Recent Developments in Bankruptcy and Restructuring
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JONES DAY

BUSINESS RESTRUCTURING REVIEW

THE YEAR IN BANKRUPTCY: 2016

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The watchword for 2016 in much of the world was "upheaval." Two unanticipated events dominated the political, business, and financial headlines of 2016, at least in Europe and the Americas: the Brexit referendum result and the election of Donald J .Trump as the 45th President of the United States. The refugee crisis, the commodities meltdown, Brazil's economic collapse, China's growing pains, Russian belligerency and alleged cyber-meddling in the U.S. election, the war on terrorism, and the beginning of the end of the bloody Syrian civil war seemed to pale by comparison.

ANOTHER GOOD YEAR FOR THE U.S.

All things considered, 2016 was another good year for the U.S., with modest growth in the economy (approximately 2 percent); only a slight increase in the fiscal year budget deficit ($587 billion); persistently low inflation (approximately 1.7 percent); a strong dollar (at a 14-year high compared to most major currencies); and, until it increased slightly at the end of December to 4.7 percent, the lowest unemployment rate since August 2007. These developments prompted the U.S. Federal Reserve on December 14 to raise its benchmark interest rate for the second time since December 2008.

> **HIGHLIGHTS OF 2015**
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> Among the most memorable business, economic, and financial sound bites of 2016 were "Brexit," the "Panama Papers," "negative interest rates," "commodities rout," and "Trumponomics."

A gold star for 2016 went to the U.S. auto industry. Seven years after Big Three automakers General Motors and Chrysler filed for chapter 11 protection with a decidedly bleak outlook, U.S. automakers had another banner year—U.S. light-vehicle sales hit a second consecutive annual high, assisted by a fourth-quarter surge in demand that exceeded expectations and bolstered the outlook for an industry that has been a key engine for economic growth.

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COMMODITIES AND THE SHIPPING NEWS

The other big stories in the turbulent business, financial, and economic narrative of 2016 included a continuing commodities meltdown precipitated by weak demand (principally from China) and, until the Organization of the Petroleum Exporting Countries (OPEC) finally agreed to slash oil production in November, rock-bottom prices for oil, gas, coal, and minerals, all of which sent hundreds of overleveraged U.S. and foreign producers and related companies scrambling down the road to bankruptcy. The year ended on a good note for oil producers. After plummeting to a 12-year low in January, the price of crude oil rebounded more than 50 percent by year-end.

Years of spending on bigger and bigger state-of-the-art container ships and of rock-bottom spot cargo rates took a heavy toll on the shipping industry in 2016. In January, Hyundai Merchant Marine negotiated an almost unprecedented reduction in daily hire rates for long-term charters as part of the South Korean carrier's restructuring. Hanjin Shipping collapsed under a mountain of debt and was forced to apply for court receivership at the end of August, leaving 100 ships and $12 billion in goods stranded around the world. Even industry-leading Maersk Line saw its profit from 2015, which had totaled $1.3 billion, reverse into a loss in 2016. Turmoil in the industry spurred a rash of consolidations. These developments overshadowed other notable events in 2016, such as the opening of the enlarged Panama Canal in June.

ANOTHER GOOD YEAR FOR M&A

M&A had a big year in 2016, despite resistance from government regulators due to antitrust and other concerns. Takeovers totaling $3.84 trillion were announced globally in 2016, according to Dealogic. Although that represents a decline of approximately 18 percent from 2015's record of $4.66 trillion, it still makes 2016 the fourth-most-active year for M&A. There were 28 transactions valued at $10 billion or more in 2016, compared with 44 the year before. Those deals included AT&T Inc.'s agreement in late October to buy Time Warner Inc. for $85 billion (the largest deal of 2016), British American Tobacco p.l.c.'s $47 billion bid for the stake of Reynolds American Inc. that it does not already own, chipmaker Qualcomm Inc.'s agreement to pay roughly $39 billion for NXP Semiconductors NV, and the December 20 announcement by industrial gas giants Praxair Inc. and Linde AG that they would merge in a deal that would create a company valued at $67 billion.

The year 2016 was also the biggest ever in terms of the volume of collapsed deals, with more than $500 billion of previously announced deals withdrawn, due in part to antitrust or other government scrutiny directed principally toward corporate "tax inversions." Among the deals that fell apart was Pfizer Inc.'s $150 billion proposed deal for drugmaker Allergan plc, oilfield service giant Halliburton Co.'s $35 billion proposed combination with Baker Hughes Inc., and Office Depot Inc.'s bid to merge with Staples Inc.

SOVEREIGN AND COMMONWEALTH DEBT

A resolution of the sovereign debt crisis of Argentina and legislation designed to alleviate the calamitous financial straits of a U.S. commonwealth—Puerto Rico—figured prominently in 2016 headlines. Argentina returned to global debt markets after a 15-year absence on April 19, 2016, when it sold $16 billion in bonds to fund a series of landmark settlements reached in February with holdout bondholders from the South American nation's 2005 and 2010 debt restructurings. This resolution of the more than decade-long battle between Argentina and the holdouts—led by hedge funds Aurelius Capital Master Ltd. and NML Capital Ltd.—provided an unlikely, albeit welcome, dénouement to a story that had long captivated the international community.

HIGHLIGHTS OF 2016

January 12—Crude oil prices plunge more than 5 percent to trade near $30 a barrel for the first time in 12 years, raising the specter of bankruptcy for a significant chunk of the U.S. oil industry.

Puerto Rico has been struggling for several years to manage more than $72 billion in bond debt. However, because the island commonwealth is a U.S. territory, its heavily indebted public corporations had been precluded from seeking the debt-adjustment relief that is available to most state public agencies under chapter 9 of the U.S. Bankruptcy Code. A new mechanism for providing debt adjustment was implemented in 2016, shortly after the U.S. Supreme Court upheld lower court rulings declaring unconstitutional a 2014 Puerto Rico law, portions of which mirrored chapter 9, that would have allowed the commonwealth's public instrumentalities to restructure a significant portion of their debt. On June 30, 2016, President Obama gave his imprimatur to the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). The law established, among other things, an oversight board entrusted with determining the adequacy of budgets and fiscal plans for the instrumentalities of Puerto Rico. It also created a mechanism to implement voluntary out-of-court restructuring agreements between an instrumentality and its bondholders, as well as bond debt-adjustment plans (consensual and nonconsensual) in a case commenced in federal district court.

U.S. MARKETS

U.S. stock markets had a very good year in 2016. The Dow Jones Industrial Average shrugged off its worst-ever yearly start to record its best performance since 2013. The index of 30 blue-chip stocks gained 13 percent in 2016. The Dow closed above 19,000 for the first time ever on November 22, gained nearly 8 percent after the U.S. election, and flirted with 20,000 before closing at 19,744. The Standard & Poor's 500 gained 9.5 percent in 2016, and the technology-heavy NASDAQ Composite added 7.5 percent—their biggest gains since 2014. The 2016 rally extended a bull market that tripled the Dow from its low of 6,547.05 during the financial crisis in March 2009.

BUSINESS BANKRUPTCY FILINGS

Business bankruptcy filings, other than chapter 11 filings, continued a downward trend in fiscal year ("FY") 2016, but the volume of business filings increased during the calendar year ("CY"). The Administrative Office of the U.S. Courts reported that business bankruptcy filings in FY 2016, which ended on September 30, 2016, totaled 24,457, down 2 percent from the 24,985 business filings in FY 2015. Chapter 11 filings, however, totaled 7,450 in FY 2016, a 5.8 percent increase from the 7,040 chapter 11 filings in FY 2015.

One hundred fifty chapter 15 cases were filed in FY 2016, compared to 74 in FY 2015. There were five chapter 9 filings in FY 2016, compared to seven in FY 2015.

According to Epiq Systems, total business bankruptcy filings during CY 2016 were 37,771, a 26 percent increase from the 29,920 filings for CY 2015. There were 5,438 business chapter 11 filings during CY 2016, a 2 percent increase over the 5,313 business chapter 11 filings in CY 2015.

