013.

On September 16, 2013, Marex applied to the BVI High Court of Justice (the "BVI Court") to place the debtors into liquidation, but later withdrew the application, citing "cost implications."

On December 12, 2013, Sevilleja directed that the debtors be put into liquidation in the BVI. The debtors then designated their own liquidator, to whom they provided just enough funding to comply with the minimum requirements of BVI law, but not enough to investigate the debtors' affairs, including pre-insolvency transfers.

On the basis of the domestication judgments, Marex entered into a court-approved stipulation on December 30, 2013, with the Refco trustees and chapter 11 plan administrator, providing that future distributions from the Refco estate in respect of the debtors' claims would be paid directly to Marex.

Even though Marex was notified of the BVI liquidation, it never informed the liquidator that it was negotiating a stipulation affecting the debtors' distributions from the Refco estate. Nor did it apprise the U.S. bankruptcy court of the commencement of the BVI liquidation before submitting the stipulation for approval.

The Refco plan administrator notified the liquidator of the proposed stipulation before it was approved by the U.S. bankruptcy court. However, the liquidator did not file an objection.

On February 10, 2014, the BVI Court approved the liquidator's appointment and authorized the liquidator to file a chapter 15 petition on the debtors' behalf in the U.S. Upon approval of his appointment, the liquidator became the sole manager of the debtors, which by that time had ceased operating. However, the liquidator did nothing to either manage or liquidate the debtors, other than performing minimum functions required by BVI law. These included administrative tasks, providing notice to creditors of the commencement of the liquidation and the claims bar date, convening the initial creditors' meeting, and issuing certain reports. The liquidator never collected or liquidated any of the debtors' assets; investigated the debtors' affairs, including claims against their estates; or asserted any causes of action on behalf of the estates. Except for agreeing to the U.K. counsel fees component of a claim asserted by Marex, the liquidator did not pay or settle any claims.

The liquidator filed a petition on February 9, 2014, in the U.S. bankruptcy court, seeking recognition of the debtors' BVI liquidation as a foreign main proceeding under chapter 15 or, alternatively, recognition of the BVI liquidation as a foreign nonmain proceeding. Marex opposed the petition, arguing that recognition should be denied for failure to meet chapter 15's requirements and on public policy grounds, by reason of, among other things, the debtors' bad faith. Marex also sought dismissal of the chapter 15 case under section 305.

When informed that another interim distribution would soon be made from the Refco chapter 11 estate, the liquidator sought pre-chapter 15 recognition relief in the form of an injunction preventing the payments from going directly to Marex. On April 4, 2015, the bankruptcy court approved a stipulation among the parties which provided that, pending the court's decision on the debtors' chapter 15 petition, future Refco distributions would be deposited into the court registry. As of the date of the court's ruling, the registry contained approximately $1.8 million.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court denied the petition for recognition under chapter 15.

Initially, bankruptcy judge Robert E. Gerber remarked that the commencement of the BVI liquidation by Sevilleja to thwart enforcement of the $5 million U.K. judgment against the debtors was "the most blatant effort to hinder, delay and defraud a creditor this Court has ever seen." With that preface, the judge stated as follows:

> The case presents two issues as to which the underlying caselaw is thin. First, are chapter 15's statutory requirements for recognition of a foreign main proceeding satisfied when—by the [D]ebtors' design—the foreign representative's activities before his chapter 15 filing have been so minimal that the Court cannot find that the Debtors' [COMI] . . . ever changed from the nation(s) where the Debtors actually did business to the different nation in which the foreign representative was appointed? . . . And second, must a U.S. Bankruptcy Court tolerate debtor bad faith in a chapter 15 case that a U.S. court would never tolerate in a case under any other chapter of the Code?

Despite this paucity of guidance, Judge Gerber concluded that "the proper outcome with respect to the issues before this Court is not at all in doubt."

Initially, Judge Gerber ruled that chapter 15 recognition should not be denied under the public policy exception stated in section 1506, which, as noted previously, permits a court to refuse recognition "if the action would be manifestly contrary to the public policy of the United States." According to the judge, while U.S. courts, in examining the narrow scope of the exception, have scrutinized the goals of a party, the fairness of a foreign judicial system, or the fairness of that forum's laws, "the Court has seen no precedent applying that exception to the misbehavior of a party alone." Judge Gerber wrote, "It does not seem right to find a violation of U.S. public policy when U.S. debtors sometimes engage in the same or similar bad faith . . . under U.S. law."

