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AÉROPOSTALE BANKRUPTCY COURT DENIES MOTION TO EQUITABLY SUBORDINATE OR RECHARACTERIZE SECURED LENDERS' CLAIMS OR TO LIMIT LENDERS' CREDIT-BIDDING RIGHTS

Brad B. Erens and Mark G. Douglas

Secured lenders have welcomed a ruling recently handed down by the U.S. Bankruptcy Court for the Southern District of New York in the chapter 11 cases of Aéropostale, Inc., and its affiliates (collectively, "Aéropostale"). In *In re Aéropostale, Inc.*, 2016 BL 279439 (Bankr. S.D.N.Y. Aug. 26, 2016), bankruptcy judge Sean H. Lane denied motions by Aéropostale to: (i) equitably subordinate the secured claims of term lenders that were affiliated with a private equity sponsor; (ii) limit the lenders' ability to credit bid their secured claim in a bankruptcy sale of the company; and (iii) recharacterize the lenders' $150 million secured claim as an equity investment.

EQUITABLE SUBORDINATION

Equitable subordination is a remedy developed under common law prior to the enactment of the current Bankruptcy Code to remedy misconduct that results in injury to creditors or shareholders. It is expressly recognized in section 510(c) of the Bankruptcy Code, which provides that the bankruptcy court may, "under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest." However, the statute explains neither the equitable subordination theory nor the standard that should be used to apply it.

In *In re Mobile Steel Co.,* 563 F.2d 692 (5th Cir. 1977), the Fifth Circuit articulated what has become the most commonly accepted standard for equitable subordination of a claim. Under this standard, a claim can be subordinated if the claimant engaged in some type of inequitable conduct that resulted in injury to creditors (or conferred an unfair advantage on the claimant) and if equitable subordination of the claim is consistent with the provisions of the Bankruptcy Code. Courts have refined the test to account for special circumstances. For example, many courts make a distinction between insiders (e.g., corporate fiduciaries) and

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noninsiders in assessing the level of misconduct necessary to warrant subordination. *See generally* COLLIER ON BANKRUPTCY ¶ 510.0[2] (16th ed. 2016).

RECHARACTERIZATION

A related but distinct remedy is "recharacterization." Like equitable subordination, the power to treat a debt as if it were actually an equity interest is derived from principles of equity. It emanates from the bankruptcy court's power to ignore the form of a transaction and give effect to its substance. However, because the Bankruptcy Code does not expressly empower a bankruptcy court to recharacterize debt as equity, some courts disagree as to whether they have the authority to do so and, if so, the source of such authority.

Four circuits have held that a bankruptcy court's power to recharacterize debt derives from the broad equitable powers set forth in section 105(a) of the Bankruptcy Code, which provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." *See Committee of Unsecured Creditors for Dornier Aviation (North America), Inc.*, 453 F.3d 225 (4th Cir. 2006); *Cohen v. KB Mezzanine Fund, II, LP (In re SubMicron Systems Corp.)*, 432 F.3d 448 (3d Cir. 2006); *Sender v. Bronze Group, Ltd. (In re Hedged-Invs. Assocs., Inc.)*, 380 F.3d 1292 (10th Cir. 2004); *Bayer Corp. v. MascoTech, Inc. (In re AutoStyle Plastics, Inc.)*, 269 F.3d 726 (6th Cir. 2001).

The Fifth and Ninth Circuits have taken a different approach, holding instead that section 502(b)(1) of the Bankruptcy Code, which provides in relevant part that "the court . . . shall allow [a] claim . . . except to the extent that . . . such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law," is the proper statutory authority for recharacterization. *See Grossman v. Lothian Oil Inc. (In re Lothian Oil Inc.),* 650 F.3d 539 (5th Cir. 2011); *Official Comm. of Unsecured Creditors v. Hancock Park Capital II, L.P. (In re Fitness Holdings Int'l, Inc.)*, 714 F.3d 1141 (9th Cir. 2013).

In some jurisdictions that recognize the doctrine of recharacterization, uncertainty exists regarding the legal standard for determining when recharacterization is appropriate. In *AutoStyle Plastics*, the Sixth Circuit applied an 11-factor test derived from federal tax law. Among the enumerated factors are the labels given to the alleged debt; the presence or absence of a fixed maturity date, interest rate, and schedule of payments; whether the borrower is adequately capitalized; any identity of interest between the creditor and the stockholder; whether the loan is secured; and the corporation's ability to obtain financing from outside lending institutions. *See also Hedged-Investments*, 380 F.3d at 1298 (applying a similar 13-factor test). Under this test, no single factor is controlling. Instead, each factor is to be considered in light of the particular circumstances of the case.

CREDIT BIDDING

Section 363(k) of the Bankruptcy Code provides that a creditor with a lien on assets to be sold outside the ordinary course of business under section 363(b) may credit bid its "allowed claim" at the sale, "unless the court for cause orders otherwise." A credit bid is an offset of a secured claim against the collateral's purchase price. The U.S. Supreme Court explained in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 265, 270 n.2 (2012), that "[t]he ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price" and "enables the creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest) without committing additional cash to protect the loan."

Aéropostale has been a welcome development for secured lenders, particularly insofar as the ruling reinforces the idea that a court-imposed limitation on a lender's right to credit bid requires something more than the possibility of bid chilling in connection with a section 363 asset sale. However, like many other recent rulings involving allegations of lender overreaching or other misconduct, the decision is a cautionary tale.

The Supreme Court ruled in *RadLAX* that, although the right to credit bid is not absolute, a nonconsensual, or "cram down," chapter 11 plan providing for the sale of encumbered property free and clear of a creditor's lien cannot be confirmed without affording the creditor the right to credit bid for the property.

In the aftermath of *RadLAX*, the debate shifted largely to the circumstances that constitute "cause" under section 363(k) to prohibit or limit a secured creditor's right to credit bid its claim. Because "cause" is not defined in the Bankruptcy Code, whether it exists has been left for the courts to determine. *See In re Olde Prairie Block Owner, LLC*, 464 B.R. 337 (Bankr. N.D. Ill. 2011) (citations omitted).

In *In re Fisker Automotive Holdings, Inc.*, 510 B.R. 55 (Bankr. D. Del. 2014), *leave to app. denied*, 2014 BL 33749 (D. Del. Feb. 7, 2014), *certification denied*, 2014 BL 37766 (D. Del. Feb. 12, 2014), the court limited the amount of a credit bid to the discounted purchase price actually paid by the credit bidder to purchase a debt.

The court held that limiting the amount of the credit bid was warranted because an unrestricted credit bid would chill bidding and because the full scope of the underlying lien was as yet undetermined. The court also expressed concern as to the expedited nature of the proposed sale under section 363(b), which in the court's view was never satisfactorily explained.

