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BUSINESS RESTRUCTURING REVIEW

THIRD CIRCUIT RULES THAT PRIVATE EQUITY FUND AND PORTFOLIO COMPANY ARE NOT A "SINGLE EMPLOYER" FOR PURPOSE OF WARN ACT LIABILITY

Timothy Hoffmann and Mark G. Douglas

As private equity funds increasingly decide to participate actively in the affairs and management of their portfolio companies, recent court rulings suggest that funds may face greater exposure to liability for a portfolio company's obligations. For example, in 2013, the First Circuit Court of Appeals fired a shot across the bow of private equity funds with portfolio companies that are participants in multi-employer pension plans. It ruled in *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 724 F.3d 129 (1st Cir. 2013), that a private equity fund was a "trade or business" which could be held jointly and severally liable under the Employee Retirement Income Security Act of 1974 ("ERISA") for the pension plan withdrawal liability incurred by one of its portfolio companies.

That ruling was reinforced earlier this year on remand from the First Circuit's decision in an opinion handed down by the U.S. District Court for the District of Massachusetts. In *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 2016 BL 95418 (D. Mass. Mar. 28, 2016), the court held that a related private equity fund was also a trade or business under ERISA and that the second prong of the test for imposing joint and several liability under ERISA—i.e., "common control"—had been met with respect to the group of related portfolio companies. The remand ruling, which we discussed in the May/June 2016 edition of the *Business Restructuring Review*, is now before the First Circuit on appeal.

Another potential minefield for private equity sponsors was the subject of a ruling recently issued by the U.S. Court of Appeals for the Third Circuit, with a different result. In *Czyzewski v. Jevic Transp., Inc. (In re Jevic Holding Corp.)*, 2016 BL 241827 (3d Cir. July 27, 2016), a three-judge panel ruled in a nonprecedential opinion that Sun Capital Partners, Inc., and a subsidiary were not a "single employer" for the purpose of assessing potential liability under the Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 *et seq.* (the "WARN Act"), and its

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New Jersey counterpart. The Third Circuit ruled, among other things, that the mere fact that a subsidiary is dependent on its parent's loans and ultimately fails without them is inadequate to demonstrate dependency of operations.

These rulings highlight the importance of maintaining structural formalities and avoiding overreaching as a way to minimize a private equity sponsor's potential exposure in connection with a portfolio company's liabilities.

THE WARN ACT

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

> An 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)[.]"

Although the WARN Act does not define "business enterprise," regulations issued by the U.S. Department of Labor (the "DOL") state that "subsidiaries which are wholly or partially owned by a parent company are treated as separate employers or as a part of the parent or contracting company depending upon the degree of their independence from the parent." 20 C.F.R. § 639.3(a)(2). The five factors to be considered in making this "single employer" determination are: "(i) common ownership, (ii) common directors and/or officers, (iii) de facto exercise of control, (iv) unity of personnel policies emanating from a common source, and (v) the dependency of operations." *Id.*

The five factors in the DOL balancing test are not accorded equal weight. Thus, for example, in *Pearson v. Component Tech. Corp.*, 247 F.3d 471 (3d Cir. 2001), the Third Circuit noted that satisfaction of the first and second factors alone is not sufficient to establish that two entities constitute a "single employer." It also explained that "if the de facto exercise of control [factor three] was particularly striking—for instance, were it effectuated by disregard[ing] the separate legal personality of its subsidiary—then liability might be warranted even in the absence of the other factors." *Id.* at 504.

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 the WARN Act. *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)*, 487 B.R. 169 (Bankr. S.D.N.Y. 2013).

DOL regulations also prescribe when an employer must give WARN Act notice, whom 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 which fails to give WARN Act 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."

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 the WARN Act's 60-day-notice provisions. *See* 29 U.S.C. §§ 2102(b)(1) and (b)(2)(A); 20 C.F.R. § 639.9. In addition, 29 U.S.C. § 2102(b)(2)(B) provides that "[n]o notice under [the WARN Act] 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 though the courts involved have reached opposite conclusions on the imposition of liability under the pertinent statutes, *New England Teamsters* and *Jevic Holding* have a common theme that private equity sponsors should not ignore: too much interference in the management and financial decision-making process of a portfolio company can have significant consequences in terms of liability.

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 Act notice, provided that 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." 20 C.F.R. § 639.9(b)(2).

Some states have enacted laws similar to the WARN Act 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); N.J. Stat. Ann. §§ 34:21-1 to 34:21-7 (2007) (the "NJ WARN Act"); 820 Ill. Comp. Stat. §§ 65 *et seq.* (2005); Cal. Lab. Code §§ 1400–1408 (2003).

The Third Circuit addressed whether a private equity fund and one of its portfolio companies constituted a "single employer" under the WARN Act and the NJ WARN Act in *Jevic Holding*.

JEVIC HOLDING

Jevic Transportation, Inc. ("Jevic Transportation") was a New Jersey-based trucking company with 1,785 employees as of 2008. In 2006, Jevic Transportation and its nonoperating affiliate, Creek Road Properties, LLC ("Creek Road" and, collectively, "Jevic"), were acquired in a leveraged buyout by Sun Transportation LLC, a subsidiary of private equity firm Sun Capital Partners, Inc. ("Sun Capital"). As part of the transaction, Jevic Holding Corp. was created to be Jevic's holding company. The transaction was financed with $85 million provided by a group of lenders led by CIT Group Business Credit Inc. ("CIT"). Jevic and Sun Capital entered into a management services agreement whereby Sun Capital provided consulting services to Jevic for a fee.

Jevic struggled financially throughout 2007 due to the general economic downturn and the negative impact of fuel surcharges on its profitability. After Jevic defaulted on a financial covenant in its loan agreement with CIT, Jevic and CIT entered into a series of forbearance agreements beginning in January 2008 under which, among other things, Sun Capital provided a $2 million guarantee.

On March 27, 2008, CIT presented Sun Capital with two options: (i) an additional investment in Jevic in exchange for a long-term forbearance agreement; or (ii) a 45-day forbearance during which Jevic would begin looking for an acquiror. Sun Capital chose the latter.

Jevic met with two potential buyers, one of which was Pitt Ohio, but the sale process stalled after CIT refused to fund further borrowing unless Sun Capital agreed to invest more money to fund a bridge loan to complete the sale. Sun Capital refused, concluding that the necessary investment would exceed the expected sale proceeds.

On May 16, 2008, with no viable sale or funding available to Jevic and with the forbearance agreement with CIT expiring, Jevic's board formally authorized a bankruptcy filing. Jevic sent its employees WARN Act termination notices that were received on May 19, 2008. Jevic filed for chapter 11 protection in the District of Delaware the next day.

On March 23, 2008, Jevic's terminated employees had filed a class action adversary proceeding alleging that Jevic and Sun Capital had violated the WARN Act and its New Jersey counterpart—the NJ WARN Act—by failing to provide employees with the requisite 60-day notice of a plant closing or mass layoff. The plaintiffs also alleged that Jevic and Sun Capital constituted a "single employer" for purposes of WARN Act and NJ WARN Act liability. After the bankruptcy court certified the class, the parties filed cross-motions for summary judgment.

The bankruptcy court ruled that Jevic and Sun Capital were not a "single employer" for the purpose of WARN Act and NJ WARN Act liability according to the five-factor DOL test, which has also been applied by New Jersey courts in construing the NJ WARN Act. *See DeRosa v. Accredited Home Lenders, Inc.*, 22 A.3d 27, 40 (N.J. Super. Ct. App. Div. 2011). The district court affirmed on appeal. *See Czyzewski v. Sun Capital Partners, Inc. (In re Jevic Holding Corp.)*, 526 B.R. 547 (D. Del. 2014).

THE THIRD CIRCUIT'S RULING

A three-judge panel of the Third Circuit affirmed in a nonprecedential ruling. Writing for the panel, circuit judge Anthony J. Scirica noted that, like the lower courts, the panel would apply the five-factor DOL test adopted in *Pearson* to determine whether Jevic and Sun Capital were a "single employer" for the purpose of assessing potential liability under the WARN Act and the NJ WARN Act. Of those factors, Judge Scirica explained, only the final three were disputed—Sun Capital did not challenge the lower courts' findings that factors one and two had been satisfied.

Addressing these disputed factors, the Third Circuit panel concluded as follows: (i) the evidence did not support the employees' contention that Sun Capital exercised de facto control (factor three) over Jevic by taking actions which "overwhelmed" the company, but rather, Jevic's board independently made the decision to shut down the company and signed the WARN Act notice terminating employees; (ii) Sun Capital did not directly hire or fire Jevic employees, share a personnel or benefits recordkeeping system with Jevic, or otherwise have any "unity of personnel practices emanating from a common source" (factor four); and (iii) Sun Capital and Jevic did not share administrative or purchasing systems, interchange employees or equipment, commingle finances, or otherwise have a "dependency of operations" (factor five).