HIGHLIGHTS OF 2016

January 16—The United States and the European nations lift oil and financial sanctions on Iran and release roughly $100 billion of its assets after international inspectors conclude that the country has followed through on promises to dismantle large sections of its nuclear program.

One hundred eighty chapter 15 petitions were filed on behalf of foreign business debtors in CY 2016, compared to 90 in CY 2015—a 100 percent increase. Only six municipal debtors filed for chapter 9 protection in CY 2016, compared to three in CY 2015.

The number of bankruptcy filings by "public companies" (defined as companies with publicly traded stock or debt) in CY 2016 was 99, according to data provided by New Generation Research, Inc.'s bankruptcydata.com, compared to 79 public company filings in CY 2015. At the height of the Great Recession, 138 public companies filed for bankruptcy in CY 2008 and 211 in CY 2009.

The combined asset value of the 99 public companies that filed for bankruptcy in 2016 was $104.6 billion, compared to $81.2 billion in 2015 and $72 billion in 2014. By contrast, the 138 public companies that filed for bankruptcy in 2008 had prepetition assets valued at $1.16 trillion in aggregate. In 2016, oil and gas, energy, and mining sector companies once again led the pack, representing 40 percent of the total public company bankruptcy filings in 2016. Eight of the 10 largest public company bankruptcy filings in 2016 were made by companies in the oil and gas, energy, and mining sectors. During the past two years, more than 80 public companies operating within these sectors filed for bankruptcy protection, with 30 of those petitioners listing more than $1 billion in prepetition assets. Other sectors with a significant number of public filings included retail (five filings), healthcare and medical (four filings), chemicals and related products (four filings), and steel and metals (three filings).

The year 2016 added 25 public company names to the billion-dollar bankruptcy club (measured by value of assets), compared to 19 in 2015 and 11 in 2014. However, the largest bankruptcy filing of 2016—solar energy company SunEdison Inc., with $11.5 billion in assets—did not even come close to cracking the Top 30 List of the largest public company bankruptcy filings in history.

Twenty-four public and private companies with assets valued at more than $1 billion exited from bankruptcy in 2016—including 11 of the 25 billion-dollar public companies that filed in 2016. Continuing a trend begun in 2012, more of these companies (19) reorganized than were liquidated or sold.

BANKS AND PENSION INSURANCE

The Federal Deposit Insurance Corporation shuttered five banks in 2016, compared to eight in 2015 and 18 in 2014. This represents the lowest number of bank failures since 2007. There were 140 bank failures in 2009 and 157 in 2010, during the height and immediate aftermath of the Great Recession.

On November 16, the Pension Benefit Guaranty Corporation (the "PBGC"), which insures pensions for approximately 40 million Americans, reported that its deficit increased 3.9 percent to $79.4 billion, with the agency's program for multi-employer pension plans continuing to account for a large share ($58.8 billion). PBGC's single-employer insurance program improved during FY 2016—the deficit narrowed from $24.1 billion at the end of FY 2015 to $20.6 billion at the end of FY 2016. The combined deficit reported for FY 2016 was the widest in the 42-year history of the PBGC, which has now run shortfalls for 14 straight years. In its most recent Projections Report, PBGC estimated that its multi-employer program will run out of money by the end of 2025, and there is considerable risk that it will run out even sooner.

GLOBAL DEFAULTS

According to Standard & Poor's Ratings Services, 162 companies worldwide defaulted on their obligations in 2016, the highest year-end figure since 2009, when the default figure hit 268. Up more than 40 percent from 2015, when there were 113 global defaults, this tally made 2016 the worst year for corporate stress since the height of the global financial crisis.

Two-thirds of 2016's global defaults came from U.S. borrowers (106), up from 59 percent in 2015. After the U.S., companies from emerging markets (Brazil and Russia) were the second-largest defaulters (31), followed by companies in Europe (14) and other developed nations, including Australia, Canada, Japan, and New Zealand (11). The oil and gas sector led the 2016 default tally with 66 defaulters, or 40 percent of the global total, followed by the metals, mining, and steel sector with 18 defaults, or 11 percent.

Of the 162 defaulting entities in 2016, 60 defaulted because of missed principal/interest/coupon payments, approximately one-third of the defaults were due to distressed debt exchanges and out-of-court restructurings, and 29 followed bankruptcy filings. The remaining defaults were due to "confidential" reasons, de facto restructurings, deferred interest payments, debt moratoriums, debt acceleration, judicial reorganization, and regulatory intervention.

DISTRESSED DEBT AND BANKRUPTCY RESTRUCTURING

According to Thomson Reuters, completed distressed debt and bankruptcy restructuring activity during 2016 totaled $346.5 billion globally, a 121.4 percent increase from 2015. The number of completed deals also increased, with 336 deals during 2016, compared to 271 during 2015. The two largest completed transactions during 2016 were the $40.3 billion debt restructuring of Energy Future Holdings Corp. ("EFH") and the $33 billion spinoff of EFH's competitive businesses to its shareholders. Completed deal activity in the U.S. totaled $183.9 billion during 2016, a more than threefold increase from 2015. There were 124 restructuring transactions completed in the U.S. during 2016, 47 more deals than completed in 2015. The energy and power sector accounted for 63 percent of the U.S. debt restructuring market. The media and entertainment sector followed, with a 19 percent share.

TOP 10 BANKRUPTCIES OF 2016

With one exception, the Top 10 List of "public company" (defined as a company with publicly traded stock or debt) bankruptcies of 2016 consisted entirely of energy companies—solar, coal, and oil and gas producers—reflecting, as in 2015, the dire straits of those sectors caused by weakened worldwide demand and, until their December turnaround, plummeting oil prices. The exception came from the airline industry. Each company gracing the Top 10 List for 2016 entered bankruptcy with assets valued at more than $3 billion. Half of the companies on the Top 10 List filed prepackaged or prenegotiated chapter 11 cases.

HIGHLIGHTS OF 2016

February 29—Argentina agrees to pay $4.6 billion to creditors NML Capital and Aurelius Capital Master Ltd. as well as other major holdout bondholders over claims arising from the country's 2001 debt default, clearing a path to end 15 years of litigation between the parties.

Saint Louis, Missouri-based solar energy company ***SunEdison Inc.*** ("SunEdison") flared into the No. 1 spot on the Top 10 List for 2016 when it filed for chapter 11 protection on April 21, 2016, in the Southern District of New York with $11.5 billion in assets and more than $8 billion in debt. Bankruptcy had been a near-certainty for one of the nation's biggest and fastest-growing developers of renewable power plants for some time. SunEdison borrowed heavily in recent years to acquire wind and solar developers but faced disappointing earnings from its yield company subsidiaries, TerraForm Global Inc. and TerraForm Power Inc., which did not file for bankruptcy. SunEdison also failed to close several deals, including the $2.2 billion takeover of Vivint Solar Inc. and the $700 million buyout of Latin America Power, and faced allegations of financial reporting improprieties as well as investigations by the U.S. Securities and Exchange Commission and the Department of Justice.

The No. 2 position on the Top 10 List for 2016 was excavated by the largest U.S. coal mining company, St. Louis, Missouri-based ***Peabody Energy Corporation*** ("Peabody"), which filed for chapter 11 protection on April 13, 2016, in the Eastern District of Missouri with $11 billion in assets and $10.1 billion in debt. Peabody's chapter 11 filing was part of a wave of bankruptcies that have ricocheted through the U.S. coal mining industry, following filings by Arch Coal Inc.; Alpha Natural Resources, Inc.; Patriot Coal Corp.; and Walter Energy, Inc. Even though just under one-third of the U.S. grid is still powered by coal, and hundreds of mines are still profitable and operating, coal mining companies have struggled with a host of challenges. These include high leverage, low energy prices, stringent new environmental regulations, the decline of steel production, and power plants that have replaced coal with natural gas made abundant and cheap by shale drilling. The industry has also been troubled by slower demand from China. Jones Day is representing Peabody in connection with its chapter 11 filing.