Since *Fisker*, a handful of courts have addressed the issue, with mixed results. *See*, *e.g.*, *SEC v. Capital Cove Bancorp LLC*, 2015 BL 449611 (C.D. Cal. Oct. 13, 2015) (finding "cause" to deny a creditor's request to credit bid at a sale due to, among other things, the existence of a prima facie case against the creditor for securities fraud, evidence of a Ponzi scheme involving the creditor, the creditor's other fraudulent acts, and the existence of a bona fide dispute regarding the validity of the creditor's liens); *In re Family Christian, LLC*, 533 B.R. 600 (Bankr. W.D. Mich. 2015) (refusing to approve a credit-bid sale to a party that, as a "consultation party" to the auction, had been privy to certain information which allowed it to gain an unfair advantage over other bidders, tantamount to insider trading); *In re The Free Lance-Star Publishing Co.*, 512 B.R. 798 (Bankr. E.D. Va.) (finding "cause" to limit a credit bid by an entity that purchased $39 million in face amount of debt at a discount where: (i) some of the creditor's liens had been improperly perfected; (ii) the creditor engaged in inequitable conduct by forcing the debtor into bankruptcy and an expedited section 363 sale process in pursuing a clearly identified loan-to-own strategy; and (iii) the creditor actively frustrated the competitive bidding process and attempted to depress the sale price of the debtors' assets), *leave to appeal denied sub nom. DSP Acquisition, LLC v. Free Lance-Star Publishing Co.*, 512 B.R. 808 (E.D. Va. 2014); *In re Charles Street African Methodist Episcopal Church of Boston*, 510 B.R. 453 (Bankr. D. Mass. 2014) (denying in part a motion to limit a credit bid where the debtor's counterclaims did not relate to the validity of the secured creditor's claims or liens, but requiring the secured creditor to include in its bid cash in an amount equal to a breakup fee payable to the stalking-horse bidder); *In re RML Dev., Inc.*, 528 B.R. 150 (Bankr. W.D. Tenn. 2014) (limiting a secured creditor's credit bid to the undisputed portion of its claim).

AÉROPOSTALE

Aéropostale, Inc. ("Aéropostale") is a retailer of casual apparel and accessories for children and young adults, with more than 800 stores in all 50 states and Puerto Rico. In 2013, private equity firm Sycamore Partners ("Sycamore") acquired 8 percent of Aéropostale stock through a subsidiary for approximately $54 million.

One of Aéropostale's largest merchandise suppliers was TSAM (Delaware) LLC (d.b.a. MGF Sourcing US LLC) ("MGF"), a global apparel and accessory sourcing company indirectly owned and controlled by Sycamore.

Aéropostale's secured debt included a $150 million term loan extended by two Sycamore affiliates (collectively, the "term lenders").

An investor rights agreement entered into in connection with the term loan gave each of the term lenders the right to nominate two directors to Aéropostale's board and to select a third independent director jointly with Aéropostale.

The term loan contained a $70 million minimum liquidity covenant. A separate sourcing agreement between Aéropostale and MGF gave MGF the right to declare a "credit review period" if Aéropostale's liquidity dropped below $150 million.

In February 2016, MGF informed Aéropostale that the $150 million minimum liquidity threshold under the sourcing agreement had been breached and that MGF was declaring a credit review period. MGF also informed Aéropostale that it was adjusting the payment terms for sourced merchandise, as was permitted by the sourcing agreement.

Aéropostale commenced a chapter 11 case on May 4, 2016, in the Southern District of New York with a plan to shutter unprofitable stores, trim costs, and pursue a sale of the company.

Claiming that Sycamore had forced the company into bankruptcy for the purpose of acquiring it at a discount, Aéropostale filed a motion requesting that the court: (i) equitably subordinate the claims of the term lenders under section 510(c) of the Bankruptcy Code due to their inequitable conduct (e.g., imposing new lending terms that violated an "objective reasonableness" standard, pursuing a secret and improper plan to buy Aéropostale "on the cheap," and trading Aéropostale's stock while possessing material nonpublic information); (ii) limit the term lenders' right to credit bid their $150 million secured claim in any sale of the company pursuant to section 363(k) of the Bankruptcy Code; and (iii) recharacterize the term lenders' claims as equity under section 105 of the Bankruptcy Code.

THE BANKRUPTCY COURT'S RULING

No Equitable Subordination

Bankruptcy judge Sean Lane denied the motion to equitably subordinate the term lenders' claims. First, he noted that Aéropostale did not dispute that it had fallen below the $150 million minimum liquidity trigger, which caused MGF to declare a credit review period and later impose new credit terms. Judge Lane agreed that MGF was limited in its ability to alter payment terms under the sourcing agreement, but he found that Aéropostale was attempting to impose an "objective reasonableness" standard on MGF which was not present in the language of the agreement. Instead, the judge noted, under the express terms of the sourcing agreement, "MGF had the right to apply *its* reasonable credit judgment in light of *its* determination of what was prudent for *it*."

Judge Lane also found that MGF acted reasonably in imposing new credit terms after the minimum liquidity threshold was triggered. Among other things, the evidence showed that MGF faced significant exposure itself—an Aéropostale default could have caused MGF to default on its own debt.

In addition, Judge Lane wrote that, "simply put," Aéropostale's "allegation of a secret plan" to "push [the company] into bankruptcy and thus buy Aéropostale on the cheap" is "not credible." He explained that, although Sycamore and its affiliates "actively tracked and managed" their investment in Aéropostale, which consisted of $54 million in equity and a $150 million loan, it was easy to understand why they were closely monitoring Aéropostale's situation, given the company's lackluster performance and their large economic stake. Judge Lane also noted that there was no credible evidence that Sycamore had caused MGF to take any improper action in connection with the sourcing agreement or the invocation of a credit review period. He explained that:

> the question is whether a party planning to exercise its rights as a creditor takes actions that step over the line into impermissible conduct to further its interest in a way that damages a debtor or the bankruptcy estate. The Court does not find such conduct here. Instead, the totality of the credible evidence at trial demonstrates that [Sycamore and its affiliates] did not take actions beyond what was proper to protect their interests.

According to Judge Lane, Aéropostale's allegations that Sycamore traded Aéropostale stock while in possession of material nonpublic information was belied by evidence that the stock price actually decreased during the relevant period. Moreover, the allegations failed to support a claim for equitable subordination because there was no evidence that Aéropostale had been harmed or that Sycamore had gained any unfair advantage.