According to the Third Circuit panel, the mere fact that a subsidiary is dependent on its parent's loans and ultimately fails without them is inadequate to demonstrate dependency of operations. Similarly insufficient to establish operational dependency, Judge Scirica observed, were the employees' thinly supported claims that Jevic depended on the administrative arrangements it shared with Sun Capital; that Sun Capital was involved in the creation, details, and manner of implementation of Jevic's business plan; and that Sun Capital undercapitalized and extracted management fees from the company.

OUTLOOK

Even though the courts involved have reached opposite conclusions on the imposition of liability under the pertinent statutes, *New England Teamsters* and *Jevic Holding* have a common theme that private equity sponsors should not ignore: too much interference in the management and financial decision–making process of a portfolio company can have significant consequences in terms of liability. It remains to be seen at this juncture what the First Circuit will ultimately rule on appeal in *New England Teamsters*. Given its previous ruling in the case, however, an abrupt change of course on the imposition of multiemployer pension plan withdrawal liability may be unlikely.

SEVENTH CIRCUIT DEEPENS CIRCUIT SPLIT ON APPLICABILITY OF SECTION 546(e) SAFE HARBOR TO TRANSACTIONS INVOLVING FINANCIAL INSTITUTION ACTING AS MERE CONDUIT

Brad B. Erens and Mark G. Douglas

In *FTI Consulting, Inc. v. Merit Management Group, LP*, 2016 BL 243677 (7th Cir. July 28, 2016), a three-judge panel of the U.S. Court of Appeals for the Seventh Circuit ruled that the "safe harbor" under section 546(e) of the Bankruptcy Code for settlement payments made in connection with securities contracts does not protect "transfers that are simply conducted *through* financial institutions (or the other entities named in section 546(e)), where the entity is neither the debtor nor the transferee but only the conduit." The ruling deepens a split among the circuit courts of appeal on the issue and may be a candidate for review by the U.S. Supreme Court to resolve the dispute.

THE SECTION 546(e) SAFE HARBOR

Section 546 of the Bankruptcy Code imposes a number of limitations on a bankruptcy trustee's avoidance powers, including the power to avoid certain preferential and/or fraudulent transfers. In 1982, Congress broadened a limited safe harbor for securities transactions then set forth in section 764(c) of the Bankruptcy Code, which applied only in commodity broker liquidation cases under chapter 7, by replacing the provision with section 546(e) (then designated as section 546(d), until renumbering in 1984).

Section 546(e) provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of [the Bankruptcy Code], the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of [the Bankruptcy Code], or settlement payment as defined in section 101 or 741 of [the Bankruptcy Code], made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7) [of the Bankruptcy Code], commodity contract, as defined in section 761(4) [of the Bankruptcy Code], or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of [the Bankruptcy Code].

The purpose of section 546(e) is to prevent "the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market." H.R. Rep. No. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583, 1982 WL 25042. The provision was "intended to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *Id.* With the enactment of section 546(e), Congress also sought to promote customer confidence in the markets by protecting market stability. *See Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990) (citing Sen. Rep. No. 989, at 8 (1978)).

If a transaction falls within the scope of section 546(e), it may not be avoided unless the transfer is avoidable under section 548(a)(1)(A) of the Bankruptcy Code—that is, because it was made with *actual* intent to hinder, delay, or defraud creditors. In determining whether a "constructively" fraudulent transfer (a transfer for which an insolvent debtor did not receive reasonably equivalent value in exchange) is shielded from avoidance under section 546(e), key issues are often whether the transfer qualifies as a "settlement payment" and whether the transfer is made under a "securities contract." In addition, to be within the scope of the safe harbor, a transfer must have been "made by or to (or for the benefit of)" a commodity broker, a forward contract merchant, a stockbroker, a financial institution, a financial participant, or a securities clearing agency.

Five circuit courts of appeal have ruled that the section 546(e) safe harbor extends to transactions even where one of the entities named in the provision is merely a "conduit" for the transfer of funds from the debtor to the ultimate transferee. *See In re Quebecor World (USA) Inc.*, 719 F.3d 94 (2d Cir. 2013) (safe harbor applicable where financial institution was trustee and actual exchange was between two private entities); *In re QSI Holdings, Inc.*, 571 F.3d 545 (6th Cir. 2009) (safe harbor applied even though financial institution involved in leveraged buyout ("LBO") was only an exchange agent); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981 (8th Cir. 2009) (section 546(e) not limited to public securities transactions and protects from avoidance debtor's payments deposited in national bank in exchange for shareholders' privately held stock during LBO); *In re Resorts Int'l, Inc.*, 181 F.3d 505, 516 (3d Cir. 1999) (noting that "the requirement that the 'commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies' obtain a 'beneficial interest' in the funds they handle . . . is not explicit in section 546"); *In re Kaiser Steel Corp.*, 952 F.2d 1230, 1240 (10th Cir. 1991) (rejecting argument that "even if the payments were settlement payments, § 546(e) does not protect a settlement payment 'by' a stockbroker, financial institution, or clearing agency, unless that payment is to another participant in the clearance and settlement system and not to an equity security holder").

The Eleventh Circuit ruled to the contrary in *In re Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996). In *Munford*, the court held that section 546(e) did not shield from avoidance payments made by the debtor to shareholders in an LBO because the "financial institution" involved was only a conduit for the transfer of funds and securities—the bank never had a "beneficial interest" sufficient to qualify as a "transferee" in the LBO. In so ruling, the Eleventh Circuit wrote:

> None of the entities listed in section 546(e)—*i.e.*, a commodity broker, forward contract merchant, stockbroker, financial institution, or a securities clearing agency—made or received a transfer/payment. Thus, section 546(e) is not applicable. . . . True, a section 546(e) financial institution was presumptively involved in this transaction. But the bank here was nothing more than an intermediary or conduit. Funds were deposited with the bank and when the bank received the shares from the selling shareholders, it sent funds to them in exchange. The bank never acquired a beneficial interest in either the funds or the shares. . . . Importantly, a trustee may only avoid a transfer to a "transferee." *See* 11 U.S.C. § 550. Since the bank never acquired a beneficial interest in the funds, it was not a "transferee" in the LBO transaction.

Id. at 610.

The Seventh Circuit weighed in on this issue in *FTI Consulting*.

FTI CONSULTING

In 2007, Valley View Downs, LP ("Valley View"), the owner of a Pennsylvania racetrack, acquired all of the stock of a competitor, Bedford Downs ("Bedford"), in a $55 million LBO transaction styled as a "settlement agreement" because Bedford and Valley View were competing for "racino" licenses. Citizens Bank of Pennsylvania ("Citizens") acted as escrow agent for the exchange. After the LBO, Valley View filed for chapter 11 protection in 2009 in the Northern District of Illinois because the Illinois gaming commission denied Valley View's application for the gambling license.

The trustee of a litigation trust created under Valley View's chapter 11 plan sued a 30 percent shareholder in Bedford, alleging that Valley View's transfer to Bedford and thence to the shareholder of approximately $16.5 million (30 percent of the $55 million) was constructively fraudulent and therefore avoidable under sections 544 and 548(a)(1)(B) of the Bankruptcy Code. The bankruptcy court and, on appeal, the district court ruled that the transfer to the shareholder was protected by the section 546(e) safe harbor.

THE SEVENTH CIRCUIT'S RULING

The Seventh Circuit reversed. "Although we have said that section 546(e) is to be understood broadly," the court wrote, "that does not mean that there are no limits." Here, the court explained, although the transaction resembled an LBO and "in that way touched on the securities market," Valley View and the shareholder were not "parties in the securities industry," but simply "corporations that wanted to exchange money for privately held stock." Citizens, the "financial institution" involved as escrow agent, was merely a conduit.

In *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 893 (7th Cir. 1988), the Seventh Circuit explained, it had previously defined "transferee" as an entity with "dominion over the money" or "the right to put the money to one's own purposes." In *Bonded Financial*, the court ruled that a bank which "acted as a financial intermediary" and "received no benefit" was not a "transferee" for purposes of chapter 5 of the Bankruptcy Code. *Id.* In *FTI Consulting*, the Seventh Circuit extended that reasoning to the section 546(e) safe harbor. It accordingly ruled that transfers "made by or to (or for the benefit of)" in the context of 546(e) refer to transfers made to "transferees."