The ruling is noteworthy also because it reaffirms the notion that COMI can be legitimately migrated from one jurisdiction to another on the basis of the activities of a liquidator or other representative of the foreign debtor, but that did not occur in this case.

Emphasizing that recognition is not a "rubber stamp exercise," however, Judge Gerber determined that the BVI liquidation should not be recognized as a foreign main proceeding because the liquidator failed to prove that the debtors' COMI was located in the BVI. The evidence demonstrated that the debtors never conducted any meaningful business in the BVI, which was merely a letterbox jurisdiction. Nor, Judge Gerber explained, did the debtors' COMI migrate from other jurisdictions (*i.e.*, Spain, Dubai, or the U.K.) to the BVI after the BVI liquidation began on the basis of the liquidator's activities. "[T]he liquidator's efforts were so minimal," Judge Gerber wrote, "that the Court cannot find the necessary change in COMI."

In addition, because the debtors never conducted any meaningful business in the BVI and the liquidator's activities there were negligible, Judge Gerber found that the debtors never even had an establishment in the BVI. This precluded recognition of the BVI liquidation as a foreign nonmain proceeding.

In light of his conclusion that recognition should be denied, Judge Gerber declined to address whether dismissal of the chapter 15 case was warranted under section 305 or due to the bad faith of the debtors or their principal. He posited in dicta, however, that even if recognition of the BVI liquidation had been warranted, a U.S. bankruptcy court is "not helpless in the face of a bad faith filing, including of the type this Court has found here." For example, Judge Gerber explained, even if recognition had triggered the automatic stay, relief from the stay could be granted "for cause," including a bad faith filing.

Finally, in light of his ruling denying recognition, Judge Gerber directed that, upon the effective date of his ruling, the standstill stipulation with respect to future Refco distributions would expire. He further directed the parties to seek approval from the bankruptcy judge presiding over Refco's chapter 11 case for disbursement of the funds held in the court registry.

OUTLOOK

Enacted in 2005, chapter 15 is patterned on the 1997 UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"). Designed to provide effective mechanisms for dealing with cross-border insolvency cases, the Model Law has now been enacted by 42 nations or territories, 18 of which adopted some form of the law in 2015.

COMI migration and, in some cases, improper COMI manipulation have become more frequent issues with the increasing volume of cross-border bankruptcy and insolvency cases filed in Model Law jurisdictions. With 18 new Model Law jurisdictions in 2015 and more on the way, this trend can be expected to continue. *Creative Finance* suggests that, at least in the U.S., courts are both well aware of this development and determined not to rubber-stamp petitions for chapter 15 recognition. The ruling is noteworthy also because it reaffirms the notion that COMI can be legitimately migrated from one jurisdiction to another on the basis of the activities of a liquidator or other representative of the foreign debtor, but that did not occur in this case.

Still, *Creative Finance* is an unusual case. Judge Gerber was clearly offended by the brazenness with which the debtors' principal attempted to manipulate the law as a means of thwarting a single creditor's collection efforts. Other cases are less likely to present such a clear-cut case for denial of chapter 15 recognition.

INTERNATIONAL LEGISLATIVE UPDATE

PROPOSED SWISS INTERNATIONAL INSOLVENCY LAW REFORMS

In October 2015, the Swiss Federal Department of Justice and Police (*Eidgenössisches Justiz- und Polizeidepartement*) published a preliminary draft of reforms to title 11 of the Swiss Private International Law Act ("SPILA"), which governs insolvency proceedings and compensation proceedings (Articles 166–175 rev-SPILA), together with an explanatory report. The consultation procedure for the proposed reforms culminated on February 5, 2016.

The preliminary draft is intended to improve existing rules, including procedures governing recognition by Swiss courts of foreign bankruptcy and insolvency cases along the lines of the procedures set forth in the 1997 UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"). Although the Model Law has now been enacted by 42 nations or territories, Switzerland has not adopted the legislation. The proposed reforms would, among other things:

- Abandon the existing requirement of reciprocity in connection with a Swiss court's recognition of foreign bankruptcy proceedings.

- Expand the scope of recognition of foreign bankruptcy proceedings to encompass proceedings commenced in the jurisdiction containing a foreign debtor's center of main interests as well as a debtor's domicile.

- Authorize a Swiss court, upon recognition of a foreign bankruptcy proceeding, to waive the existing requirement that secondary bankruptcy proceedings be commenced in Switzerland, unless the initiation of such proceedings is necessary to protect secured and preferred Swiss creditors; and in the event of a waiver, grant the foreign debtor's bankruptcy administrator the power to collect and dispose of the debtor's Swiss assets.