No Cause to Limit Credit Bid

Judge Lane also denied Aéropostale's motion to limit the term lenders' right to credit bid their $150 million secured claim. Explaining that "[t]he decision of whether to deny credit bidding based on cause [under section 363(k) of the Bankruptcy Code] is within the discretion of the court," he found no inequitable conduct which would justify limiting a credit bid by the term lenders. According to Judge Lane, there was no evidence of inappropriate behavior by the term lenders in connection with the bankruptcy case, such as "allegations of collusion, undisclosed agreements, or any other actions designed to chill the bidding or unfairly distort the sale process." In fact, he noted, "consistent with the exercise of their own legal rights," the term lenders were relatively cooperative with the bidding and sale process, and no party challenged the validity or extent of their liens.

Judge Lane rejected Aéropostale's argument that bidding on the sale of its assets would be chilled by the term lenders. First, he noted, none of the cases commonly cited as a basis for limiting a credit bid involved bid chilling as the sole factor warranting such a limitation. Instead, he explained, rulings such as *Free Lance-Star, Fisker*, and *Aloha Airlines* have involved other factors as well, such as a dispute regarding the validity of the secured creditor's lien or inequitable conduct. Moreover, he noted, the record reflected an active interest in Aéropostale assets rather than chilled bidding.

Finally, Judge Lane explained that his reasoning is supported by the final report issued on December 8, 2014, by the American Bankruptcy Institute Commission to Study the Reform of Chapter 11. The report noted that "all credit bidding chills an auction process to some extent" and that, as a consequence, "the Commissioners did not believe that the chilling effect of credit bids alone should suffice as cause under section 363(k)."

No Basis to Recharacterize Debt as Equity

Judge Lane ruled that there was no basis to recharacterize the term loan as an equity investment in Aéropostale. "Based on the *AutoStyle* factors and the surrounding facts and circumstances," he wrote, "the Court finds that the parties intended the [term loan facility] to be a loan."

OUTLOOK

Aéropostale has been a welcome development for secured lenders, particularly insofar as the ruling reinforces the idea that a court-imposed limitation on a lender's right to credit bid requires something more than the possibility of bid chilling in connection with a section 363 asset sale. However, like many other recent rulings involving allegations of lender overreaching or other misconduct, the decision is a cautionary tale. A variety of tools are available in bankruptcy to remedy creditor misconduct or overreaching. In addition to equitably subordinating a claim, recharacterizing a debt as equity, or limiting a secured creditor's right to credit bid, a bankruptcy court can "designate," or not count, a creditor's vote on a chapter 11 plan if it determines that the vote was cast in bad faith.

Aéropostale's stated fears that the term lenders' right to credit bid their secured claim would chill bidding were ultimately unfounded. On September 13, 2016, Judge Lane approved an auction sale of Aéropostale's assets for $243.3 million to a consortium of mall owners, including retail property management firm General Growth Properties and apparel brand licensor Authentic Brands Group. The sale saved 229 of the teen apparel retailer's stores and prevented a complete liquidation, which would have left hundreds of vacant stores in malls throughout the U.S.

MODIFICATION OF CHAPTER 15 RECOGNITION ORDER WARRANTED TO AVOID PREJUDICE TO U.S. CREDITORS

Veerle Roovers and Mark G. Douglas

In the 11 years since its enactment in 2005, chapter 15 of the Bankruptcy Code has proved to be an effective, if not foolproof, mechanism for coordinating and harmonizing cross-border bankruptcy cases. An important aspect of chapter 15 and other laws patterned on the 1997 UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law") is the flexibility given to bankruptcy and insolvency courts in applying the sometimes markedly different insolvency laws of the multiple international jurisdictions involved in cross-border cases. A ruling recently handed down by the U.S. Bankruptcy Court for the Western District of Texas is emblematic of this principle. In *In re Sanjel (USA) Inc.*, 2016 BL 24261 (Bankr. W.D. Tex. July 28, 2016), the court held that, because the statute of limitations governing claims against a Canadian debtor's officers and directors under the Fair Labor Standards Act might expire, the order recognizing the debtor's Canadian bankruptcy proceeding under chapter 15 and enforcing the Canadian court's stay of actions against the debtor's officers and directors should be modified to allow U.S. creditors to assert their claims.

PROCEDURES AND RELIEF UNDER CHAPTER 15

Under chapter 15, the representative of a foreign debtor may file a petition in a U.S. bankruptcy court seeking "recognition" of a "foreign proceeding." A "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 foreign "main" proceeding—a case pending in the country where the debtor's "center of main interests" ("COMI") is located—and foreign "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment."

The Bankruptcy Code does not define COMI. 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. An "establishment" is defined in section 1502(2) as "any place of operations where the debtor carries out a nontransitory economic activity."

Section 1517 of the Bankruptcy Code provides that, subject to section 1506, "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 debtor and the 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." Under section 1521, upon the recognition of a foreign nonmain proceeding, the stay does not automatically apply, but the foreign representative may request it and the bankruptcy court may impose it.

Furthermore, following recognition of a foreign main or nonmain proceeding, a bankruptcy court is authorized under section 1521 to grant, among other things, injunctive relief; the authority to distribute the proceeds of the debtor's U.S. assets; and, with certain exceptions, any additional relief available to a bankruptcy trustee, "where necessary to effectuate the purpose of [chapter 15] and to protect the assets of the debtor or the interests of the creditors."

Moreover, section 1507 provides that, if recognition is granted, the court may provide "additional assistance"—a term that is not defined—to a foreign representative under chapter 15 or other U.S. laws. However, in granting such relief, the court must conclude, "consistent with the principles of comity," that 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. Section 1507 reflects lawmakers' recognition that chapter 15 otherwise may not anticipate all the types of relief which a foreign representative might require. *See* COLLIER ON BANKRUPTCY ¶ 1507.01 (16th ed. 2016).

During the gap period between the filing of a chapter 15 petition and the entry (or denial) of a recognition order, section 1519(a) of the Bankruptcy Code authorizes a bankruptcy court to grant provisional injunctive relief and certain other forms of relief "where relief is urgently needed to protect the assets of the debtor or the interests of the creditors." In addition to an order staying execution against the debtor's U.S. assets, such relief can include an order that entrusts the administration of assets to the foreign representative (section 1519(a)(2)), provides for the examination of witnesses and the taking of evidence regarding the debtor's affairs (sections 1519(a)(3) and 1521(a)(4)), or grants additional relief (other than avoidance of transfers) available to a bankruptcy trustee (sections 1519(a)(3) and 1521(a)(7)).