NEWSWORTHY

Jeffrey B. Ellman (Atlanta), Dan B. Prieto (Dallas), Thomas M.Wearsch (Cleveland), Scott J. Greenberg (New York), Thomas A. Howley (Houston), Richard L. Wynne (Los Angeles), Pedro A. Jimenez (Miami and New York), James O. Johnston (Los Angeles), Heather Lennox (New York and Cleveland), Gregory M. Gordon (Dallas), David G. Heiman (Cleveland), Corinne Ball (New York), Carl E. Black (Cleveland), Bruce Bennett (Los Angeles and New York), and ***Brad B. Erens (Chicago)*** were recognized in *Best Lawyers in America* (2017) in the field of Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law.

Sidney P. Levinson (Los Angeles), Carl E. Black (Cleveland), Corinne Ball (New York), James O. Johnston (Los Angeles), and ***Bruce Bennett (Los Angeles and New York)*** were recognized in *Best Lawyers in America* (2017) in the field of Litigation - Bankruptcy.

David G. Heiman (Cleveland), Carl E. Black (Cleveland), Jeffrey B. Ellman (Atlanta), Thomas A. Wilson (Cleveland), Daniel J. Merrett (Atlanta), George R. Howard (New York), and ***Danielle Barav-Johnson (Atlanta)*** represented Alpha Natural Resources, Inc. ("ANR"), one of the largest U.S. coal producers, in connection with chapter 11 cases filed on behalf of the company and its affiliates on August 3, 2015, in the U.S. Bankruptcy Court for the Eastern District of Virginia. The bankruptcy court confirmed a plan of reorganization for ANR on July 12, 2016. Under the plan, ANR sold certain core coal assets and emerged from bankruptcy as a privately held entity.

Ben Larkin (London) and ***Sion Richards (London)*** were named "Leaders in Their Field" for Restructuring/Insolvency by *Chambers UK* (2017).

Kevyn D. Orr (Washington) served on a panel discussing "The Road to Restructuring on the Highway of Chapter 9: Inside the Detroit Bankruptcy and Emerging Issues in Puerto Rico" on September 15, 2016, at the Federal Bar Association Annual Meeting in Cleveland.

Brad B. Erens (Chicago), George R. Howard (New York), Joseph M. Tiller (Chicago), and ***Bryan M. Kotliar (New York)*** were part of a team of Jones Day professionals representing Molycorp, Inc. ("Molycorp") and 20 of its subsidiaries in connection with their chapter 11 reorganization and secured creditor buyout. Molycorp, the only U.S. supplier of rare-earth minerals, filed for chapter 11 protection in June 2015. During the bankruptcy case, Molycorp pursued a potential sale of substantially all of its assets while simultaneously negotiating with its major creditor groups regarding a stand-alone reorganization of the company. Ultimately, it was determined that Molycorp and 14 of its subsidiaries would reorganize pursuant to a chapter 11 plan which was confirmed by the bankruptcy court in April 2016. After waiting several months to obtain the necessary regulatory approvals, Molycorp successfully emerged from bankruptcy on August 31, 2016, as Neo Performance Materials. Molycorp's major creditors acquired the company and 14 of its subsidiaries in exchange for $1.8 billion in indebtedness and other claims. Molycorp's remaining six subsidiaries were not reorganized; instead, they sold certain mineral rights and other miscellaneous assets to a separate creditor group and remain in chapter 11 cases being overseen by a chapter 11 trustee.

Amy Edgy (Washington) will moderate a panel discussion on September 29, 2016, regarding "Turmoil in the Energy Markets" at the 2016 Consumer and Business Bankruptcy Seminar sponsored by the Institute of Continuing Legal Education in Georgia, held in Greensboro, Georgia.

An article written by ***Mark A. Cody (Chicago)*** and ***Mark G. Douglas (New York)*** entitled "A Look At 3 Bankruptcy Remedies Lenders Commonly Use" was published in the September 2, 2016, edition of *Law360.*

Thomas A. Howley (Houston) gave a presentation entitled "Environmental Issues in Distressed Energy Transactions: Examining and Addressing the Interests of the State, the Public, and the Company" on September 9, 2016, at the annual meeting of the American Bar Association Business Law Section in Boston.

Gregory M. Gordon (Dallas) was interviewed for a panel discussion entitled "Operational and financial restructuring in the energy & natural resources sector" in the September 2016 edition of *Financier Worldwide*.

Examining the history of section 546(e), the Seventh Circuit explained that nothing Congress did in originally enacting the safe harbor, or in later expanding its scope to other types of actors in the securities industry, including financial institutions, indicates "that the safe harbor applie[s] to those institutions in their capacity as intermediaries." According to the court, "the safe harbor has ample work to do when an entity involved in the commodities trade is a debtor or actual recipient of a transfer, rather than simply a conduit for funds."

***FTI Consulting* effectively rekindles a two-decade-long circuit split that had largely faded into obscurity before the Seventh Circuit chose to resurrect the minority approach articulated in *Munford* but rejected by five other circuits.**

The Seventh Circuit rejected the argument that Congress effectively overruled *Munford* by adding the phrase "(or for the benefit of)" to section 546(e) as part of the Financial Netting Improvements Act of 2006, Pub. L. No. 109-390 § 5(b)(1) (2006), in response to the Eleventh Circuit's statement in *Munford* that "[t]he bank never acquired a beneficial interest in either the funds or the shares." *Munford*, 98 F.3d at 610. The Seventh Circuit acknowledged that, in *Quebecor*, the Second Circuit construed the 2006 amendment to mean that section 546(e) was satisfied if one of the designated entities made a transfer, received a transfer, or acquired a beneficial interest in the transferred assets. *See Quebecor*, 719 F.3d at 100 n.3. Even so, the Seventh Circuit wrote that "[w]e do not believe that Congress would have jettisoned *Munford*'s rule by such a subtle and circuitous route." According to the court, "If Congress had wanted to say that acting as a conduit for a transaction between non-named entities is enough to qualify for the safe harbor, it would have been easy to do that . . . [b]ut it did not."

OUTLOOK

FTI Consulting effectively rekindles a two-decade-long circuit split that had largely faded into obscurity before the Seventh Circuit chose to resurrect the minority approach articulated in *Munford* but rejected by five other circuits. On August 11, 2016, the shareholder defendant filed a petition asking the Seventh Circuit to rehear the case en banc, claiming that the panel ruling conflicts with those of five other circuits, as well as with decisions within the Seventh Circuit, and that the panel's decision would lead to inequitable results which Congress could not have intended. The Seventh Circuit denied the motion on August 30, 2016. It remains to be seen whether *FTI Consulting* will be overturned by the U.S. Supreme Court, should it grant a petition for certiorari to resolve the circuit split.

In the meantime, the ruling means that participants, such as selling shareholders, in LBO transactions involving companies whose solvency is questionable face different levels of exposure depending on the law on this issue in the circuit in which the LBO could later be challenged as a fraudulent transfer.

CONFLICTING RULINGS ON PREEMPTION OF STATE LAW FRAUDULENT TRANSFER CLAIMS BY SECTION 546 SAFE HARBOR CREATE UNCERTAINTY

Ben Rosenblum

In *Deutsche Bank Trust Co. Ams. v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2d Cir. 2016), the U.S. Court of Appeals for the Second Circuit held that the "safe harbor" under section 546(e) of the Bankruptcy Code for settlement payments and for payments made in connection with securities contracts preempted claims under state law by creditors to avoid as fraudulent transfers pre-bankruptcy payments made to shareholders in connection with a leveraged buyout ("LBO") of the debtor.

While *Tribune* resolved a split on this issue within the Second Circuit, shortly after the ruling was handed down, a Delaware bankruptcy court in *PAH Litigation Trust v. Water Street Healthcare Partners, L.P. (In re Physiotherapy Holdings, Inc.)*, 2016 BL 251441 (Bankr. D. Del. June 20, 2016), elected not to follow the Second Circuit, holding instead that the state law claims assigned to a litigation trust in that case were not preempted by section 546(e). These two decisions represent differing views by sophisticated courts on the breadth of section 546(e) and its preemptive scope. While *Tribune* controls within the Second Circuit, other circuit courts of appeal have not weighed in on this issue, and litigation concerning the application of section 546(e) to state law avoidance claims in the hands of a litigation trustee will likely persist.

BANKRUPTCY AVOIDANCE POWERS AND LIMITATIONS

The Bankruptcy Code gives a bankruptcy trustee or chapter 11 debtor-in-possession ("DIP") the power to avoid, for the benefit of the estate, certain transfers made or obligations incurred by a debtor, including fraudulent transfers, within a specified time prior to a bankruptcy filing. Fraudulent transfers include transfers that were made with "actual" fraudulent intent—the intent to hinder, delay, or defraud creditors—as well as transfers that were "constructively" fraudulent, because the debtor received less than "reasonably equivalent value" in exchange and, at the time of the transfer, was insolvent, undercapitalized, or unable to pay its debts as such debts matured.