Houston, Texas-based oil and gas producer ***LINN Energy, LLC*** ("Linn Energy") trickled into the No. 3 spot on the Top 10 List for 2016 when it filed for chapter 11 protection on May 11, 2016, in the Southern District of Texas after reaching the broad terms of a deal with the majority of its lenders to restructure $8.3 billion in debt and obtain $2.2 billion in fresh financing. Linn Energy focuses its exploration and production efforts on the Colorado Rockies, California, the Hugoton Basin, the Mid-Continent, the Permian Basin, Texas, Louisiana, Michigan, and Illinois. It listed $10 billion in assets at the time of the chapter 11 filing. Yet another victim of the commodities rout, Linn Energy was once the largest energy producer operating as a partnership. Such partnerships were bankrolled by the U.S. shale boom, but many took on heavy debt loads to fund their acquisitions.

St. Louis, Missouri-based ***Arch Coal, Inc.*** ("Arch Coal") collapsed into the No. 4 position on the Top 10 List of 2016. The second-largest coal miner in the U.S., Arch Coal filed for chapter 11 protection on January 11, 2016, in the Eastern District of Missouri to implement a restructuring to eliminate more than $4.5 billion in debt from the company's balance sheet. Arch Coal produces and sells thermal and metallurgical coal from 16 surface and underground mines located in the U.S. It also sells coal to power plants, steel mills, and industrial facilities. Arch Coal ran into debt trouble after purchasing International Coal Group Inc. for $3.4 billion during a coal price peak in 2011. The company listed $8.4 billion in assets and $6.5 billion in debt at the time of the bankruptcy filing. The bankruptcy court confirmed a chapter 11 plan for Arch Coal on September 13,

2016. The plan provides for a debt-for-equity swap that cut Arch Coal's debt load by 93 percent.

Los Angeles, California-based ***Breitburn Energy Partners LP*** ("Breitburn") drilled into the No. 5 spot on the Top 10 List for 2016 when it filed for chapter 11 protection in the Southern District of New York on May 15, 2016, with $4.8 billion in assets and $3.4 billion in debt. Breitburn, once the largest U.S. oil producer organized as a master limited partnership, acquires, exploits, and develops oil, natural gas liquids (NGLs), and natural gas properties in the Midwestern U.S., Ark-La-Tex, the Permian Basin, the Mid-Continent, the Rockies, the Southeastern U.S., and California. Another victim of plunging oil prices and an unsustainable debt load, the company joined a crowd of oil and gas firms in bankruptcy.

HIGHLIGHTS OF 2016

April 3—A group of news media outlets publishes articles based on 11.5 million leaked documents from a Panamanian law firm that helped some of the world's wealthiest people—including politicians, athletes, and business moguls—establish offshore bank accounts. The "Panama Papers" reveal the offshore accounts of 140 politicians and public officials, including a dozen current and former world leaders. The leak includes emails, financial spreadsheets, passport information, and corporate records from 1977 through the end of 2015.

Hamilton, Bermuda-based oil and natural gas producer ***Energy XXI Ltd.*** ("Energy XXI") trickled into the No. 6 spot on the Top 10 List when it filed for chapter 11 protection on April 14, 2016, in the Southern District of Texas with $4.7 billion in assets and $3.6 billion in debt. Energy XXI engages in the acquisition, exploration, development, and operation of oil and natural gas properties onshore in Louisiana and Texas and offshore on the Gulf of Mexico. Energy XXI filed for bankruptcy to implement a prenegotiated chapter 11 plan that would eliminate substantially all of its debt by means of a debt-for-equity swap. The bankruptcy court confirmed Energy XXI's chapter 11 plan on December 13, 2016.

Indianapolis, Indiana-based short-haul carrier ***Republic Airways Holdings Inc.*** ("Republic") taxied into the No. 7 position on the Top 10 List for 2016 when it filed for chapter 11 protection in the Southern District of New York on February 25, 2016, with $3.5 billion in assets and $3.6 billion in debt. Republic operates a fleet of smaller planes that provide flights for larger airlines, including American Airlines Group Inc. ("American"), Delta Air Lines Inc., and United Continental Holdings Inc. Republic's bankruptcy filing is the first by a major airline since American filed for chapter 11 in 2011. Republic blamed its failure to succeed on a pilot shortage and the grounding of planes during its negotiation of labor contracts and agreements with larger carriers. Key features of a proposed chapter 11 plan filed by Republic on November 16, 2016, include reinstatement of its secured debt, distributions of cash and stock to unsecured creditors, and the extinguishment of old equity. Republic also intends to standardize its operating fleet to a single line of jets, return "out of favor" leased aircraft, and modify codeshare agreements with other airlines.

Houston, Texas-based oil and gas exploration company ***Halcón Resources Corporation*** ("Halcón") drilled its way into the No. 8 position on the Top 10 List for 2016 when it filed for chapter 11 protection on July 27, 2016, in the District of Delaware to implement a prenegotiated restructuring agreement that would eliminate $1.8 billion in debt and $222 million in preferred stock by means of a debt-for-equity swap. Founded in 2011 by legendary wildcatter Floyd C. Wilson, Halcón was a pioneer of the shale oil and gas boom, with operations in the Bakken Shale in North Dakota and the El Halcón in central Texas. The company listed $3.5 billion in assets and $3.1 billion in debt at the time of the filing. The bankruptcy court confirmed Halcón's prenegotiated chapter 11 plan on September 8, 2016.

The No. 9 spot on the Top 10 List for 2016 belonged to Houston, Texas-based offshore drilling rig operator ***Paragon Offshore PLC*** ("Paragon"). Paragon filed for chapter 11 protection on February 14, 2016, in the District of Delaware to implement a prenegotiated restructuring plan that would reduce its debt by approximately $1.1 billion. Paragon listed $3.3 billion in assets and $2.6 billion in debt at the time of the filing. Sinking oil prices slowed Paragon's drilling and production activities. In addition, Paragon's big customers, including Petróleos Mexicanos and Petrobras, cut back their contracts significantly. Paragon proposed a chapter 11 plan that offered bondholders cash and equity in the reorganized company and allowed existing equity holders to retain a 65 percent stake

NEWSWORTHY

Jones Day's ***Business Restructuring & Reorganization Practice*** was named a "Practice Group of the Year 2016" by *Law360*.

Jones Day topped The BTI Consulting Group's "Client Service A-Team" ranking for 2017, which identifies the top law firms for client service through a national survey of corporate counsel. Jones Day is the only law firm to earn "Best of the Best" in all 17 activities in the 16 years BTI has been publishing this report.

Jones Day's ***Business Restructuring & Reorganization Practice*** received a Tier 1 ranking for 2017 in the "Best Law Firms" survey published jointly by *U.S. News & World Report* and *Best Lawyers®*.

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

Sion Richards (London) and ***Ben Larkin (London)*** were recommended as leading individuals in the practice area of Restructuring/Insolvency in the 2017 edition of *Chambers UK: A Client's Guide to the UK Legal Profession*.

Thomas A. Howley (Houston), ***Paul M. Green (Houston)***, ***Jonathan M. Fisher (Dallas)***, and **Cassie Suttle (Dallas)** are part of a team of Jones Day professionals representing Houston, Texas-based oil and gas exploration and production company Shoreline Energy LLC and its affiliates in connection with their chapter 11 filings on November 2, 2016, in the U.S. Bankruptcy Court for the Southern District of Texas.

Scott J. Greenberg (New York), ***Erin N. Brady (Los Angeles)***, ***Michael J. Cohen (New York)***, ***Carl E. Black (Cleveland)***, ***Robert W. Hamilton (Columbus)***, ***Stacey L. Corr-Irvine (New York)***, ***Genna L. Ghaul (New York)***, ***Anna Kordas (New York)***, ***Peter S. Saba (New York)***, and ***William J. Schumacher (Los Angeles)*** are part of a team of Jones Day professionals representing clothing manufacturer and retailer American Apparel LLC in connection with a chapter 11 case filed by the company in the U.S. Bankruptcy Court for the District of Delaware on November 14, 2016. The company recently completed an auction of its brands, other intellectual property, and certain other assets in which Gildan Activewear prevailed with a bid of $103 million.