Section 1522(c) provides that a bankruptcy court "may, at the request of the foreign representative or an entity affected by relief granted under section 1519 or 1521, or on its own motion, modify or terminate such relief." However, under section 1522(a), the court may grant relief under section 1519 or 1521, or may modify or terminate relief under section 1522(c), "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected." The purpose of section 1522 is "to ensure a balance between the relief that may be granted to the foreign representative and the interests of the persons potentially affected by such relief." *See* COLLIER ON BANKRUPTCY ¶ 1522.01 (16th ed. 2016) (citing Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency (1997) ¶ 161 (amended in 2013) and various court rulings, including *Jaffé v. Samsung Elecs. Co. (In re Qimonda)*, 737 F.3d 14 (4th Cir. 2013)). The legislative history of the provision

NEWSWORTHY

Jones Day received a Tier 1 ranking in the 2017 "Best Law Firms" survey published jointly by *U.S. News* and *Best Lawyers®* in the practice areas of Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law and Litigation—Bankruptcy.

Bruce Bennett (Los Angeles and New York) participated in a panel discussion on October 7, 2016, entitled "America Now!" at the American Bankruptcy Institute's 12th Annual International Insolvency & Restructuring Symposium in Amsterdam.

Thomas A. Howley (Houston) and ***Paul M. Green (Houston)*** are representing privately held Shoreline Energy and seven affiliated debtors in connection with chapter 11 cases filed by the companies on November 2, 2016, in the U.S. Bankruptcy Court for the Southern District of Texas. The debtors, which engage in the exploration, development, production, and acquisition of oil and gas and related properties, filed for chapter 11 with the intention of selling substantially all of their assets.

On November 3, 2016, ***Amy Edgy (Washington)*** attended the Turnaround Management Association ("TMA") board of trustees meeting as part of TMA's 28th Annual Conference in Orlando, Florida, in her capacity as a trustee and the global cochair of TMA's Network of Women.

An article written by ***Timothy Hoffmann (Chicago)*** and ***Mark G. Douglas (New York)*** entitled "Third Circuit Rules That Private Equity Fund and Portfolio Company Are Not a 'Single Employer' for Purpose of WARN Act Liability" was published in the November 2016 issue of the *INSOL International* newsletter.

Gregory M. Gordon (Dallas), ***Dan B. Prieto (Dallas)***, and ***Amanda Suzuki (Dallas)*** are representing Kaiser Gypsum Co. Inc. and its parent, Hanson Permanente Cement Inc., in connection with chapter 11 cases filed by the companies on September 30, 2016, in the U.S. Bankruptcy Court for the Western District of North Carolina. The debtors have faced 38,000 asbestos-related lawsuits since 1978 and, as of August 31, 2016, were defendants in 14,000 asbestos-related bodily injury lawsuits throughout the U.S.

Kevyn D. Orr (Washington) spoke on October 13, 2016, before the Oversight Board of the Latin American Business Council in Puerto Rico.

Kevyn D. Orr (Washington) served as a panelist on October 14, 2016, at the National Bureau of Economic Research, Inc., Entrepreneurship and Economic Growth Conference in Durham, North Carolina.

On October 20, 2016, ***Gregory M. Gordon (Dallas)*** moderated a panel discussion entitled "Bankruptcy Roundtable—To resettle in- or out-of-Court—and other issues in light of recent court rulings and regulatory changes" at the International Institute for Business Information & Growth 2016 Distressed ENERGY Summit in Houston.

On October 15, 2016, ***Kevyn D. Orr (Washington)*** participated in a panel discussing "Issues Concerning Governmental Entities in Bankruptcy Proceedings" at the Federal Council Fall Retreat in Skytop, Pennsylvania.

Kevyn D. Orr (Washington) participated in a panel discussion on October 21, 2016, entitled "Detroit and Its Impact on Future Chapter 9 Cases" at the 2016 Young Lawyers Conference in Detroit.

On March 10, 2017, ***Kevyn D. Orr (Washington)*** will be inducted as a Fellow in the 28th Class of the American College of Bankruptcy in Washington, D.C.

indicates that Congress intended to give bankruptcy courts "broad latitude to mold relief to meet specific circumstances." H.R. Rep. No. 109-31, at 116.

SANJEL

Sanjel (USA) Inc. (together with its affiliates, "Sanjel") is a Canada-based oil and gas industry acidizing and cementing services provider. Certain former Sanjel employees were the named plaintiffs in class action litigation filed in the U.S. District Court for the District of Colorado in September 2015 and February 2016 against Sanjel and its officers and directors, alleging violations of the Fair Labor Standards Act of 1938, 29 U.S.C. ch. 8 (the "FLSA").

On April 4, 2016, a Canadian court granted Sanjel's petition for bankruptcy relief under the Companies' Creditor Arrangement Act (the "CCAA"). Among other things, the court's order (the "CCAA Order") stayed all actions against Sanjel's officers and directors, including its chief restructuring officer. Also on April 4, 2016, Sanjel's foreign representative filed a petition in the U.S. Bankruptcy Court for the Western District of Texas seeking recognition of the Canadian CCAA case as a foreign main proceeding under chapter 15. The representative filed an emergency motion for provisional injunctive relief under sections 105(a), 1519, and 1521 of the Bankruptcy Code.

After granting a temporary restraining order under section 1519 that prohibited any actions during the gap period against Sanjel or its U.S. assets, the U.S. bankruptcy court entered an order on April 29, 2016, recognizing Sanjel's CCAA case as a foreign main proceeding. The recognition order provided, among other things, that, with certain exceptions, "the terms of the [CCAA Order] are given full force and effect in the United States." It further provided that Sanjel and its foreign representative were granted all relief afforded under section 1520, including the imposition of the automatic stay with respect to U.S. assets. Finally, the recognition order provided additional relief under section 1521 of the Bankruptcy Code, including a stay of all actions "concerning the assets, rights, obligations or liabilities" of Sanjel to the extent that such actions were not already stayed under section 1520.

One month afterward, the class action plaintiffs filed a motion with the U.S. bankruptcy court seeking relief from the automatic stay to continue the Colorado FLSA litigation against Sanjel's officers and directors. According to the plaintiffs, although the recognition order did not specifically bar the continuation of litigation against the officer and director defendants, the order nevertheless gave full force and effect to the CCAA Order, which included such a stay. In addition, the plaintiffs claimed that, because the FLSA statute of limitations for causes of action against officers and directors is not tolled during the pendency of a debtor employer's chapter 15 case, their FLSA claims could be extinguished if the stay against pursuing claims against the officers and directors remained in effect in the U.S.

Sanjel countered that U.S. courts have "universally upheld" stays of actions against officers and directors issued by Canadian courts under the CCAA. In addition, Sanjel argued that the request for stay relief was misguided because the automatic stay issued pursuant to the recognition order did not apply to Sanjel's officers and directors. Finally, Sanjel asserted that: (i) the plaintiffs would not be prejudiced by the stay because they could ask the Canadian court to modify the stay in the CCAA Order; and (ii) Sanjel itself would be prejudiced by relief from the stay because continuation of the FLSA litigation would subject its limited personnel to onerous discovery demands and damage Sanjel's ability to restructure in chapter 15 and the CCAA case.