Fraudulent transfers can be avoided by a bankruptcy trustee or DIP for the benefit of the estate under either: (i) section 548 of the Bankruptcy Code, which creates a federal cause of action for avoidance of transfers made or obligations incurred up to two years before a bankruptcy filing, or (ii) section 544, which gives the trustee or DIP the power to avoid transfers or obligations that may be avoided by creditors under applicable non-bankruptcy law. Some state fraudulent transfer laws that may be utilized under section 544 have reach-back periods longer than two years.

Section 546 of the Bankruptcy Code imposes limitations on these avoidance powers. Among those limitations, section 546(e) prohibits, with certain exceptions, avoidance of transfers made by or to certain protected parties that are margin or settlement payments or transfers made in connection with securities, commodities, or forward contracts. The purpose of section 546(e) and other financially focused "safe harbors" in the Bankruptcy Code is to minimize "systemic risk" to the securities and commodities markets that could be caused by a financial contract counterparty's bankruptcy filing.

Like sections 544 and 548, section 546(e) is expressly directed at a bankruptcy trustee or, pursuant to section 1107(a), a DIP: "Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, *the trustee may not avoid* a transfer that is a margin payment . . . or settlement payment . . . made by or to (or for the benefit of) a [protected participant] . . . or that is a transfer made by or to (or for the benefit of) a [protected participant] . . . in connection with a securities contract . . . ." (emphasis added).

PREEMPTION

The Bankruptcy Clause of the U.S. Constitution grants authority to Congress to establish a uniform federal law of bankruptcy. U.S. CONST. art. I, § 8, cl. 4. The Supremacy Clause of the Constitution mandates that federal laws, such as those concerning bankruptcy, "shall be the supreme Law of the Land; . . . [the] Laws of any State to the Contrary notwithstanding." U.S. CONST., art. VI, cl. 2. Thus, under the doctrine of preemption, "state laws that interfere with or are contrary to federal law are preempted and are without effect pursuant to the Supremacy Clause." *In re Loranger Mfg. Corp.*, 324 B.R. 575, 582 (Bankr. W.D. Pa. 2005); *accord Hillsborough County v. Automated Medical Labs, Inc.*, 471 U.S. 707, 712 (1985).

Through the years, three types of federal law preemption over state law have been developed by the courts: (i) express preemption; (ii) field preemption; and (iii) conflict preemption. *In re Nickels Midway Pier, LLC*, 332 B.R. 262, 273 (Bankr. D.N.J. 2005). Express preemption applies "when there is an explicit statutory command that state law be displaced." *Id.* Field preemption applies when federal law "is sufficiently comprehensive to warrant an inference that Congress 'left no room' for state regulation." *In re Miles*, 294 B.R. 756, 759 (B.A.P. 9th Cir. 2003); *Hillsborough County*, 471 U.S. at 713. Conflict preemption applies if state law conflicts with federal law such that: "(1) it is impossible to comply with both state law and federal law; or (2) the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Nickels Midway Pier*, 332 B.R. at 273.

***Tribune* and *Physiotherapy* represent a split of authority between the Second Circuit and the Delaware bankruptcy court on the preemptive application of section 546(e) of the Bankruptcy Code. Whereas *Tribune* interpreted the preemptive effect of section 546(e) more broadly, *Physiotherapy* limited the reach of section 546(e) by focusing on the need to protect financial markets as a whole rather than individual investors and transactions that were unlikely to implicate systemic risk.**

In *Tribune* and *Physiotherapy*, the courts considered, among other things, whether section 546(e) preempts state law fraudulent transfer claims with respect to prepetition LBO transactions.

TRIBUNE

In 2007, Tribune Media Company ("Tribune") was acquired in an LBO transaction. As part of the transaction, Tribune borrowed more than $11 billion of secured debt, of which more than $8 billion was used to cash out existing shareholders. A year or so later, Tribune filed for chapter 11 relief in the District of Delaware. The fraudulent transfer suits followed.

After the bankruptcy court confirmed Tribune's chapter 11 plan in July 2012, the official committee of unsecured creditors was granted standing to pursue the bankruptcy estate's claims against Tribune's cashed-out shareholders. The committee asserted actual fraudulent transfer claims against the defendants, but not constructive fraudulent transfer claims. Instead, the bankruptcy court conditionally lifted the bankruptcy stay to allow creditors to assert state law constructive fraudulent transfer claims outside of the bankruptcy. Individual creditors filed suit across the country, and the actions were consolidated in a multidistrict litigation proceeding in the U.S. District Court for the Southern District of New York. The defendants moved to dismiss the suits on the basis that section 546(e) of the Bankruptcy Code barred such constructive fraudulent transfer claims.

The district court rejected the argument that section 546(e) of the Bankruptcy Code preempts the claims, but it nonetheless granted dismissal because the automatic stay deprived the individual creditors of standing to sue while the official committee's suit was ongoing. The Second Circuit affirmed the dismissal but disagreed with the district court's reasoning. According to the Second Circuit, the Delaware bankruptcy court had lifted the automatic stay, and it was, therefore, not an impediment to filing suit. However, the Second Circuit ruled, the claims nonetheless had to be dismissed because section 546(e) of the Bankruptcy Code preempts creditor state law fraudulent transfer suits under the circumstances.

Prior to *Tribune*, lower courts within the Second Circuit had come to various conclusions with respect to the preemptive scope of section 546(e) of the Bankruptcy Code. In *Tribune*, the Second Circuit concluded that the purposes and history of section 546(e) preempted the claims before the court.

At the outset, the court rejected the argument for a strong presumption against preemption in this context. Claims under section 544 of the Bankruptcy Code, the Second Circuit explained, are federal law claims, not state law claims, and any state law claims in this context could proceed only by the grace of federal authority. Thus, the court concluded, it was wrongheaded to apply a robust presumption against preemption, as there was no measurable concern about federal intrusion into traditional state law domains.

The Second Circuit also viewed the purpose and history of section 546(e) of the Bankruptcy Code as justifying preemption. The narrowest purpose of section 546(e) of the Bankruptcy Code, according to the court, is to safeguard intermediaries from avoidance claims between the intermediaries' customers. Yet even that narrow purpose would be frustrated if creditors could assert constructive fraudulent transfer claims against intermediaries.

Moreover, the Second Circuit viewed section 546(e)'s purpose as extending to much more than intermediaries. Instead, the court reasoned, the history and language of the section reflect a concern regarding the use of avoidance powers against not only a bankrupt intermediary, but any bankrupt customer or participant in the securities markets. The court also observed that Congress had a larger purpose in mind—namely, to promote finality and certainty for investors by limiting the circumstances under which securities transactions could be unwound to situations involving intentional fraud. These purposes not only comport with section 546(e)'s history, the court explained, but make good policy. According to the Second Circuit, a contrary interpretation would result in a lack of protection against unwinding securities transactions that could, in turn, create substantial deterrents to investing in the securities markets. This would unjustifiably create new and substantial risks to market participants and increase monitoring costs.

Accordingly, the Second Circuit concluded that section 546(e)'s language, its history, its purposes, and the policies embedded in the securities laws and elsewhere lead to the conclusion that the safe harbor was intended to preempt the claims before it.

PHYSIOTHERAPY

Just a few months after *Tribune* was decided, a Delaware bankruptcy court refused to interpret section 546(e) of the Bankruptcy Code to preclude a litigation trustee from pursuing state law constructive fraudulent transfer claims arising from the LBO of a debtor.

In 2012, a private equity firm acquired Physiotherapy Holdings, Inc. ("Physiotherapy") through a reverse-triangular merger. The transaction was financed by, among other things, the issuance of senior notes that were assumed by the new Physiotherapy. As part of the transaction, Physiotherapy's prior owners received hundreds of millions of dollars for their interests in the company.

On November 12, 2013, Physiotherapy filed a prepackaged chapter 11 case in the District of Delaware. The bankruptcy court confirmed the prepackaged chapter 11 plan, which provided for, among other things, the creation of a litigation trust and the assignment of claims to the trust by consenting senior noteholders. On September 1, 2015, the litigation trustee commenced suit against, among other parties, Physiotherapy's prior owners.

In substance, the complaint alleged that Physiotherapy's prior owners had been engaged in accounting fraud for years prior to the LBO. According to the litigation trustee, through the LBO transaction, Physiotherapy incurred a massive amount of new debt that was predicated on false financial statements and used to cash out Physiotherapy's former owners for inadequate consideration. On the basis of those allegations, the complaint sought to avoid and recover certain transfers (including the payments to the prior owners) as actual and constructive fraudulent transfers under federal and state law.

As in *Tribune*, the defendants in *Physiotherapy* argued that the payments made to the defendants were immune from avoidance as constructive fraudulent transfers under section 546(e) of the Bankruptcy Code. However, unlike in *Tribune*, the court allowed such claims to proceed.