Richard L. Wynne (Los Angeles) moderated a panel at the American Bankruptcy Institute's Winter Leadership Conference on December 2, 2016, in Rancho Palos Verdes, California. The panel discussion was entitled "Rapid Fire: Strategies for a Quick Reorganization."

Pedro A. Jimenez (Miami and New York), ***Carl E. Black (Cleveland)***, ***Brett P. Barragate (New York)***, ***Heather Lennox (Cleveland and New York)***, ***Erin N. Brady (Los Angeles)***, ***Joshua M. Mester (Los Angeles)***, ***Bruce Bennett (Los Angeles and New York)***, ***Jeffrey B. Ellman (Atlanta)***, ***Brad B. Erens (Chicago)***, ***David G. Heiman (Cleveland)***, ***James O. Johnston (Los Angeles)***, ***Sidney P. Levinson (Los Angeles)***, ***Mark A. Cody (Chicago)***, ***Bennett L. Spiegel (Los Angeles)***, and ***Richard L. Wynne (Los Angeles)*** were recognized in the field of Bankruptcy for 2017 by *Super Lawyers*.

Paul M. Green (Houston) was named a Texas "Rising Star" for 2017 by *Super Lawyers.*

Joseph M. Tiller (Chicago) was named an Illinois "Rising Star" for 2017 by *Super Lawyers*.

An article written by ***Daniel J. Merrett (Atlanta)*** and ***Danielle Barav-Johnson (Atlanta)*** entitled "Taking Stock: United States Supreme Court Presented With Opportunity to Settle Meaning of Section 546(e)" was published in the December 2016 issue of the *Norton Journal of Bankruptcy Law and Practice*.

An article written by ***Brad B. Erens (Chicago)*** and ***Mark G. Douglas (New York)*** entitled "Aéropostale Bankruptcy Court Denies Motion to Equitably Subordinate or Recharacterize Secured Lenders' Claims or to Limit Lenders' Credit Bidding Rights" was published in the January 2017 issue of *Pratt's Journal of Bankruptcy Law*.

An article written by ***Amanda A. Parra Cristie (Miami)*** and ***Mark G. Douglas (New York)*** entitled "Court Adopts Majority View in Sanctioning Bankruptcy Trustee's Use of Tax Code Look-Back Period in Avoidance Actions" was published in the January 2017 edition of *Pratt's Journal of Bankruptcy Law*.

An article written by ***Veerle Roovers (New York)*** and ***Mark G. Douglas (New York)*** entitled "Modification of Chapter 15 Recognition Order Warranted to Avoid Prejudice to U.S. Creditors" was published in the January 2017 issue of *Pratt's Journal of Bankruptcy Law*.

An article written by ***Aaron M. Gober-Sims (Cleveland)*** entitled "Common Interest Doctrine: NY's Restrictive Interpretation Unlikely to Have Significant Bankruptcy Impact" was published in the December 2016 edition of *The Bankruptcy Strategist*.

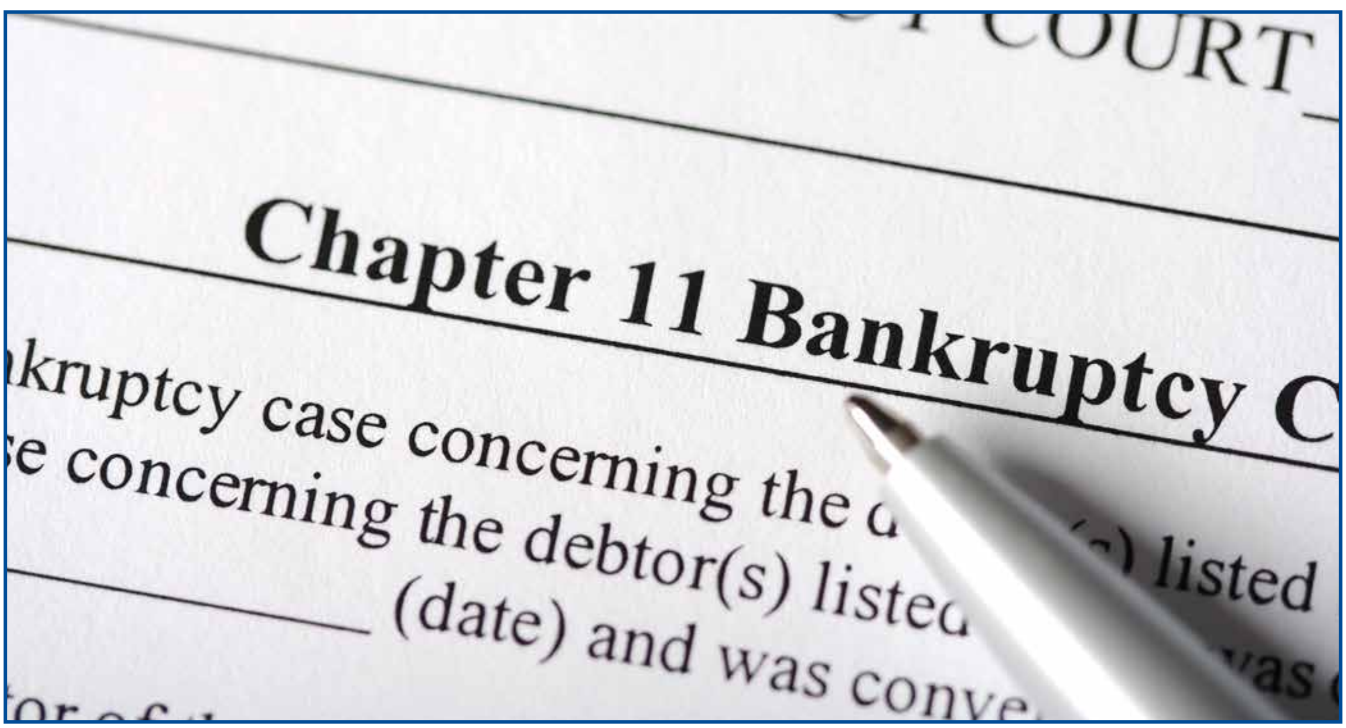
in the company. The bankruptcy court denied confirmation of Paragon's plan on October 28, 2016, ruling that the plan was not feasible because it drained too much cash from the company to allow it to survive the current downturn in the oil and gas industry.

Oklahoma City, Oklahoma-based oil and gas producer ***SandRidge Energy, Inc.*** ("SandRidge") trickled into the final spot on the Top 10 List for 2016 when it filed for chapter 11 protection on May 16, 2016, in the Southern District of Texas to implement a prenegotiated $3.7 billion debt-for-equity swap. SandRidge listed $3 billion in assets and $4.4 billion in debt at the time of the filing; the company engages in the exploration, development, and production of crude oil, natural gas, and NGLs in Oklahoma and Kansas. The bankruptcy court confirmed SandRidge's chapter 11 plan on September 9, 2016.

Other notable debtors (public, private, and foreign) in 2016 included the following:

Hanjin Shipping Co., Ltd. ("Hanjin"), the world's ninth-largest container shipping company worldwide and No. 1 in South Korea, with a fleet of 100 container vessels. The foreign representative of Hanjin, a victim of global overcapacity and high debt, filed a petition on September 2, 2016, in the District of New Jersey, seeking recognition under chapter 15 of the company's South Korean reorganization proceedings. The filing was part of a worldwide effort (which also included legal proceedings in Canada, the U.K., Germany, Japan, Spain, Singapore, Belgium, Italy, Australia, and France, among other countries) to stop creditors from seizing Hanjin's vessels. The petition listed $5.9 billion in assets and $5.4 billion in debt. After the filings, Hanjin drastically reduced its fleet in an effort to streamline the company. The bankruptcy court entered an order on December 14, 2016, recognizing Hanjin's South Korean reorganization proceedings under chapter 15.