THE BANKRUPTCY COURT'S RULING

At the outset, the bankruptcy court found that, in accordance with section 1520 of the Bankruptcy Code and the explicit terms of the recognition order, the automatic stay did not apply to Sanjel's officers and directors and, moreover, that modifying the automatic stay would "have no bearing" on the stay in the CCAA Order which prevented the plaintiffs from continuing the FLSA litigation.

However, the court concluded that, even though the plaintiffs did not specifically request such relief, it had the authority to modify the recognition order under section 1522(c) to the extent that the order implemented the stay contained in the CCAA Order. According to the court, despite the absence of a request to do so by the plaintiffs, Sanjel was afforded sufficient notice to raise arguments against modification and actually did so.

In balancing the hardships under section 1522, the court wrote that "a court may refuse to recognize specific orders in a foreign proceeding when those orders unjustifiably harm an interested party" (citing *Jaffé*, 737 F.3d at 29 (affirming a bankruptcy court order applying section 365(n) of the Bankruptcy Code in a chapter 15 case to protect licensees of a German debtor's U.S. patents, even though no such protections existed under the insolvency law of Germany)).

Sanjel highlights an important feature of chapter 15 and other versions of the Model Law that have now been enacted in 41 countries—namely, flexibility. If the insolvency laws of a foreign nation where a main proceeding has been commenced are contrary to domestic law or public policy and, if applied extraterritorially, would prejudice domestic creditors, a court can recognize the foreign proceeding under principles of comity but exercise its discretion to refuse recognition of the repugnant foreign laws or court orders implementing them.

By contrast, the bankruptcy court noted, when a party seeking modification of a chapter 15 recognition order would not be "severely prejudiced" by recognition of a foreign court's order and when granting such relief would prejudice the debtor, a bankruptcy court has discretion to deny the requested modification under section 1522(c) (citing *In re Nortel Networks Corp.*, 2013 BL 317273, at *3–4 (D. Del. Nov. 15, 2013)).

The bankruptcy court explained that, in *Nortel*, the district court upheld a bankruptcy court's denial of a motion to modify a recognition order to pursue securities litigation against the debtor's officers and directors. Pursuant to section 1521 of the Bankruptcy Code, the *Nortel* bankruptcy court had given full force and effect to a stay of such litigation previously issued by the Canadian court overseeing the debtors' CCAA cases. The district court ruled that the bankruptcy court "properly relied heavily on principles of comity, concluding correctly that the request for relief sought by Appellants could have and should have been brought before the Canadian court." *Nortel*, 2013 BL 317273, at *3.

The bankruptcy court in *Sanjel* disagreed with *Nortel* on this point, concluding that the balance of hardships favored the FLSA plaintiffs.

Because section 108(c) of the Bankruptcy Code automatically tolls only the deadline by which a debtor must commence litigation in another court, the bankruptcy court explained, absent modification or expiration of the stay in the CCAA Order, the plaintiffs could not petition the Colorado district court to seek an order tolling the deadline for other potential class members to assert FLSA claims. Thus, the court concluded, without modification of the recognition order, the plaintiffs "risk losing their FLSA claims in the entirety during the pendency of [Sanjel's] CCAA proceeding."

The bankruptcy court rejected Sanjel's argument, bolstered by the court's ruling in *Nortel*, that the FLSA plaintiffs would not be prejudiced because they "have an appropriate avenue to seek relief from the [stay in the CCAA Order] in the form of the Canadian Court." The *Sanjel* bankruptcy court noted that the *Nortel* court provided no reasoning as to why it believed the Canadian court to be the proper venue for seeking such relief. According to the bankruptcy court, "[I]t would be unreasonable and exceedingly burdensome to require [the FLSA plaintiffs] to go to Canada and request that the Canadian Court lift the [stay in the CCAA Order] to allow [the plaintiffs] to pursue claims in Colorado based wholly on a statutory right created by United States law to protect employees within the United States."

Given the absence of any "incredible burden or threat" to Sanjel and its restructuring, the bankruptcy court ruled that its recognition order should be modified "for the specific purpose of preserving [the FLSA plaintiffs'] and potential opt-in plaintiffs' FLSA claims given the running statute of limitations," including the ability of other plaintiffs to opt into the litigation and limited discovery to determine the identity of the officer and director defendants.

OUTLOOK

Chapter 15 has now entered its second decade as a vehicle for coordinating and harmonizing cross-border bankruptcy and insolvency cases. *Sanjel* highlights an important feature of chapter 15 and other versions of the Model Law that have now been enacted in 41 countries—namely, flexibility. If the insolvency laws of a foreign nation where a main proceeding has been commenced are contrary to domestic law or public policy and, if applied extraterritorially, would prejudice domestic creditors, a court can recognize the foreign proceeding under principles of comity but exercise its discretion to refuse recognition of the repugnant foreign laws or court orders implementing them.

Sanjel is an interesting, albeit somewhat unusual, example of how this principle works in practice. U.S. bankruptcy law permits injunctive relief effectively to expand the scope of the automatic stay to cover nondebtors—such as officers and directors—under narrowly defined circumstances that involve, among other things, an examination of the prejudice to creditors and other parties who would be affected by the expansion. Canadian practice under the CCAA is more flexible in this regard.

Thus, the bankruptcy court in *Sanjel* confronted a situation where, although the automatic stay imposed upon chapter 15 recognition of Sanjel's CCAA case did not expressly prevent litigation against Sanjel's officers and directors pursuant to section 1520(a)(1), the court, perhaps unwittingly, imposed such a stay by giving "full force and effect" to the CCAA Order, including the officer and director stay.

Concluding that the FLSA plaintiffs could be severely prejudiced without relief, the bankruptcy court exercised its discretion under section 1522(c) to modify the recognition order.

Interestingly, however, notice of Sanjel's CCAA case and the entry of the CCAA Order including the stay covering both Sanjel and its officers and directors was filed in the Colorado district court. Thus, even though the U.S. bankruptcy court modified its recognition order to provide the FLSA plaintiffs limited ability to prosecute their claims, it appears that the plaintiffs will still need to obtain the Colorado district court's permission to do so.

COURT ADOPTS MAJORITY VIEW IN SANCTIONING BANKRUPTCY TRUSTEE'S USE OF TAX CODE LOOK-BACK PERIOD IN AVOIDANCE ACTIONS

Amanda A. Parra Criste and Mark G. Douglas

The ability of a bankruptcy trustee or chapter 11 debtor-in-possession ("DIP") to avoid fraudulent or preferential transfers is an important tool promoting the bankruptcy policy of equality of distribution among creditors. One limitation on this avoidance power is the statutory "look-back" period during which an allegedly fraudulent transfer can be avoided—two years for fraudulent transfer avoidance actions under section 548 of the Bankruptcy Code and, as generally understood, three to six years if the trustee or DIP seeks to avoid a fraudulent transfer under section 544(b) and state law by stepping into the shoes of a "triggering" creditor plaintiff.