- Create procedures to promote coordination between Swiss and foreign authorities and institutions with respect to cross-border bankruptcy cases.

- Provide for the recognition and enforcement of foreign judgments with respect to avoidance and insolvency-related claims, subject to certain conditions.

After the Federal Department of Justice and Police prepares a report on the results of the recently completed consultation procedure, the Swiss Federal Council (*Bundesrat*) will determine the next steps in moving the proposals, which may be amended, toward legislative enactment.

PROPOSED INDIAN BANKRUPTCY REFORMS

In December 2015, the Indian government introduced a long-awaited bill—the Insolvency and Bankruptcy Bill 2015—to overhaul India's outdated and burdensome bankruptcy process. According to recent World Bank data, India ranks 136th out of the 189 countries surveyed in terms of fast and efficient resolution of insolvencies, with creditors having limited power in the event of a debtor's default. The proposed bill aims to expedite decisions on whether to rehabilitate or liquidate ailing companies, in a move to curb asset stripping and ensure higher recovery rates for creditors, both of which are key to fostering a modern credit market and increased investment in India.

If adopted, the proposed legislation would:

- Establish a formal insolvency resolution process for businesses by, among other things, appointing an Insolvency and Bankruptcy Board of India as the regulatory authority and creating specialized bankruptcy courts as part of the National Company Law Tribunal.

- Permit corporate debtors that have defaulted on debts, financial creditors (banks and bondholders), and trade creditors to initiate the corporate insolvency resolution process ("IRP").

- Establish a 180-day deadline for the completion of an IRP, during which time the company must present restructuring proposals to creditors for approval. If the requisite majority of creditors do not agree on a restructuring plan within the 180-day period, the company will automatically be placed into liquidation. The 180-day period may be extended by 90 days if at least 75 percent of the creditors decide that the case is too complex to be resolved within the 180-day period and the court grants the extension.

- In the event a company is placed into liquidation, establish a hierarchy of claim priorities, including, in descending order, administrative costs of any preceding IRP and the liquidation proceeding, secured claims, certain employee claims, and unsecured claims.

- Create a "fast-track" IRP for smaller companies, to be completed within 90 days (unless the period is extended with the consent of creditors).

SOVEREIGN DEBT UPDATE

In a historic decision with the potential to end 15 years of litigation between the Republic of Argentina and holdout bondholders from the financially strapped South American nation's 2005 and 2010 sovereign debt restructurings, Judge Thomas Griesa of the U.S. District Court for the Southern District of New York entered an order on March 2, 2016, conditionally dissolving 2012 and 2015 injunctions that preclude Argentina from making payments on its restructured debt unless it also pays amounts owed to holdout bondholders. The injunctions effectively locked the country out of international credit markets. Judge Griesa's order paves the way for Argentina to regain access to those markets and enables the country to raise capital so that it can begin paying settling holdout bondholders. The fly in the ointment is that certain holdouts, including hedge funds NML Capital and Aurelius Capital Partners, have appealed the order to the U.S. Court of Appeals for the Second Circuit, which is expected to hear argument on the appeal sometime in April 2016.

Judge Griesa's ruling came on the heels of a series of landmark settlements with holdout bondholders, including: (i) a $1.35 billion settlement between Argentina and 50,000 Italian holdout bondholders announced on February 2, 2016; (ii) a $1.1 billion settlement between Argentina and holdout bondholders EM Ltd. and Montreux Partners LP, announced on February 5, 2016; and (iii) a $4.6 billion settlement between Argentina and NML Capital, Aurelius Capital Partners, and other major holdout bondholders, announced on February 29, 2016.

These settlements were reached shortly after newly elected Argentine President Mauricio Macri pledged to return Argentina from credit markets exile and to make a fresh start following Argentina's second sovereign debt default in 13 years, in July 2014 (Argentina first defaulted in 2001, in the midst of one of the worst economic crises in its history). The President's more conciliatory approach stands in stark contrast to the strategy employed by former Argentine President Cristina Fernández de Kirchner, who systematically refused to negotiate with the holdouts for eight years, characterizing them as "economic terrorists." Additional settlements in the aggregate amount of approximately $350 million were announced on March 9 and March 18.