Singapore-based ***China Fishery Group Limited*** ("China Fishery"), which through its subsidiaries sources, harvests, onboard-processes, and delivers fish worldwide. China Fishery filed for chapter 11 protection in the Southern District of New York on June 30, 2016, with $2.6 billion in assets and $2.5 billion in debt, to prevent creditors from selling off the company's assets at fire-sale prices. China Fishery and its subsidiaries are part of the Pacific Andes Group, the world's 12th-largest seafood company and one of the world's largest producers of fish meal and fish oil. On October 28, 2016, the bankruptcy court appointed a chapter 11 trustee for China Fishery, concluding that creditors had justifiably lost confidence in its



management and that the debtors' prospects for rehabilitation under existing management were "problematic, if not dim."

Oilfield helicopter services company ***CHC Group Ltd.*** ("CHC"), the parent company of Vancouver, British Columbia-based CHC Helicopter, which filed for chapter 11 protection on May 5, 2016, in the Northern District of Texas with $2.3 billion in assets and $2 billion in debt. Yet another company reeling from the downturn in oil prices and reduced demand for its logistics services, CHC filed for bankruptcy shortly after the company grounded much of its fleet following a crash of one of its helicopters in Norway that killed two pilots and 11 oil workers returning to the Norwegian mainland.

HIGHLIGHTS OF 2016

April 3—The U.S. Treasury Department imposes tough new curbs on corporate inversions. The new rules will make it harder for companies to move their tax addresses out of the U.S. and then shift profits to low-tax countries, a maneuver known as "earnings stripping."

Dallas, Texas-based Yellow Pages publisher ***Dex Media, Inc.*** ("Dex"), which filed for chapter 11 protection for the third time in seven years on May 16, 2016, in the District of Delaware to implement a prepackaged chapter 11 plan. Tracing its roots to 1917 and R.H. Donnelly Co., publisher of the first Yellow Pages business directory, Dex (then known as Dex One Corp.) exited its first bankruptcy in 2009. It later merged with its rival SuperMedia Inc. in dual-track chapter 11 cases filed in 2013. The combined companies, with 3,100 employees and assets valued at $1.3 billion, struggled due to falling print revenues and the burdens of high-cost, legacy information technologies. Dex emerged from bankruptcy as a private company on July 29, 2016, after the bankruptcy court confirmed a chapter 11 plan that eliminated $1.8 billion in debt by means of a debt-for-equity swap.

Spanish alternative energy producer ***Abengoa SA*** ("Abengoa"), a Seville-based clean energy and environmental sustainability engineering company with 35,000 employees in 50 countries. The foreign representatives of Abengoa and 24 Spanish affiliates filed petitions on March 28, 2016, in the District of Delaware, seeking recognition under chapter 15 of a Spanish insolvency proceeding in which Abengoa is attempting to restructure $16.5 billion in debt and thereby avoid the largest Spanish bankruptcy ever. The bankruptcy court entered an order recognizing the proceeding on April 27, 2016. The threat of involuntary bankruptcy prompted other U.S. affiliates of Abengoa to file chapter 11 petitions. These included Chesterfield, Missouri-based ethanol plant operator ***Abengoa Bioenergy US Holding, LLC***, which filed for chapter 11 protection in the Eastern District of Missouri, and construction and engineering firm ***Abeinsa Holding Inc.*** ("Abeinsa"). Abeinsa and nearly 20 affiliates filed chapter 11 cases in the District of Delaware on March 29, 2016. The bankruptcy court confirmed the companies' joint plans of reorganization and liquidation on December 14, 2016.

Privately held, Englewood, Colorado-based sporting goods retailer ***Sports Authority, Inc.*** ("Sports Authority"), which filed for chapter 11 protection on March 2, 2016, in the District of Delaware with $1.1 billion in debt and intentions to find a buyer after closing 140 of its 463 stores. Leonard Green & Partners L.P. bought Sports Authority, once the largest sporting goods chain in the U.S., in a $1.3 billion leveraged buyout in 2006. Since the buyout, rival Dick's Sporting Goods Inc. ("Dick's") added hundreds of locations, but Sports Authority's debt load hampered its ability to expand or innovate. The big-box chain also struggled with a shift to online shopping. Sports Authority ultimately was forced to sell its retail assets to liquidators, which conducted going-out-of-business sales beginning in May 2016. Dick's acquired Sports Authority's intellectual property, including its brand name, as well as more than 30 stores at a bankruptcy auction in June 2016.

Brazilian telecommunications company ***Oi SA*** ("Oi"), which filed the largest bankruptcy case in Brazil's history on June 20, 2016, after a $19 billion out-of-court restructuring proposal collapsed. The foreign representatives of Oi and several affiliates filed petitions seeking chapter 15 recognition of the Brazilian restructuring proceeding on June 21, 2016, in the Southern District of New York. The bankruptcy court entered an order recognizing the restructuring on July 22, 2016. Oi, Brazil's fourth-largest telecom, with more than 74 million customers and 142,000 employees, ascribed its financial woes to Brazil's deep recession and corruption scandals that have hurt foreign investment and crippled the Brazilian capital markets. The company was also caught off guard by a rapid shift in demand from fixed-line telephone service to more profitable mobile service.

Privately owned ***Modular Space Corp.*** ("ModSpace"), a Berwyn, Pennsylvania-based manufacturer of office and construction trailers, portable storage solutions, classrooms, and other temporary structures. ModSpace filed a restructuring proceeding in Toronto and a chapter 11 case in the District of Delaware on December 21, 2016, to restructure more than $1 billion in long-term debt by means of a prepackaged chapter 11 plan providing for a debt-for-equity swap. ModSpace was hurt by the slowdown in the oil and gas and mining sectors, as well as the diminished volume of nonresidential construction. ModSpace listed $1.3 billion in assets and more than $1 billion in debt at the time of the filings.

Performance Sports Group Ltd. ("Performance"), maker of the Bauer hockey and Easton baseball equipment brands, which filed for chapter 11 protection in the District of Delaware on October 31, 2016, with plans to auction its assets. New Hampshire-based Performance, which also filed a bankruptcy case in Canada, stated that the filing was due to high-profile bankruptcies of its retail customers, weakness in the baseball and softball equipment market, and the relative strength of the U.S. dollar, which reduced profitability in overseas markets. The bankruptcy filings came just months after Performance revealed that it was under investigation by securities regulators in Canada and the U.S. for accounting irregularities.

HIGHLIGHTS OF 2016

April 11—The *Financial Times* reports that the U.S. public pension system has developed a $3.4 trillion funding hole that will pressure cities and states to cut spending or raise taxes to avoid Detroit-style bankruptcies. The collective funding shortfall of U.S. public pension funds is three times larger than official figures showed and is getting bigger.

Carmel, Indiana-based for-profit college operator ***ITT Educational Services Inc.*** ("ITT"). ITT filed a chapter 7 case on September 16, 2016, in the Southern District of Indiana after closing 136 technical schools and leaving more than 35,000 students stranded in one of the largest college shutdowns in U.S. history. The 50-year-old company, which had campuses in 38 states, was forced to close its doors after the U.S. Department of Education demanded a steep increase in the security the company was required to post to guarantee federal student aid. More than 8,000 employees were also affected by the shutdown, with the majority losing their jobs. The U.S. Securities and Exchange Commission brought fraud claims against ITT in 2015 for allegedly concealing major losses in two student loan programs. In addition, the Consumer Financial Protection Bureau sued the company in 2014, accusing it of overstating students' job prospects and potential salaries and then pushing them into high-cost private loans that were likely to end in default.