The longer look-back periods governing avoidance actions under various state laws significantly expand the universe of transactions that may be subject to fraudulent transfer avoidance. A ruling recently handed down by the U.S. Bankruptcy Court for the Southern District of Florida, however, suggests that the look-back period in avoidance actions under section 544(b) may be much longer—10 years—in bankruptcy cases where the Internal Revenue Service (the "IRS") or another governmental entity is the triggering creditor. In *Mukamal v. Citibank (In re Kipnis),* 555 B.R. 877 (Bankr. S.D. Fla. 2016), the court, adopting the majority approach, held that a chapter 7 trustee could effectively circumvent Florida's four-year statute of limitations for fraudulent transfer actions by stepping into the shoes of the IRS, which is bound not by Florida law, but by the 10-year statute of limitations for collecting taxes specified in the Internal Revenue Code (the "IRC").

DERIVATIVE AVOIDANCE POWERS UNDER SECTION 544(b) OF THE BANKRUPTCY CODE

Section 544(b)(1) of the Bankruptcy Code provides in relevant part as follows:

> [T]he trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

11 U.S.C. § 544(b). Thus, a trustee (or DIP pursuant to section 1107(a)) may seek to avoid transfers or obligations that are "voidable under applicable law," which is generally interpreted to mean state law. *See Ebner v. Kaiser (In re Kaiser)*, 525 B.R. 697, 709 (Bankr. N.D. Ill. 2014); *Wagner v. Ultima Holmes (In re Vaughan)*, 498 B.R. 297, 302 (Bank. D.N.M. 2013).

State fraudulent transfer statutes (generally, versions of the Uniform Fraudulent Conveyance Act or the Uniform Fraudulent Transfer Act (the "UFTA"), which was recently amended and renamed the "Uniform Voidable Transactions Act") have a look-back period of three to six years. For example, Florida's version of the UFTA provides that avoidance actions are time-barred unless brought within four years of the time the transfer was made or the obligation was incurred. *See* Fla. Stat. § 726.110.

Longer-Look Back Period for Certain Governmental Entities

However, the federal government is generally not bound by state statutes of limitations. *Vaughan*, 498 B.R. at 304. Instead, various federal statutes or regulations specify the statute of limitations for enforcement actions. For example, the IRC provides that, with certain exceptions, an action to collect a tax must be commenced by the IRS no later than 10 years after the tax is assessed. *See* 26 U.S.C. § 6502(a). The rationale behind a longer federal statute of limitations is that public rights and interests which the federal government is charged with defending should not be forfeited due to public officials' negligence. *Vaughan*, 498 B.R. at 304.

On the basis of the plain meaning of section 544(b), nearly all of the courts which have considered the issue have concluded that a trustee or DIP bringing an avoidance action under that section may step into the shoes of the IRS to utilize the IRC's 10-year statute of limitations. *See*, *e.g.*, *Kaiser*, 525 B.R. at 711–12; *Finkel v. Polichuk (In re Polichuk)*, 2010 WL 4878789, at *3 (Bankr. E.D. Pa. Nov. 23, 2010); *Alberts v. HCA Inc. (In re Greater Southeast Cmty. Hosp. Corp. I)*, 365 B.R. 293, 299–306 (Bankr. D.D.C. 2006); *Shearer v. Tepsic (In re Emergency Monitoring Technologies, Inc.)*, 347 B.R. 17, 19 (Bankr. W.D. Pa. 2006); *Osherow v. Porras (In re Porras)*, 312 B.R. 81, 97 (Bankr. W.D. Tex. 2004).

Vaughan is the only published decision to the contrary. The *Vaughan* court reached its conclusion after considering policy and legislative intent. It noted that the IRS is not bound by state law statutes of limitations because it exercises sovereign powers and is therefore protected by the doctrine of *nullum tempus occurrit regi* ("no time runs against the king"). According to the court in *Vaughan*, Congress did not intend for section 544(b) to vest sovereign power in a bankruptcy trustee, and allowing a trustee to take advantage of the IRC's 10-year statute of limitations would be an overly broad interpretation.

Triggering Creditor Must Have an "Allowable Claim"

Avoidance under section 544(b) is permitted only if a transfer could be avoided under applicable law by a creditor holding an "allowable" unsecured claim. The term "allowable" is not defined in the Bankruptcy Code. However, section 502(a) provides that a claim for which the creditor files a proof of claim is deemed "allowed" unless a party in interest objects. Rule 3003(c) of the Federal Rules of Bankruptcy Procedure provides that, in a chapter 9 or chapter 11 case, a creditor need not file a proof of claim if the claim is listed on the debtor's schedules in the proper amount and is not designated as disputed, contingent, or unliquidated.

Thus, if an unsecured creditor has not filed a proof of claim and if, in a chapter 9 or chapter 11 case, its claim either is not scheduled in any amount or is scheduled as disputed, contingent, or unliquidated, a handful of courts have concluded that the claim is not "allowable" and the trustee or DIP may not step into the creditor's shoes to bring an avoidance action under section 544(b). *See In re Republic Windows & Doors*, 2011 WL 5975256, *11 (Bankr. N.D. Ill. Oct. 17, 2011) (a chapter 7 trustee could not take advantage of the IRC's 10-year statute of limitations because the IRS had not filed a proof of claim in the case); *Campbell v. Wellman (In re Wellman),* 1998 WL 2016787, *3 (Bankr. D.S.C. June 2, 1998) ("[A]s Robert McKittrick was the only creditor of these three [creditors] to file a proof of claim, he is the only one with an allowable claim into whose shoes the [chapter 7] Trustee may step pursuant to § 544(b).").

However, the majority approach is otherwise. Most courts have held that the allowability of a claim for purposes of section 544(b) should be determined as of the petition date and, therefore, that the failure to file a proof of claim does not disqualify a creditor from being the triggering creditor. *See*, *e.g.*, *Whittaker v. Groves Venture, LLC (In re Bolon),* 538 B.R. 391, 408 n.8 (Bankr. S.D. Ohio 2015); *Finkel v. Polichuk (In re Polichuk),* 506 B.R. 405, 432 (Bankr. E.D. Pa. 2014); *In re Kopp,* 374 B.R. 842, 846 (Bankr. D. Kan. 2007). In *Polichuk,* the court applied a broad definition of "allowable" in ruling that a chapter 7 trustee could step into the shoes of the IRS even though it had not filed a proof of claim.