Even though they reached a deal with Argentina, NML Capital and Aurelius Capital Partners appealed Judge Griesa's order, contending that the ruling "rests on the erroneous premise that 'changed circumstances' necessary to warrant lifting the Injunctions exist solely on the basis of Argentina's hope that it will pay some subset of creditors who agreed to terms under coercive conditions." According to the appellants, while they "sincerely hope" Argentina will pay under their settlement agreement, payment is "far from certain," and the Second Circuit should correct the "misimpression that Argentina may obtain even conditional relief from the Injunctions simply by claiming a willingness to settle."

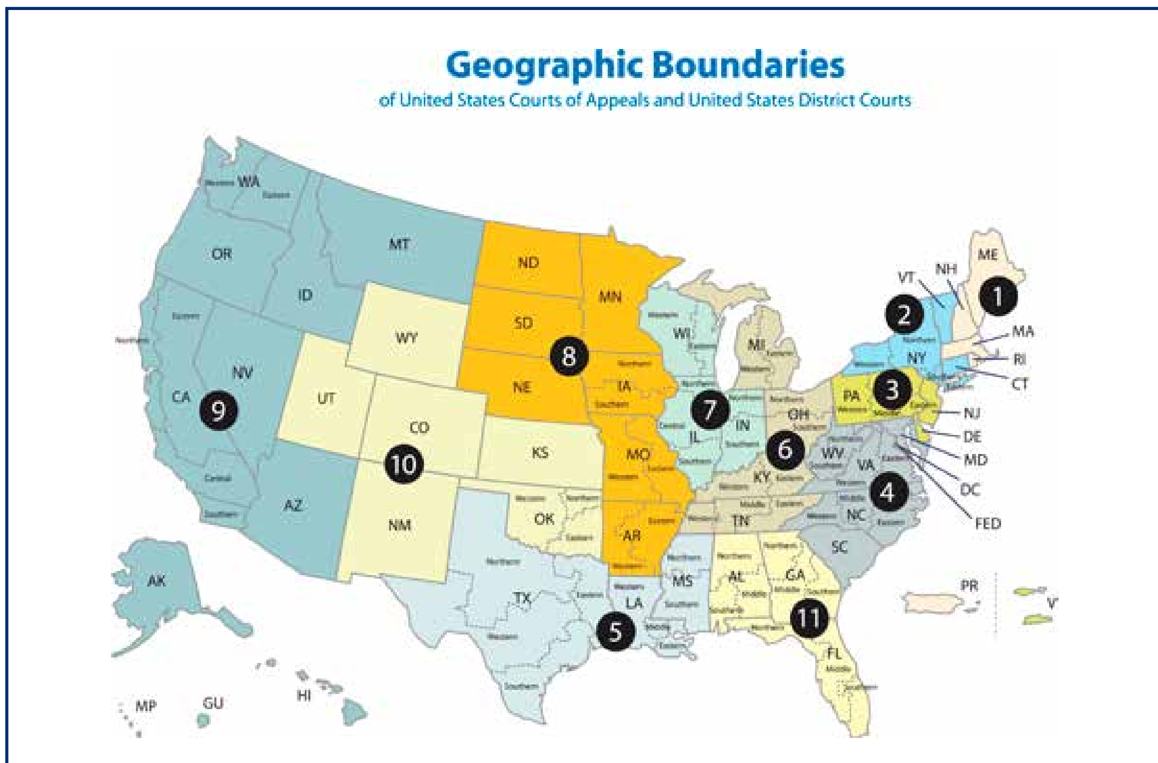
Even if Judge Griesa's ruling is ultimately upheld on appeal, his vacatur of the injunctions is conditioned upon: (i) Argentina's repeal of several laws, including the "Lock Law," which prohibits payments to bondholders other than holders of exchange bonds; and (ii) Argentina's payment of any funds promised to holdout bondholders that settled on or before February 29, 2016.

On March 11, 2016, the Second Circuit granted an unopposed motion to stay the effectiveness of Judge Griesa's order until it could adjudicate appeals from the ruling. In an order issued earlier, the Second Circuit set a briefing schedule that would run through March 25, stating that the date of any arguments on the appeals would be determined "at a later time."

On March 16, 2016, Argentina's Chamber of Deputies approved legislation introduced by the Macri administration to issue new debt and repeal the sovereign payment law and the Lock Law, which would permit Argentina to consummate settlements it has reached with holdout bondholders. Argentina's Senate is also expected to approve the bill.

Stay tuned for further developments.

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.

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Executive Editor: Charles M. Oellermann
Managing Editor: Mark G. Douglas

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