LEGISLATIVE/REGULATORY DEVELOPMENTS

PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT

On June 30, 2016, President Obama gave his imprimatur to the Puerto Rico Oversight, Management, and Economic Stability Act, Pub. L. No. 114-187 (2016) ("PROMESA"). The bipartisan legislation was approved by both houses of Congress in a flurry of legislative dealmaking that preceded a July 1, 2016, deadline for Puerto Rico to make $2 billion in bond payments. The enactment of PROMESA followed a June 13, 2016, ruling by the U.S. Supreme Court that upheld lower court rulings declaring unconstitutional a 2014 law (portions of which mirrored chapter 9 of the Bankruptcy Code) that would have allowed the commonwealth's public instrumentalities to restructure a significant portion of Puerto Rico's bond debt (widely reported to be as much as $72 billion). *See Commonwealth v. Franklin Cal. Tax-Free Tr.*, 136 S. Ct. 1938 (2016). PROMESA provides for, among other things, the establishment of an oversight board entrusted with determining the adequacy of budgets and fiscal plans for the instrumentalities of Puerto Rico and other covered territories. It also provides a mechanism for the implementation of voluntary out-of-court restructuring agreements between an instrumentality and its bondholders as well as bond debt adjustment plans (consensual and nonconsensual) in a case commenced in federal district court.

CHANGES TO THE U.S. BANKRUPTCY RULE AND OFFICIAL BANKRUPTCY FORMS

Changes and one addition to the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and the Official Bankruptcy Forms became effective on December 1, 2016. The changes affecting business and international bankruptcy cases include the following:

- **Cross-Border Bankruptcy Cases.** Rule 1010(a) and Rule 1011(a) and (f) were amended to remove chapter 15 petition and responsive pleading procedures, which are now contained in new Rule 1012. Rule 2002(q) was amended to clarify notice procedures in cross-border cases.

- **Jurisdiction.** Rules 7008, 7012(b), 7016(a) and (b), 9027 and 9033 were amended to remove the distinction between "core" and "non-core" matters. Parties are now required to state whether they consent to the entry of final orders or judgment by the bankruptcy court in all adversary proceedings, not merely in "non-core" matters. The amendments provide that the court shall decide, on the request of a party-in-interest or *sua sponte*, whether to: (i) hear and determine a proceeding; (ii) hear a proceeding and issue proposed findings of fact and conclusions of law; or (iii) take some other action.

- **Service/Computation of Time.** Rule 9006(f) was amended to eliminate the three days formerly added to the time to respond if service was made by electronic means.

The Judicial Conference Advisory Committee on Bankruptcy Rules has proposed additional amendments to the Bankruptcy Rules and the Official Bankruptcy Forms and has 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 at http://www.uscourts.gov/rules-policies/proposed-amendments-published-public-comment. Comments on the proposed amendments must be submitted no later than February 15, 2017.

HIGHLIGHTS OF 2016

June 2—Credit ratings agency Fitch reports that the amount of debt globally yielding below zero has passed $10 trillion (£6.9 trillion) for the first time in history.

EUROPEAN COMMISSION PROPOSAL FOR DIRECTIVE ON PREVENTIVE RESTRUCTURING FRAMEWORKS

On November 22, 2016, the European Commission published a Proposal for a Directive on preventive restructuring frameworks; second-chance measures; and measures to increase the efficiency of restructuring, insolvency, and discharge procedures. The proposed Directive sets out a number of legal principles and a series of more detailed minimum rules that would have to be adopted by Member States as part of their restructuring and insolvency laws. Among these rules are the following: (i) debtors should remain fully or partly in possession during bankruptcy or insolvency cases; (ii) the appointment of an insolvency practitioner should not be mandatory; (iii) the court or administrative authority shall have the power to stay creditor enforcement actions, other than actions by

employees to collect nonstate guaranteed obligations, for up to one year, including actions to terminate essential "executory" contracts; (iv) restructuring plans can be consensual or confirmed by a judicial or administrative authority over the objections of dissenting creditors or equity holders under certain circumstances; and (v) new rescue financing or interim financing extended during a restructuring should be excluded from anti-avoidance laws (other than in cases of fraud or bad faith) and rank senior in priority to the claims of unsecured creditors.

The proposed Directive, once made, will need to be enacted by Member States within two years of its entry into force (subject to certain longer-dated exceptions).

SWISS INTERNATIONAL INSOLVENCY LAW REFORMS

In October 2015, the Swiss Federal Department of Justice and Police (*Eidgenössisches Justiz- und Polizeidepartement*) published a preliminary draft of reforms to title 11 of the Swiss Private International Law Act ("SPILA"), which governs insolvency proceedings and compensation proceedings (Articles 166–175 rev-SPILA), together with an explanatory report. The consultation procedure for the proposed reforms culminated on February 5, 2016. The preliminary draft was intended to improve existing rules, including procedures governing recognition by Swiss courts of foreign bankruptcy and insolvency cases along the lines of the procedures set forth in the 1997 UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"). Although the Model Law has now been enacted by 41 nations or territories, Switzerland has not adopted the legislation.

INDIAN BANKRUPTCY REFORMS

On May 11, 2016, India's parliament (*Lok Sabha*) passed a bill—the Insolvency and Bankruptcy Code (2016)—to overhaul the country's archaic bankruptcy laws. The bill was signed into law on May 28, 2016, by Indian Prime Minister Narendra Modi. The law unifies more than four overlapping sets of rules. It is intended to expedite decisions on whether to rehabilitate or liquidate ailing companies, in a move to curb asset stripping and ensure higher recovery rates for creditors, both of which are key to fostering a modern credit market and increased investment in India. The new law includes provisions: (i) entrusting the resolution process to insolvency professionals; (ii) establishing creditors' committees that will participate in bankruptcy cases; and (iii) ending government involvement that has created decades of judicial gridlock.

DECREE TO PROMOTE EFFICIENCY OF ITALIAN INSOLVENCY PROCEEDINGS

The Italian government has recently focused on reforming the Italian lending market, with the aim of boosting access to financing for Italian businesses and improving bankruptcy and enforcement proceedings. As part of this reform process, the Italian Council of Ministers enacted Decree No. 59 of 3 May 2016 (the "Decree"). The Decree introduced measures designed to, among other things: (i) create a new form of security—a "non-possessory pledge," or floating charge; (ii) establish the "*patto marciano*" agreement, which permits extrajudicial foreclosure on real property collateral; and (iii) expedite and improve the efficiency of enforcement and insolvency proceedings. The Decree was later amended and converted into law by Law No. 119/2016, which came into force in November 2016.

UNITED KINGDOM LEGISLATION TO EXPEDITE RECOVERY FROM INSOLVENT DEBTOR'S LIABILITY INSURERS

On August 1, 2016, six years after it received Royal Assent, the U.K. Third Parties (Rights against Insurers) Act 2010 (the "2010 Act") finally came into force. The 2010 Act provides a more effective mechanism for third-party claimants to seek recovery directly from an insolvent debtor's liability insurers. It supersedes the U.K. Third Parties (Rights against Insurers) Act 1930, which provided for a statutory assignment to a third-party claimant of an insolvent debtor's rights to claim against its liability insurer, but it proved cumbersome because it required two separate sets of proceedings. Under the 2010 Act, the claimant can simply sue the defendant's insurers directly, while at the same time seeking a declaration of the insured defendant's liability in that single set of proceedings.

NOTABLE BUSINESS BANKRUPTCY RULINGS OF 2016

ALLOWANCE OF CLAIMS—MAKE-WHOLE PREMIUMS

After filing for bankruptcy, Energy Future Holdings Corp. ("EFH") proposed to refinance first- and second-lien notes without paying "make-whole" premiums provided for in the governing indentures designed to compensate the noteholders for early repayment of their notes. Aligning itself with a number of Southern District of New York courts (*see In re MPM Silicones, LLC*, 2014 BL 250360 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015)), the Delaware bankruptcy court ruled in 2015 that, although EFH had repaid the bonds prior to maturity, make-whole premiums were not payable under the bond indentures because the plain language of the indentures did not require the payment of a make-whole premium following a bankruptcy acceleration. The court also held that EFH's repayment of the bonds was not an "optional redemption" because, under New York law, a borrower's repayment after acceleration is not considered "voluntary." *See Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 527 B.R. 178 (Bankr. D. Del. 2015); *Computershare Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 539 B.R. 723 (Bankr. D. Del. 2015).