In addition, when the deadline for filing a proof of claim has not passed, the court may be more inclined to allow the trustee or an estate representative to go forward. *See In re GI Holdings, Inc.,* 313 B.R. 612, 636 (Bankr. D.N.J. 2004) (permitting the asbestos claimants' committee in a chapter 11 case to step into the shoes of the New Jersey Department of Environmental Protection for purposes of section 544(b) and to take advantage of the 10-year statute of limitations period for asserting fraudulent transfer actions made applicable to the governmental entity, even though it had not filed a proof of claim), *vacated in part, affirmed in part, and remanded, Official Comm. of Asbestos Claimants v. Bank of New York (In re G-I Holdings, Inc.),* 2006 BL 71226 (D.N.J. June 21, 2006).

In *Kipnis*, the bankruptcy court considered whether a chapter 7 trustee could step into the shoes of the IRS for purposes of section 544(b).

KIPNIS

In June 2003, the IRS notified Donald Jerome Kipnis (the "debtor") that his 2000 and 2001 taxes were under investigation. The investigation ultimately resulted in a 2012 tax court ruling in favor of the IRS affirming tax deficiencies exceeding $1 million.

The debtor filed for chapter 11 protection in the Southern District of Florida on January 21, 2014. The IRS filed a proof of claim in the case for $1.9 million, of which, it asserted, approximately $25,000 was unsecured.

After the case was converted to chapter 7, the trustee filed two adversary proceedings in January 2016 seeking to avoid as fraudulent, under the Florida UFTA, transfers of a bank account and a condominium in 2005 to the debtor's wife (the "defendant"). The defendant moved to dismiss, arguing that both actions were barred by Florida's four-year statute of limitations and that section 544(b) did not give the trustee the right to step into the shoes of the IRS and apply the 10-year IRC look-back period.

THE BANKRUPTCY COURT'S RULING

Explaining that no other court in the Eleventh Circuit had considered the issue to date, the court canvassed relevant case law elsewhere and concluded that *Kaiser*'s plain-reading approach was preferable to the approach applied in *Vaughan.* Applying a plain-meaning analysis to the facts in *Kipnis*, the court concluded that the meaning of section 544(b) is clear and does not limit the type of creditor from which a trustee can choose to derive rights. Moreover, because the court determined that its interpretation of the statute was not "absurd," the court did not deem it necessary to expand its inquiry beyond the express language of section 544(b) to consider legislative intent or policy concerns. *Kipnis*, 555 B.R. at 882 (citing *Lamie v. United States Trustee,* 540 U.S. 526, 534 (2004) ("It is well established that 'when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.' ")).

Although perhaps surprising to some observers, *Kipnis* does not break new ground on the power of a bankruptcy trustee or DIP to bring avoidance actions under section 544(b) of the Bankruptcy Code. Still, the court's endorsement of the majority approach on the availability of a longer look-back period in cases in which the IRS is a creditor is notable. If followed by other courts, the approach could significantly augment estate avoidance action recoveries.

The court agreed with *Kaiser* that *Vaughan*'s *nullum tempus* argument was misplaced. Because section 544(b) is a derivative statute, the *Kipnis* court wrote, "the focus is not on whether the trustee is performing a public or private function, but rather, the focus is on whether the IRS, the creditor from whom the trustee is deriving her rights, would have been performing that public function if the IRS had pursued the avoidance actions."

However, the court agreed with *Vaughan* on one point—if applied in other cases, the court's ruling could result in a 10-year look-back period in many cases. By contrast, the court in *Kaiser* found this argument to be a "logical fallacy" because the issue had then appeared in very few cases, despite the fact that section 544(b) had been enacted more than 35 years prior to the court's ruling. According to the *Kipnis* court, because the IRS is a creditor in a significant number of cases, the paucity of decisions addressing the issue can more likely be attributed to the fact that trustees and DIPs have not realized that this "weapon is in their arsenal."

OUTLOOK

Although perhaps surprising to some observers, *Kipnis* does not break new ground on the power of a bankruptcy trustee or DIP to bring avoidance actions under section 544(b) of the Bankruptcy Code. Still, the court's endorsement of the majority approach on the availability of a longer look-back period in cases in which the IRS is a creditor is notable. If followed by other courts, the approach could significantly augment estate avoidance action recoveries.

Furthermore, the IRS is not the only triggering creditor under section 544(b) with a longer look-back period. Other governmental entities may also provide that additional tool to a trustee or DIP. *See*, *e.g.*, *Alberts v. HCA Inc. (In re Greater Southeast Cmty. Hosp. Corp. I)*, 365 B.R. 293, 304 (Bankr. D.D.C. 2006) (the trustee of a liquidating trust created by a chapter 11 plan could step into the shoes of the IRS as well as the Department of Health and Human Services (six-year statute of limitations for actions to collect Medicare overpayments under 28 U.S.C. § 2415) for the purpose of bringing an avoidance action under section 544(b) and the Illinois UFTA); *G-I Holdings, Inc.*, 313 B.R. at 636 (the asbestos claimants' committee in a chapter 11 case could step into the shoes of the New Jersey Department of Environmental Protection (10-year statute of limitations for enforcement action) for purposes of section 544(b)).

IN BRIEF: DELAWARE BANKRUPTCY COURT CLARIFIES BURDEN OF PROOF FOR AUTOMATIC STAY RELIEF

In *In re Abeinsa Holding, Inc.*, 2016 BL 335099 (Bankr. D. Del. Oct. 6, 2016), the U.S. Bankruptcy Court for the District of Delaware addressed what it perceived to be a flaw in the approach that many courts apply to motions for relief from the automatic stay. Specifically, the court noted that, although the Bankruptcy Code expressly places the burden of proof on the party opposing such relief (generally, the debtor or the bankruptcy trustee), except as to whether the debtor has equity in property, the three-factor test applied by many bankruptcy courts (principally in Delaware) "is sometimes inadequate to the task of determining whether stay relief should be granted" because it does not adequately reflect the statutory burden.

Subsections (d)(1) and (d)(2) of section 362 of the Bankruptcy Code provide that, on the request of a party in interest and after notice and a hearing, the court shall grant relief from the automatic stay: (i) "for cause, including the lack of adequate protection of an interest in property of such party in interest"; or (ii) regarding the stay with respect to an act against property, if "the debtor does not have an equity in such property; and . . . such property is not necessary to an effective reorganization."

Except for the "lack of adequate protection" language quoted above, the term "cause" is not defined in the Bankruptcy Code. Courts have devised various balancing tests to determine whether this flexible standard has been met in any given case. For example, in *Izzarelli v. Rexene Prods. Co. (In re Rexene Prods. Co.)*, 141 B.R. 574, 576 (Bankr. D. Del. 1992), the court applied a three-factor test examining whether:

(i) the estate or the debtor will be greatly prejudiced by continuation of litigation in another court;

(ii) the hardship arising from denial of stay relief to the party seeking it considerably outweighs the hardship to the debtor; and

(iii) the movant has a probability of prevailing on the merits.