According to the bankruptcy court, *Tribune* was not binding upon it. Moreover, for several reasons, the bankruptcy court found the lower court decisions in the Second Circuit more persuasive than the reasoning in *Tribune*.

First, the bankruptcy court found persuasive the argument that states traditionally occupied the field of fraudulent transfer law and that applying the presumption against preemption was therefore appropriate.

Second, while the section 546(e) safe harbor was designed to protect against systemic risk, there was little support, in the bankruptcy court's view, for the Second Circuit's focus on promoting finality for individual investors.

Third, the bankruptcy court found it meaningful that, unlike in *Tribune*, Physiotherapy had no public shareholders. Indeed, the two former shareholders of Physiotherapy controlled 90 percent of the company's stock, and therefore, the bankruptcy court could see no potential systemic ripple effect.

Fourth, the bankruptcy court accepted as persuasive certain statutory arguments that the Second Circuit rejected. Specifically, the bankruptcy court credited arguments that other provisions of the Bankruptcy Code demonstrate how Congress goes about expressing preemptive intent. For instance, section 544(b)(2) states that "[a]ny claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case." Section 546(e) of the Bankruptcy Code, by contrast, does not contain such express preemption language.

Fifth, unlike in *Tribune*, the defendants in *Physiotherapy* had allegedly acted in bad faith. The bankruptcy court found this meaningful because reading section 546(e) to apply to that situation would run counter to other important congressional policies of protecting creditors from being defrauded by corporate insiders.

On the basis of these and other factors, the bankruptcy court refused to hold that the section 546(e) safe harbor preempted the state law fraudulent transfer claims before it.

OUTLOOK

Tribune and *Physiotherapy* represent a split of authority between the Second Circuit and the Delaware bankruptcy court on the preemptive application of section 546(e) of the Bankruptcy Code. Whereas *Tribune* interpreted the preemptive effect of section 546(e) more broadly, *Physiotherapy* limited the reach of section 546(e) by focusing on the need to protect financial markets as a whole rather than individual investors and transactions that were unlikely to implicate systemic risk. Although *Tribune* and *Physiotherapy* involved somewhat different circumstances in which the state claims were not being asserted by the bankruptcy trustee or the DIP, the two opinions signal that the preemptive scope of section 546(e) remains uncertain, at least outside the Second Circuit.

The creditors in *Tribune* filed a petition on September 9, 2016, asking the U.S. Supreme Court to review the Second Circuit's ruling. A petition for a writ of certiorari to review a decision in a companion case, *Whyte v. Barclays Bank PLC*, 2016 BL 90805 (2d Cir. Mar. 24, 2016), in which the Second Circuit concluded that the separate section 546(g) safe harbor "impliedly preempts" a chapter 11 plan litigation trustee from bringing state law fraudulent transfer actions seeking to avoid swap transactions, was filed on August 19, 2016.

The bankruptcy court's ruling in *Physiotherapy* has also been appealed, but it is unclear at this juncture whether the appeal will be heard by a Delaware district court or the U.S. Court of Appeals for the Third Circuit.

NEW YORK'S RESTRICTIVE INTERPRETATION OF COMMON INTEREST DOCTRINE UNLIKELY TO HAVE SIGNIFICANT IMPACT IN BANKRUPTCY

Aaron M. Gober-Sims

On June 9, 2016, the New York State Court of Appeals, in *Ambac Assur. Corp. v. Countrywide Home Loans*, 2016 BL 184648 (N.Y. June 9, 2016), reversed a lower court decision, consistent with the overwhelming majority of federal court decisions, that the common interest doctrine under New York law is not limited to communications made in connection with pending or reasonably anticipated litigation. In so ruling, the New York Court of Appeals distanced itself from the approach applied in most federal courts and in other states with a significant volume of corporate transactions, such as Delaware and California. However, the impact of this development in bankruptcy cases, where courts generally apply federal law and treat bankruptcy as a form of litigation, may be limited.

THE COMMON INTEREST DOCTRINE

The common interest doctrine, which in most jurisdictions is an extension of the attorney-client privilege and the work product doctrine, serves to protect the confidentiality of information and documents that are shared by attorneys representing different clients with aligned legal interests. Although issues concerning the common interest doctrine must usually be analyzed under the relevant state law, the general rule is that parties invoking the privilege must demonstrate that: (1) the communication was made by separate parties in the course of a matter of common interest; (2) the communication was designed to further that effort; and (3) the privilege was not otherwise waived. *Velo Holdings, Inc. v. Paymentech, LLC (In re Velo Holdings, Inc.)*, 473 B.R. 509, 514 (Bankr. S.D.N.Y. 2012); *In re Leslie Controls, Inc.*, 437 B.R. 493, 496 (Bankr. D. Del. 2010).

The first element requires that the communication be made between separate parties in the course of a matter of common interest. However, the common interest doctrine is not limited to parties who are perfectly aligned on the same side of a single litigation. Rather, "the doctrine applies where parties demonstrate actual cooperation toward a common legal goal with respect to the documents [that] they seek to withhold." *Costello v. Poisella*, 291 F.R.D. 224, 232 (N.D. Ill. 2013). Thus, the common interest doctrine does not require complete agreement or accord among the parties. The focus of an inquiry concerning the common interest doctrine should be the purpose for which the information was disclosed among the parties asserting a common interest.

The second element requires that the purpose of the communication at issue be to further the common interest shared among the parties. Stated otherwise, the existence of a theoretical common interest is not sufficient; parties must affirmatively demonstrate a collective cooperation in the development of a shared legal strategy. *Leslie Controls, Inc.*, 437 B.R. at 496–97.

The third element simply requires that the parties have not otherwise waived the attorney-client privilege or protections afforded under the work product doctrine. *Id.*

AMBAC ASSURANCE

In 2007, Countrywide Home Loans ("Countrywide") and Bank of America ("BOA") began negotiating a merger. The merger was publicly announced on January 11, 2008, and closed on July 1, 2008. After the merger was consummated, Ambac Assurance Corporation ("Ambac") sued Countrywide, alleging that Countrywide had breached contractual representations, fraudulently misrepresented the quality of certain loans, and fraudulently induced Ambac to guarantee certain loans. Ambac also named BOA as a defendant in the action on the basis of its merger with Countrywide.

In November 2012, BOA refused to produce approximately 400 communications made during its merger negotiations with Countrywide, notwithstanding the fact that the communications took place after the merger was announced but before the merger was consummated. BOA argued that New York's common interest doctrine protected the communications from discovery because the communications pertained to legal issues which the companies needed to resolve jointly in anticipation of the merger closing. These issues included filing disclosure statements, securing regulatory approvals, reviewing contractual obligations to third parties, maintaining employee benefit plans, and obtaining legal advice on state and federal tax consequences. In addition, the merger agreement signed by BOA and Countrywide required them to share privileged information relating to these issues. Thus, BOA argued that the merger agreement was evidence of the shared legal interest of BOA and Countrywide in the successful completion of the merger.

Ambac moved to compel production of the communications, arguing, among other things, that the parties did not share a common legal interest in litigation or anticipated litigation at the time of the communications. According to Ambac, because BOA and Countrywide failed to share a common legal interest in litigation or anticipated litigation at the time of the communications, they waived the attorney-client privilege when they voluntarily shared confidential material.

A special referee appointed to handle privilege disputes ruled in favor of Ambac, reasoning that New York law required a common legal interest in litigation or anticipated litigation in order for the common interest doctrine to apply. BOA moved to vacate the special referee's decision, but the New York Supreme Court denied the motion. *See Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 2013 BL 285640 (N.Y. Sup. Ct. Oct. 16, 2013).

BOA appealed to the Appellate Division, which reversed, holding that "in today's business environment, pending or reasonably anticipated litigation is not a necessary element of the common-interest privilege." *Ambac Assur. Corp. v. Countrywide Home Loans, Inc.*, 124 A.D.3d 129, 130 (N.Y. App. Div. 2014). The Appellate Division noted that communications between a single party and counsel are privileged, regardless of whether litigation is anticipated or pending, and it reasoned that imposing the anticipated or pending litigation element on communications between two parties with a common legal interest could not be reconciled with the purposes underlying the attorney-client privilege. The Appellate Division also noted that federal courts have overwhelmingly rejected a litigation requirement in the context of the common interest doctrine.

The New York State Court of Appeals reversed on appeal. It explained that requiring pending or anticipated litigation limits use of the common interest doctrine to situations where the benefit and necessity of communications are at their highest and the potential for misuse is minimal. The court also noted that when businesses share a common interest in closing a transaction, their shared interest in the transaction's completion is already an adequate incentive for exchanging the information necessary to achieve that end. As such, the court concluded, any benefits that supported an expansion of the common interest doctrine were outweighed by the substantial loss of relevant evidence and the potential for abuse.