The bankruptcy court later denied the noteholders' request for retroactive relief from the automatic stay to rescind the acceleration and demand payment of the make-whole premiums. *See Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 533 B.R. 106 (Bankr. D. Del. 2015). Those rulings were upheld on appeal to the district court in early 2016. *See Computershare Trust Co. v. Energy Future Intermediate Holding Co. (In re Energy Future Holdings Corp.)*, 2016 BL 113612 (D. Del. Apr. 11, 2016); *Del. Trust Co. v. Energy Future Intermediate Holding Co. (In re Energy Future Holdings Corp.)*, 2016 BL 42871 (D. Del. Feb. 16, 2016).

In a highly anticipated ruling, the Third Circuit reversed, thereby obligating EFH to pay noteholders approximately $800 million in make-whole premiums and invalidating one of the cornerstones of EFH's confirmed chapter 11 plan. *See Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy*

Future Holdings Corp.), 842 F.3d 247 (3d Cir. 2016). The court concluded, among other things, that EFH's refinancing of the notes after filing for bankruptcy was a voluntary redemption under the terms of the indentures. In so ruling, the court created a rift between courts in the Second and Third Circuits on this issue. On December 15, 2016, EFH asked the Third Circuit to reconsider its ruling, arguing that the decision clashes with rulings from the Southern District of New York and that the question should be certified to the New York Court of Appeals. A more detailed discussion of the ruling can be found elsewhere in this issue of the *Business Restructuring Review*.

AVOIDANCE ACTIONS—SAFE HARBORS

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 cert. filed*, 85 U.S.L.W. 3095 (U.S. Sept. 9, 2016), 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.

In *Whyte v. Barclays Bank PLC*, 644 Fed. Appx. 60, 2016 BL 90805 (2d Cir. Mar. 24, 2016), *petition for cert. filed*, 85 U.S.L.W. 3077 (U.S. August 19, 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) of the Bankruptcy Code also "impliedly preempts" a chapter 11 plan litigation trustee from bringing state law fraudulent transfer actions seeking to avoid swap transactions. Section 546(g) prevents a trustee from avoiding a transfer under or in connection with a swap agreement unless the transfer is made with the intent to hinder, delay, or defraud creditors.

While *Tribune* resolved a split on this issue within the Second Circuit, 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). The *Tribune* and *Physiotherapy* holdings represent differing views by sophisticated courts on the breadth of section 546(e) and its preemptive scope.

In *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690 (7th Cir. 2016), the Seventh Circuit ruled that the section 546(e) safe harbor 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 and may be a candidate for review by the U.S. Supreme Court to resolve the issue.

AVOIDANCE ACTIONS—FRAUDULENT TRANSFERS

In *In re SemCrude, L.P.*, 648 Fed. Appx. 205, 2016 BL 135006 (3d Cir. Apr. 29, 2016), the Third Circuit addressed the meaning of "unreasonably small capital" in the context of constructive fraudulent transfer avoidance litigation. It affirmed a district court decision upholding a bankruptcy court's rulings that: (i) a debtor can have unreasonably small capital even if it is solvent; and (ii) a "reasonable foreseeability" standard should be applied in assessing whether capitalization is adequate.

> **HIGHLIGHTS OF 2016**
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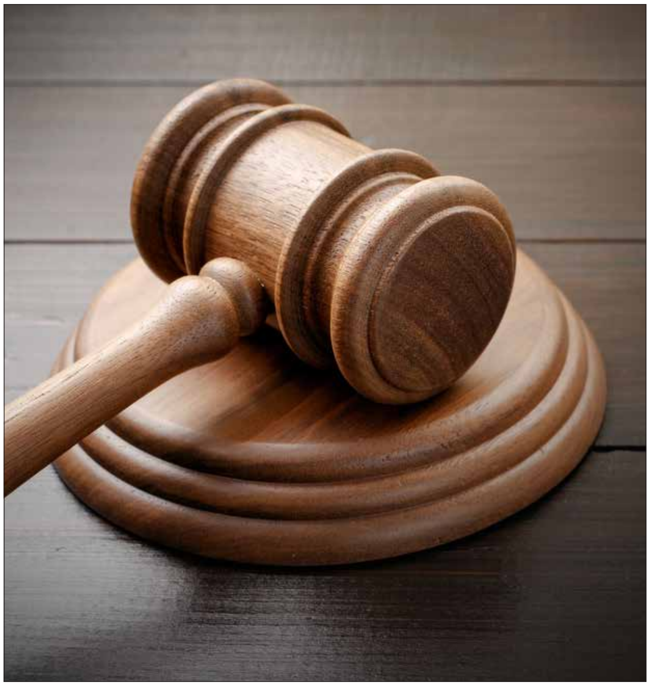
> **June 23—**In a historic referendum, Britain votes to leave the EU by 52 percent to 48 percent. Not long after the vote, Prime Minister David Cameron, who led the campaign to remain in the bloc, announces that he plans to step down. If "Brexit" actually occurs, Britain will become the first country to leave the 28-member bloc, which has been increasingly weighed down by its failures to deal fully with a succession of crises, from the financial collapse of 2008 to a resurgent Russia and the huge influx of migrants in 2015.

The Second Circuit handed down a ruling reaffirming these basic concepts in *Adelphia Recovery Trust v. FPL Grp., Inc. (In re Adelphia Commc'ns Corp.)*, 652 Fed. Appx. 19, 2016 BL 190083 (2d Cir. June 15, 2016). In *Adelphia*, the Second Circuit affirmed lower court rulings that the assets of defunct cable services provider Adelphia Communications Corp. ("Adelphia") were not "unreasonably small" within the meaning of Pennsylvania's



version of the Uniform Fraudulent Transfer Act when Adelphia repurchased its stock in 1999. The court concluded that the "unreasonably small" test focuses on reasonable foreseeability and that the test is met if the debtor shows it had such minimal assets that insolvency was "inevitable in the foreseeable future." The court also determined that, although insolvency and unreasonably small capital are analytically distinct, the concepts overlap and "adequacy of capital is typically a major component of any solvency analysis."

In *Weisfelner v. Hofmann (In re Lyondell Chem. Co.)*, 554 B.R. 635 (S.D.N.Y. 2016), *motion for reconsideration or certification denied*, 2016 BL 332813 (S.D.N.Y. Oct. 5, 2016), the district court reversed a bankruptcy court ruling dismissing 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 Chemical Company ("Lyondell") in connection with its 2007 LBO. The bankruptcy court ruled that: (i) the trustee did not adequately allege that Lyondell had incurred debt and transferred the payments to shareholders with "actual intent" to hinder, delay, or defraud its creditors, as required by section 548(a)(1)(A) of the Bankruptcy Code; 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." The court also held that the trustee adequately pleaded that Lyondell had made the transfers to its shareholders with the intent to hinder, delay, or defraud creditors.

One limitation on a bankruptcy trustee's avoidance powers is the statutory "look-back" period during which an allegedly fraudulent transfer can be avoided—two years prior to the bankruptcy filing for fraudulent transfer avoidance actions under section 548 of the Bankruptcy Code and, as generally understood, three to six years if the trustee or debtor-in-possession seeks to avoid a fraudulent transfer under section 544(b) and state law by stepping into the shoes of a "triggering" creditor plaintiff. 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 Internal Revenue Service (a creditor in the *Kipnis* case), which is bound not by Florida law, but by the 10-year statute of limitations for collecting taxes specified in the Internal Revenue Code.

BANKRUPTCY SETTLEMENTS

In *In re Energy Future Holdings Corp.*, 648 Fed. Appx. 277, 2016 BL 142290 (3d Cir. May 4, 2016), *cert. denied*, 196 L. Ed. 2d 336 (U.S. 2016), the Third Circuit ruled that a tender offer may be used to implement a classwide debt exchange in bankruptcy outside a plan of reorganization. It also held that the Bankruptcy Code's confirmation requirements do not apply to a pre-confirmation settlement and that the settlement was not "inconsistent with the equal treatment rule." Finally, the Third Circuit ruled that the settlement at issue did not constitute a *sub rosa* chapter 11 plan. In so ruling, the *Energy Future* courts rejected the reasoning of other courts that have applied certain chapter 11 plan confirmation requirements—such as the "absolute priority rule"—to pre-confirmation settlements.