Section 362(g) of the Bankruptcy Code allocates the burden of proof in connection with a motion for relief from the automatic stay as follows:

> In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section—
>
> (1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and
>
> (2) the party opposing such relief has the burden of proof on all other issues.

In *Abeinsa Holding*, the debtors entered into a contract to construct an energy generating facility for Portland General Electric ("PGE"). The contract designated the U.S. District Court for the District of Oregon as the exclusive forum to resolve disputes. The debtors' parent corporation—Spanish energy, telecom, transport, and environmental conglomerate Abengoa, S.A. ("Abengoa")—guaranteed the debtors' obligations under the construction contract, which were also secured by a performance bond issued by two sureties.

The court noted that, although the Bankruptcy Code expressly places the burden of proof on the party opposing such relief (generally, the debtor or the bankruptcy trustee), except as to whether the debtor has equity in property, the three-factor test applied by many bankruptcy courts (principally in Delaware) "is sometimes inadequate to the task of determining whether stay relief should be granted" because it does not adequately reflect the statutory burden.

Prior to the petition date, PGE terminated the construction contract, claiming the debtors were in default, and, upon denial of its claim under the performance bond, sued the sureties in the Oregon district court. In accordance with the terms of the guaranty, Abengoa commenced an arbitration proceeding to resolve PGE's claims. After the debtors filed for chapter 11 protection in the District of Delaware, PGE sought relief from the automatic stay to commence litigation in the district court against the debtor for breach of the contract.

The bankruptcy court granted the motion.

At the outset of its opinion, bankruptcy judge Kevin J. Carey explained that, because the debtors' equity in property was not at issue, "the burden to resist lifting of the stay rests entirely" with the debtors. However, he noted, "[c]uriously, the cases considering such requests for relief tend toward asking the question: 'Why should the court lift the stay?' . . . [while] [t]he statute, by its burden shifting, seems almost instead to ask, 'why shouldn't the stay be lifted?' " According to Judge Carey, the *Rexene* factors appear to limit the significance of putting the burden squarely upon the party opposing stay relief. Thus, he found that "use of the *Rexene* test in situations like this one is sometimes inadequate to the task of determining whether stay relief should be granted."

Instead, Judge Carey looked for guidance to the Second Circuit's ruling in *Sonnax Indus., Inc. v. Tri Component Products Corp. (In re Sonnax Indus., Inc.)*, 907 F.2d 1280 (2d Cir. 1990), where the court listed the following factors—only one of which is the balancing of harms—to consider in connection with a request for stay relief to continue pending litigation:

> (1) whether relief would result in a partial or complete resolution of the issues; 2) lack of any connection with or interference with the bankruptcy case; (3) whether the other proceeding involves the debtor as a fiduciary; (4) whether a specialized tribunal with the necessary expertise has been established to hear the cause of action; (5) whether the debtor's insurer has assumed full responsibility for defending it; (6) whether the action primarily involves third parties; (7) whether litigation in another forum would prejudice the interests of other creditors; (8) whether the judgment claim arising from the other action is subject to equitable subordination; (9) whether movant's success in the other proceeding would result in a judicial lien avoidable by the debtor; (10) the interests of judicial economy and the expeditious and economical resolution of litigation; (11) whether the parties are ready for trial in the other proceeding; and (12) impact of the stay on the parties and the balance of harms.

Id. at 1286 (citing *In re Curtis*, 40 B.R. 795, 799–800 (Bankr. D. Utah 1984)).

Applying these factors, Judge Carey found in *Abeinsa Holdings* that "no great prejudice" would result to the debtors from commencement of litigation in the Oregon district court and, further, that the debtors "failed to carry their burden to demonstrate harm." The judge found, among other things, that the debtors had failed to prove that litigation in the district court would prejudice the interests of the rest of the creditor body. He also concluded that the potential hardship to PGE "considerably outweighs" any prejudice to the debtors because the Oregon district court was in the best position to manage the jurisdictional disputes presented by the parallel court and arbitration proceedings. In addition, Judge Carey determined that PGE had a "sufficient likelihood of success" on the issue of forum selection under the construction contract.

IN BRIEF: DISTRICT COURT DENIES LYONDELL SHAREHOLDERS' MOTION TO RECONSIDER ACTUAL FRAUD IMPUTATION RULING OR TO CERTIFY DIRECT APPEAL

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"). By that ruling, the bankruptcy court 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 district court revisited its examination of Delaware agency law. As before, it concluded that, on the basis of the facts in *Lyondell*, the authorities cited in its July 27 decision confirmed "the fundamental principle that the knowledge and actions of a corporation's officers and directors, acting within the scope of their authority, [are] imputed to the corporation."

The avoidance claims dismissed by the bankruptcy court were brought 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. The court 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. In the alternative, the shareholders asked the district court to certify an interlocutory appeal to the U.S. Court of Appeals for 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"; rather, "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 denied the shareholders' motion on October 5, 2016. *See Weisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 2016 BL 332813 (S.D.N.Y. Oct. 5, 2016).

In its October 5 ruling, the district court revisited its examination of Delaware agency law. As before, it concluded that, on the basis of the facts in *Lyondell*, the authorities cited in its July 27 decision confirmed "the fundamental principle that the knowledge and actions of a corporation's officers and directors, acting within the scope of their authority, [are] imputed to the corporation."

The court rejected the shareholders' argument that the opinions cited in its July 27 opinion—principally *Hecksher v. Fairwinds Baptist Church*, 115 A.3d 1187 (Del. 2015), and *Stewart v. Wilmington Tr. SP Servs., Inc.*, 112 A.3d 271 (Del. 2015)—compel the conclusion that the fraudulent intent of Lyondell's CEO cannot be imputed to Lyondell under the circumstances. The court explained, among other things, that: (i) *Hecksher*'s mandate that imputation of an employee's knowledge to its employer is warranted only if the employee "has the authority to act on the knowledge" does not mean that "the employee must be able to effectuate all of the challenged conduct in this case, that is, that [Lyondell's CEO] must have had the power by himself to approve the Shareholder Payments or must have caused the Board to do so"; and (ii) the shareholders' attempt to distinguish *Stewart* is unavailing because the court in *Stewart* did not hold that, in order for an officer's intent to be imputed to the company, the officer must dominate the company.

The district court also denied the shareholders' request for certification of an interlocutory appeal to the U.S. Court of Appeals for the Second Circuit. The district court concluded, among other things, that the shareholders, who did not identify any conflicting authorities other than the reversed ruling of the bankruptcy court below, failed to show that there is a "substantial ground for difference of opinion" on the issue of imputation.

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