After *Ambac*, parties in New York seeking to invoke the common interest doctrine must demonstrate that: (1) the communication was made with respect to legal advice in pending or reasonably anticipated litigation in which the parties have a common legal interest; (2) the communication was designed to further the common legal interest; and (3) the privilege was not otherwise waived. Federal and state courts in Texas, which also has a large volume of mergers and commercial disputes, have adopted a similar approach. *See U.S. v. Newell*, 315 F.3d 510, 525 (5th Cir. 2002) (the Fifth Circuit requires a palpable threat of litigation for the common interest doctrine to apply); *In re XL Specialty Ins. Co.*, 373 S.W.3d 46, 51–52 (Tex. 2012) ("Texas requires that the communications be made in the context of a pending action. . . . Thus, in jurisdictions like Texas, which have a pending action requirement, no commonality of interest exists absent actual litigation."). Like New York, Texas imposes this requirement because it "restricts the opportunity for misuse [and] limits the privilege to situations where the benefit and the necessity are at their highest." *XL Specialty*, 373 S.W.3d at 51–52 (internal quotations omitted).

Even in jurisdictions requiring pending or anticipated litigation to invoke the common interest doctrine, *Ambac* and its reasoning may not have a significant impact on whether communications made in anticipation of or during a bankruptcy case are protected by the common interest doctrine. This is because communications made in anticipation of or during a bankruptcy case should be protected by the doctrine because bankruptcy is generally deemed by the courts to qualify as litigation for purposes of the common interest doctrine.

This differs from the approach taken in many other states, including Delaware and California. Parties in Delaware can invoke the common interest doctrine absent pending or anticipated litigation. *See, e.g., 3Com Corp. v. Diamond II Holdings, Inc.*, 2010 BL 133915 (Del. Ch. May 31, 2010) (Delaware's common interest doctrine is applicable when two companies have a common interest in the approval of a merger). However, parties in Delaware can invoke the common interest doctrine only if the communications primarily concern legal advice. *See Glassman v. Crossfit, Inc.*, 2012 BL 270254 (Del. Ch. Oct. 12, 2012) ("The common-interest doctrine does not protect communications between parties, or even between their attorneys, when those communications primarily concern a common commercial objective.") (internal citations omitted).

Similarly, California does not require pending or anticipated litigation to invoke the common interest doctrine. Parties must establish: (i) a common interest in securing legal advice related to the same matter; and (ii) that the communications were made to advance the parties' shared interest in securing legal advice on the common matter. *See Seahaus La Jolla Owners Assn. v. Superior Court*, 169 Cal. Rptr. 3d 390 (Cal. App. 4th Dist. 2014).

IMPACT ON COMMUNICATIONS MADE IN ANTICIPATION OF OR DURING BANKRUPTCY

The common interest doctrine applies in bankruptcy. *See, e.g., In re Mortg. & Realty Trust*, 212 B.R. 649 (Bankr. C.D. Cal. 1997). In bankruptcy cases, the doctrine has been applied to communications between a debtor and an ad hoc committee, a future asbestos claims representative, a creditors' committee, an affiliate of the debtor, and a creditor. *See, e.g., In re Tribune Co.*, 2011 Bankr. LEXIS 299, at *4 (Bankr. D. Del. Feb. 23, 2011) (discussing federal common law and Delaware law); *Leslie Controls*, 437 B.R. at 496 (citing federal court rulings); *Kaiser Steel Corp. v. Frates*, 84 B.R. 202, 205 (Bankr. D. Colo. 1988) (citing federal common law and state law); *In re Quigley Co.*, 2009 Bankr. LEXIS 1352, at *1 (Bankr. S.D.N.Y. Apr. 24, 2009) (applying federal common law); *Village at Lakeridge, LLC v. United States Bank N.A. (In re Village at Lakeridge, LLC)*, 2013 BL 370668 (B.A.P. 9th Cir. Apr. 5, 2013) (applying federal common law), *aff'd*, 814 F.3d 993 (9th Cir. 2016).

It remains to be seen if *Ambac* and its reasoning will have any significant impact on whether communications made in anticipation of or during a bankruptcy case are protected by the common interest doctrine. For a couple of reasons, however, the impact may be limited. First, bankruptcy courts, in determining matters of privilege, generally apply federal common law, which generally does not impose a litigation requirement for the common interest doctrine to apply (see the cases cited above). Second, "bankruptcy itself constitutes litigation for purposes of delineating privilege." *Brown v. Adams (In re Fort Worth Osteopathic Hosp., Inc.)*, 2008 Bankr. LEXIS 3156, at *44 (Bankr. N.D. Tex. Nov. 14, 2008); *see also In re McDowell*, 483 B.R. 471, 494 (Bankr. S.D. Tex. 2012) ("The Fifth Circuit has implied that the filing of a bankruptcy petition itself creates litigation."); *Tri-State Outdoor Media Group, Inc. v. Official Comm. of Unsecured*

Creditors (In re Tri-State Outdoor Media Group, Inc.), 283 B.R. 358, 364 (Bankr. M.D. Ga. 2002) ("While Bankruptcy is not entirely litigation, it is an adversarial proceeding, particularly when considering the rights of the debtor versus the rights of an unsecured creditor.").

McDowell is illustrative in this regard. In that case, which involved the application of Fifth Circuit law (which is relatively restrictive) on the common interest doctrine, the bankruptcy court reasoned that the filing of a bankruptcy petition constitutes litigation because: (1) the filing of a bankruptcy petition imposes the automatic stay on all creditors; (2) the automatic stay is nothing more than an injunction; and (3) injunctions can be obtained only through the filing of a lawsuit. As such, the *McDowell* court held that documents prepared in anticipation of a bankruptcy filing were protected by the common interest doctrine.

Similarly, the court in *Quigley* held that a debtor's bankruptcy was considered litigation for purposes of the work product doctrine. The court reasoned that "[a]sbestos bankruptcies, by their nature, are designed to stop existing and threatened litigation." Similarly, in *Osherow v. Vann (In re Hardwood P-G, Inc.)*, 403 B.R. 445, 460 (Bankr. W.D. Tex. 2009), the bankruptcy court held that the common interest doctrine was applicable to a report which was prepared by the debtors' forensic accountants and shared with the official committee of unsecured creditors as well as certain of the debtors' lenders. The court reasoned that although the Fifth Circuit requires pending or anticipated litigation to trigger the common interest doctrine, this element was satisfied when the parties who received the report agreed to work together to confirm a chapter 11 plan of liquidation.

CONCLUSION

Even in jurisdictions requiring pending or anticipated litigation to invoke the common interest doctrine, *Ambac* and its reasoning may not have a significant impact on whether communications made in anticipation of or during a bankruptcy case are protected by the common interest doctrine. This is because communications made in anticipation of or during a bankruptcy case should be protected by the doctrine because bankruptcy is generally deemed by the courts to qualify as litigation for purposes of the common interest doctrine. Nevertheless, careful attention to the law of the jurisdiction involved is warranted to determine whether particular communications would be protected under this doctrine.

RULING PROVIDES GUIDANCE ON STANDARD TO REOPEN FULLY ADMINISTERED CHAPTER 11 CASE "FOR OTHER CAUSE"

Anna Kordas

Section 350(b) of the Bankruptcy Code permits a bankruptcy court under certain circumstances to reopen a bankruptcy case even after the estate has been fully administered and the case is closed. In *In re Atari*, 2016 BL 125936 (Bankr. S.D.N.Y. Apr. 20, 2016), the U.S. Bankruptcy Court for the Southern District of New York explored the circumstances under which it may be appropriate to reopen a closed chapter 11 case. The court ruled that "other cause" existed to reopen the case under section 350(b) because, among other things, the bankruptcy court, rather than a foreign court, was a more appropriate forum to adjudicate disputes, including the enforceability of releases, concerning a confirmed chapter 11 plan which implemented a global settlement among the debtor and other stakeholders.

CLOSING AND REOPENING BANKRUPTCY CASES

Generally, after a bankruptcy estate has been "fully administered"—e.g., the debtor's chapter 11 plan has been confirmed, all bankruptcy claims have been resolved, and the plan is "substantially consummated"—the court, pursuant to section 350(a) of the Bankruptcy Code, is required to close the case by issuing a "final decree" in accordance with Rule 3022 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). Once a case is closed, the bankruptcy court's jurisdiction over the debtor and its estate normally terminates.

However, section 350(b) of the Bankruptcy Code and Bankruptcy Rule 5010 authorize the court, on motion of the debtor or another party in interest, to reopen a closed bankruptcy case "to administer assets, to accord relief to the debtor, or for other cause." Pursuant to Bankruptcy Rule 9024(1), a motion to reopen a case is not subject to the one-year time limit that generally applies to motions for relief from an order of the court. A decision on a motion to reopen is committed to the sound discretion of the bankruptcy court.

Common reasons that have warranted reopening a closed case under section 350(b) include: (i) the discovery of unadministered assets which were unknown at the time of closure; (ii) amending schedules to add a previously omitted debt or creditor; (iii) avoiding a lien impairing exempt property; (iv) granting the debtor a discharge if the case was closed before a discharge was granted; and (v) enforcing the discharge injunction under section 524(a) of the Bankruptcy Code. *See generally* COLLIER ON BANKRUPTCY ¶ 350.03 (16th ed. 2016).

Atari illustrates the circumstances that rise to the level of "other cause" to reopen a closed bankruptcy case under section 350(b) of the Bankruptcy Code. In addition, the decision highlights the importance of a retention of jurisdiction provision in a chapter 11 plan.

Neither section 350(b) nor any other provision of the Bankruptcy Code specifies what constitutes "other cause" for reopening a closed case. In the absence of statutory guidance, bankruptcy courts have broad discretion in making this determination. For example, courts have granted motions to reopen a case to modify a chapter 11 plan or to interpret a provision in a previously confirmed plan. *Id.* (citing cases).

Courts are generally reluctant to reopen closed cases. Reopening a case removes the element of certainty and finality that comes with full administration of an estate and entry of a final decree. For this reason, courts consider a number of factors in determining whether reopening a case is justified under the particular circumstances of each case. For example, bankruptcy courts in the Southern District of New York have applied the following six-factor test:

(1) The length of time that the case was closed;

(2) Whether a nonbankruptcy forum has jurisdiction to determine the issue cited for reopening the case;

(3) Whether prior litigation in the bankruptcy court determined that another court would be a more appropriate forum;

(4) Whether any parties would suffer prejudice if the court grants or denies the motion to reopen;

(5) The extent of any benefit to any party by reopening the case; and

(6) Whether it would be futile to reopen the case because the requested relief cannot be granted.

See In re Easley-Brooks, 487 B.R. 400 (Bankr. S.D.N.Y. 2013); *In re PlusFunds Grp., Inc.*, 2015 BL 113361 (Bankr. S.D.N.Y. Apr. 21, 2015). The moving party bears the burden of establishing "other cause" to reopen.

The bankruptcy court in *Atari* considered a motion to reopen a closed chapter 11 case under section 350(b).

ATARI

Video arcade and video gaming industry pioneer Atari, Inc., and certain of its affiliates (collectively, "Atari") filed for chapter 11 protection in the Southern District of New York in January 2013. Atari and a nondebtor affiliate, Atari S.A. ("Atari SA"), proposed a chapter 11 plan that provided for a global settlement among Atari; Atari SA; Alden Global Recovery Master Fund, L.P. ("Alden"), a prepetition lender to Atari under a €20 million credit facility (the "credit agreement"); and the official creditors' committee.

The proposed plan provided significant debt relief to Atari SA and another nondebtor affiliate, Atari Europe, as well as Atari, and modified Alden's rights under the credit agreement. Atari SA and Atari Europe were signatories to the credit agreement, but Atari was not, although certain of its intellectual property ("IP") assets acted as security for the obligations of Atari SA and Atari Europe under the agreement. Among other things, the plan provided that Alden waived its right to receive distributions from Atari or to enforce its security interest in Atari's IP assets. In addition, Atari SA and Atari Europe waived their intercompany claims against Atari, which also served as collateral under the credit agreement.

The plan also provided for broad mutual releases. Finally, the plan provided that the bankruptcy court would retain exclusive jurisdiction to determine disputes arising in connection with the interpretation, implementation, and enforcement of the plan or the confirmation order and authorized the court to "issue . . . orders in aid of [the plan's] execution, enforcement, implementation, and consummation."

The court confirmed the plan in December 2013. Shortly after the plan became effective, the parties to the credit agreement and reorganized Atari entered into an amendment to the credit agreement whereby, among other things, reorganized Atari pledged substantially all of its assets as additional collateral to secure the obligations of Atari SA and Atari Europe.

A final decree closing Atari's chapter 11 case was issued in June 2014. More than a year afterward, a dispute arose among the parties to the amended credit agreement over alleged overpayments. After Alden declared an event of default under the agreement and notified Atari of its intent to foreclose on the IP collateral, Atari sued Alden in the Commercial Court of Paris seeking, among other things, a stay of enforcement of Alden's rights, recovery of the overpayments, and damages for wrongful foreclosure. Alden then filed a motion with the U.S. bankruptcy court to reopen Atari's chapter 11 case for the purpose of staying the French litigation and enforcing the confirmed plan.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court applied the six-factor test described previously to determine whether Atari's chapter 11 case should be reopened under section 350(b) "for other cause." It concluded that all six factors weighed in favor of granting the requested relief. The court found, among other things, that:

(i) Although Atari's chapter 11 case had been closed for more than one year, Alden filed its motion to reopen the case only three months after the French litigation was commenced (factor one);

(ii) While another forum—the Commercial Court of Paris—also had jurisdiction to interpret and, if necessary, enforce the releases contained in Atari's chapter 11 plan, the U.S. bankruptcy court expressly had jurisdiction to interpret and enforce its own prior orders even post-confirmation, and in the bankruptcy court's view, it was a more appropriate forum to adjudicate disputes, including the enforceability of releases, concerning Atari's reorganization and the global settlement (factors two and three);

(iii) Although the obligation to defend a claim in another forum is not typically the type of "legal prejudice" that is relevant to a section 350(b) inquiry, Alden would have been unduly prejudiced by having to litigate in a different forum issues relating to the scope of the chapter 11 plan's release provisions because, as part of the global settlement, the parties agreed to litigate those issues before the bankruptcy court (factor four);

(iv) Reopening the cases to enforce rights that were bargained for in a confirmed chapter 11 plan constitutes sufficient "benefit" to justify reopening the cases (factor five); and

(v) It was not clear at the outset that no relief would be forthcoming if the cases were reopened because Alden made "at least a colorable claim" that the releases entitled Alden to an injunction barring the pending French litigation (factor six).

The bankruptcy court rejected Atari's argument that, even though the court had jurisdiction to consider the issues raised in the motion to reopen, it should abstain from exercising that jurisdiction because the litigation before the French court was filed first, the parties to the actions were the same, and the issues raised in the French litigation were sufficiently similar to the issues raised in the motion. According to the court, because the main inquiry in this case was interpretation and enforcement of its own prior order, abstention in favor of the French court was not appropriate.

OUTLOOK

Atari illustrates the circumstances that rise to the level of "other cause" to reopen a closed bankruptcy case under section 350(b) of the Bankruptcy Code. In addition, the decision highlights the importance of a retention of jurisdiction provision in a chapter 11 plan. Careful attention should be devoted to the drafting of such a provision if the plan proponent and other stakeholders involved want to ensure that disputes regarding the plan's provisions and implementation are decided in the bankruptcy court, rather than another forum, which may be less familiar with the issues involved.

IN BRIEF: RECENT RULINGS DEMONSTRATE EVOLVING LAW ON ABILITY OF PLAN TRUSTEES TO ASSERT CREDITORS' PRE-BANKRUPTCY STATE LAW FRAUDULENT TRANSFER CLAIMS

In *Weisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 2016 BL 241310 (S.D.N.Y. July 27, 2016), the U.S. District Court for the Southern District of New York reversed a 2015 ruling by the bankruptcy court presiding over the chapter 11 case of Lyondell Chemical Company ("Lyondell") that dismissed claims asserted by a chapter 11 plan litigation trustee seeking to avoid as actual fraudulent transfers $6.3 billion in payments made to the former stockholders of Lyondell in connection with its 2007 leveraged buyout ("LBO") by Basell AF S.C.A. *See Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 541 B.R. 172 (Bankr. S.D.N.Y. 2015).

The bankruptcy court ruling dismissed claims seeking to avoid the payments under section 548(a)(1)(A) of the Bankruptcy Code, which empowers a bankruptcy trustee to avoid pre-bankruptcy transfers made with the intent to hinder, delay, or defraud creditors. It ruled that: (i) the trustee did not adequately allege that Lyondell incurred debt and transferred the payments to shareholders with "actual intent" to hinder, delay, or defraud its creditors; and (ii) the knowledge, conduct, and intent of Lyondell's CEO in connection with the shareholder transfers could not be imputed to Lyondell.

The district court reversed on appeal. It ruled that the bankruptcy court "relied on inapposite law" in concluding that the CEO's intent could be imputed to Lyondell only if the litigation trustee adequately pleaded that the CEO was in a position to control the decision of Lyondell's board to proceed with the LBO. According to the district court, the imputation of intent to defraud under the circumstances was "entirely consistent with Delaware agency law." It also held that the trustee adequately pleaded that Lyondell made the transfers to its shareholders with the intent to hinder, delay, or defraud creditors. The district court accordingly reversed the bankruptcy court's ruling and reinstated the actual fraudulent transfer claims.

On August 10, 2016, the shareholder defendants asked the district court to reconsider its July 27 decision reversing the bankruptcy court's 2015 decision. In the alternative, the shareholders requested that the district court certify an interlocutory appeal to the Second Circuit. According to the shareholders, the district court overlooked controlling agency law regarding the imputation of an agent's intent. Under Delaware agency law, they argued, Lyondell's CEO did not have authority to make that "extraordinary, merger-related transfer" and "only the Lyondell Board did." Accordingly, the shareholders contended that "[the CEO's] intent cannot be imputed with respect to a transfer that he had no authority to approve (and did not approve), and without imputation."

The district court's ruling in *Lyondell* came on the heels of a more favorable decision for Lyondell's former shareholders by the bankruptcy court on July 20. In that decision, the court retracted 2014 and 2015 rulings that the fraudulent transfer "safe harbor" under section 546(e) of the Bankruptcy Code does not preclude claims brought by a litigation trustee on behalf of creditors to avoid transfers which are constructively fraudulent under state law. *See Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 2016 BL 244458 (Bankr. S.D.N.Y. July 20, 2016). Section 546(e) expressly precludes the avoidance by "the [bankruptcy] trustee" of constructively fraudulent transfers—i.e., transfers made in exchange for less than reasonably equivalent value when the debtor is insolvent or becomes insolvent due to the transfer—made in connection with the settlement of securities contracts.

The bankruptcy court was constrained to retract its previous rulings after the U.S. Court of Appeals for the Second Circuit held to the contrary in *Deutsche Bank Trust Co. Ams. v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2d Cir. 2016), *petition for rehearing denied*, No. 13-03992 (2d Cir. July 22, 2016). In *Tribune*, the Second Circuit unequivocally ruled that "creditors' state law, constructive fraudulent conveyance claims are preempted by Bankruptcy Code Section 546(e)." Even so, the court foreclosed an expansive reading of its ruling. It expressly stated that the decision does not address the rights of creditors to bring state law fraudulent transfer claims which are "not limited in the hands of a trustee *et al.*" by section 546(e) or similar provisions. A more detailed discussion of the Second Circuit's ruling in *Tribune* can be found elsewhere in this issue of the *Business Restructuring Review*.

In *Whyte v. Barclays Bank PLC*, 2016 BL 90805 (2d Cir. Mar. 24, 2016), which was heard in tandem with *Tribune*, the Second Circuit (in a summary order) affirmed the district court's ruling that the separate safe harbor of section 546(g) also "impliedly preempts" a chapter 11 plan litigation trustee from bringing state law fraudulent transfer actions seeking to avoid swap transactions.

On August 19, 2016, the litigation trustee in *Whyte* filed a petition asking the U.S. Supreme Court to review the Second Circuit's ruling. *See Whyte v. Barclays Bank PLC*, No. 16-00239 (U.S. Aug. 19, 2016). According to the litigation trustee's petition, courts must start with the presumption that federal law does not preempt state law—a principle she says the Second Circuit disregarded. She also argued that the Second Circuit's ruling is contrary to the Supreme Court's decision in *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (U.S. 1994), where the Court held that congressional intent to preempt state law by the Bankruptcy Code must be "clear and manifest." The creditors in *Tribune* filed a petition on September 9, 2016, asking the U.S. Supreme Court to review the Second Circuit's ruling.

The Second Circuit's approach in *Tribune* has already been rejected by a bankruptcy court in another circuit. In *PAH Litigation Trust v. Water Street Healthcare Partners, L.P. (In re Physiotherapy Holdings, Inc.)*, 2016 BL 251441 (Bankr. D. Del. June 20, 2016), the court granted in part and denied in part a motion to dismiss a chapter 11 plan litigation trustee's complaint seeking to recover $248.6 million in payments made to selling shareholders in connection with a 2012 LBO.

In an unpublished ruling, the court denied a motion to dismiss actual fraudulent transfer claims as well as claims brought directly under state law, but it granted a motion to dismiss federal constructive fraudulent transfer claims and state law constructive fraudulent transfer claims brought under section 544 of the Bankruptcy Code. In so ruling, the court rejected the approach applied in *Tribune*:

> [T]he [section 546(e)] safe harbor does not bar the litigation trust from asserting its state law fraudulent transfer claims on behalf of the Senior Noteholders. Specifically, the Court holds that a litigation trustee may assert state law fraudulent transfer claims in the capacity of a creditor-assignee when: (1) the transaction sought to be avoided poses no threat of "ripple effects" in the relevant securities markets; (2) the transferees received payment for non-public securities[;] and (3) the transferees were corporate insiders that allegedly acted in bad faith. When these three factors are present, a finding of implied preemption is inappropriate.

The bankruptcy court's ruling in *Physiotherapy* has also been appealed, but it is unclear at this juncture whether the appeal will be heard by a Delaware district court or the U.S. Court of Appeals for the Third Circuit. A more detailed discussion of *Physiotherapy Holdings* can be found elsewhere in this issue of the *Business Restructuring Review*.

PROPOSED AMENDMENTS TO BANKRUPTCY RULES AND FORMS

The Judicial Conference Advisory Committee on Bankruptcy Rules has proposed amendments to the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and the Official Bankruptcy Forms and requested that the proposals be circulated to the bench, bar, and public for comment. The proposed amendments, Advisory Committee reports, and other information are posted on the Judiciary's website at http://www.uscourts.gov/rules-policies/proposed-amendments-published-public-comment. Comments to the proposed amendments must be submitted no later than February 15, 2017.

Members of the public who wish to present testimony may appear at public hearings on these proposals. The Advisory Committee will convene a hearing on the proposed amendments on January 24, 2017, in Pasadena, California. Anyone wishing to testify must notify the Advisory Committee at least 30 days before the scheduled hearing. Requests to testify should be emailed to Rules_Support@ao.uscourts.gov, with a copy mailed to:

> Committee on Rules of Practice and Procedure
> Administrative Office of the United States Courts
> Thurgood Marshall Federal Judiciary Building
> One Columbus Circle, N.E., Suite 7-240
> Washington, D.C. 20544

Following the public comment period, the Advisory Committee will decide whether to submit the proposed amendments to the Committee on Rules of Practice and Procedure. If approved, the proposed amendments would become effective on December 1, 2018, with or without revision by the Advisory Committee, the Committee on Rules of Practice and Procedure, the Judicial Conference, and the U.S. Supreme Court, provided that Congress does not act to defer, modify, or reject them.

The proposed amendments include the following, among other changes:

Bankruptcy Rule 8002(b) (timeliness of tolling motions). Bankruptcy Rule 8002(b) and its counterpart, Rule (a)(4) of the Federal Rules of Appellate Procedure (the "FRAP"), contain a list of post-judgment motions that toll the time for filing an appeal. Under the current rules, the motion must be "timely file[d]" in order to have a tolling effect. Amendments to the FRAP have been approved by the Supreme Court and submitted to Congress and are scheduled to become effective on December 1, 2016. The amendment to FRAP 4(a)(4) resolves a circuit split on the question whether a tolling motion filed outside the time period specified by the relevant rule, but nevertheless ruled on by the district court, is timely filed for purposes of the rule. Adopting the majority view on this issue, ***the pending amendment adds an explicit requirement that the motion must be filed within the time period specified by the rule under which it is made in order to have a tolling effect for the purpose of determining the deadline for filing a notice of appeal.*** A corresponding amendment has been proposed to Bankruptcy Rule 8002(b).

New Bankruptcy Rule 8018.1 (district court review of a judgment that the bankruptcy court lacked constitutional authority to enter). The proposed rule would authorize a district court to treat a bankruptcy court's judgment as proposed findings of fact and conclusions of law if the district court determines that the bankruptcy court lacked constitutional authority to enter a final judgment. This procedure is consistent with the Supreme Court's decision in *Executive Benefits Insurance Agency v. Arkison*, 134 S. Ct. 2165 (2014).

Bankruptcy Rule 8023 (voluntary dismissal; cross-reference regarding settlements). The rule would be amended by adding a cross-reference to Bankruptcy Rule 9019 (Compromise and Arbitration) to provide a reminder that when dismissal of an appeal is sought as the result of a settlement by the parties, Bankruptcy Rule 9019 may require approval of the settlement by the bankruptcy court.

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