CHAPTER 11 PLANS—IMPAIRMENT, CLASSIFICATION OF CLAIMS, AND GOOD FAITH

One of the prerequisites to confirmation of any chapter 11 plan is section 1129(a)(10) of the Bankruptcy Code's mandate that at least one "impaired" class of creditors must vote in favor of the plan. In *Village Green I, GP v. Federal National Mortgage Association (In re Village Green I, GP)*, 811 F.3d 816 (6th Cir. 2016), the Sixth Circuit joined the Fifth and Ninth Circuits in ruling that artificial impairment—creating an immaterially impaired class for the purpose of obtaining confirmation—does not preclude a plan from satisfying the impaired class acceptance requirement, but instead is relevant in determining whether the debtor has proposed a chapter 11 plan in good faith.

CHAPTER 11 PLANS—CURE OF DEFAULTS

In 1994, Congress amended the Bankruptcy Code to add section 1123(d), which provides that, if a chapter 11 plan proposes to "cure" a default under a contract, the cure amount must be determined in accordance with the underlying agreement and applicable nonbankruptcy law. Since then, a majority of courts have held that such a cure amount must include any default-rate interest required under either the contract or applicable nonbankruptcy law.

HIGHLIGHTS OF 2016

June 26—The expanded Panama Canal formally opens, following a $5.4 billion project to double the capacity of the waterway that took nine years to complete. The opening of the expansion comes at a difficult time for the shipping industry, given the downturn in global trade levels and the economic slowdown in China, the canal's second-biggest user after the U.S.

Until 2016, courts in the Ninth Circuit adhered to a contrary approach articulated nearly three decades ago (well before the enactment of section 1123(d)) in *Great Western Bank & Trust v. Entz-White Lumber and Supply, Inc. (Entz-White Lumber and Supply, Inc.)*, 850 F.2d 1338 (9th Cir. 1988). However, the primacy of *Entz-White* in the Ninth Circuit finally ended in 2016. In *In re New Invs., Inc. (Pacifica L 51 LLC v. New Invs., Inc)*, 840 F.3d 1137 (9th Cir. 2016), a divided three-judge panel of the Ninth Circuit held that "*Entz-White*'s rule of allowing a curing debtor to avoid a contractual post-default interest rate in a loan agreement is no longer valid in light of § 1123(d)." A more detailed discussion of *New Investments* can be found elsewhere in this edition of the *Business Restructuring Review*.

CROSS-BORDER RESTRUCTURINGS—EXTRATERRITORIALITY OF AVOIDANCE POWERS

In *Weisfelner v. Blavatnik (In re Lyondell)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016), the court refused to dismiss a claim seeking avoidance of a fraudulent transfer under section 548 of the Bankruptcy Code on the ground that the challenged transfer had occurred outside the U.S. The court reasoned that Congress could not have intended to exclude extraterritorial transfers from avoidance under section 548 while explicitly defining property of the bankruptcy estate under section 541 to include all of the debtor's property "wherever located and by whomever held." Thus, the court explained, evidence from the context of section 548 that Congress intended for it to apply extraterritorially rebutted the "presumption against extraterritoriality."

CROSS-BORDER RESTRUCTURINGS—MODIFICATION OF RECOGNITION ORDER

In *In re Sanjel (USA) Inc.*, 2016 BL 246261 (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 in pending U.S. district court litigation. In so ruling, the court rejected the argument, based on *In re Nortel Networks Corp.*, 2013 BL 317273 (D. Del. Nov. 15, 2013), that the plaintiffs would not be prejudiced because they could seek relief from the Canadian court. According to the *Sanjel* court, it would be "unreasonable and exceedingly burdensome" to require the plaintiffs to seek a Canadian court's permission to pursue claims in the U.S. district court "based wholly on a statutory right created by United States law to protect employees within the United States."

CROSS-BORDER RESTRUCTURINGS—CHAPTER 15 ELIGIBILITY

In *In re Creative Finance Ltd. (In Liquidation)*, 2016 BL 8825 (Bankr. S.D.N.Y. Jan. 13, 2016), the court denied recognition of a British Virgin Islands ("BVI") liquidation commenced as part of a scheme to avoid paying a U.K. judgment. The court ruled that the debtors' foreign representative failed to demonstrate that the debtors' "center of main interests" was in the BVI—either at the time of the filing of the liquidation or because of the liquidator's post-filing activities—or even that the debtors had an "establishment" in the BVI. Moreover, in so ruling, the court emphasized that "[f]rom beginning to end, . . . [the] tactics [of the debtors' principal] were a paradigmatic example of bad faith, and the [BVI] Liquidator's actions—and inaction—facilitated them."

BANKRUPTCY REMOTENESS—BLOCKING PROVISIONS

A contractual waiver of an entity's right to file for bankruptcy is generally invalid as a matter of public policy. Nonetheless, lenders sometimes attempt to prevent a borrower from seeking bankruptcy protection by conditioning financing on a covenant, bylaw, or corporate charter provision that restricts the power of the borrower's governing body to authorize such a filing. In *In re Lake Mich. Beach Pottawattamie Resort LLC*, 2016 BL 109205 (Bankr. N.D. Ill. Apr. 5, 2016), the court held that one such restriction in the membership agreement of a limited liability company—a lender-designated "special member" with the power to block a bankruptcy filing—was unenforceable because it did not require the member to comply with his fiduciary obligations under applicable nonbankruptcy law.

In *In re Intervention Energy Holdings, LLC*, 553 B.R. 258 (Bankr. D. Del. 2016), the court held invalid as a violation of federal public policy a provision in a limited liability company governance document, "the sole purpose and effect of which is to place into the hands of a single, minority equity holder [by means of a 'golden share'] the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief."

EXECUTORY CONTRACTS—ASSUMPTION, REJECTION, AND ASSIGNMENT

In *In re Trump Entm't Resorts*, 810 F.3d 161 (3d Cir. 2016), *cert. denied*, 136 S. Ct. 2396 (2016), the Third Circuit answered a question of apparent first impression by ruling that section 1113 of the Bankruptcy Code permits a bankruptcy trustee or chapter 11 debtor-in-possession to reject a collective bargaining agreement even after the agreement has expired. Lower courts have been divided over whether such terminated contracts can be rejected or if the surviving terms of an expired bargaining agreement continue in force until a new agreement is executed.

HIGHLIGHTS OF 2016

June 30—President Obama signs the Puerto Rico Oversight, Management, and Economic Stability Act, which is intended to provide fiscal stability and oversight to Puerto Rico (among other territories), as well as a mechanism for restructuring the debts of instrumentalities that was patterned on chapter 9 of the U.S. Bankruptcy Code.

In *In re Sabine Oil & Gas Corp.*, 547 B.R. 66 (Bankr. S.D.N.Y. 2016), the court permitted the debtor to reject gas gathering and handling agreements governed by Texas law. The court held that the debtor's rejection of the midstream agreements was a proper exercise of business judgment, but it also determined that the related questions of Texas real property law were not properly before the court because it could not adjudicate the issues in the context of a motion to reject an executory contract.

Subsequently, in *Sabine Oil & Gas Corp. v. HPIP Gonzales Holdings, LLC (In re Sabine Oil & Gas Corp.)*, 550 B.R. 59 (Bankr. S.D.N.Y. 2016), the court held that the covenants in the rejected midstream gathering agreements did not run with the land either as real covenants or as equitable servitudes. The court concluded, among other things, that, in accordance with Texas law, the covenants in the agreements did not "touch and concern" the debtor's real property. The court also ruled that the covenants at issue did not limit the use of or burden the debtor's mineral estate such that they could run with the land as equitable servitudes because the agreements were fundamentally service contracts relating to the debtor's personal property.

EXECUTORY CONTRACTS—TRADEMARK LICENSE AGREEMENTS

In *Mission Prod. Holdings, Inc. v. Tempnology LLC (In re Tempnology LLC)*, 559 B.R. 809 (B.A.P. 1st Cir. 2016), a bankruptcy appellate panel for the First Circuit reversed the ruling of a bankruptcy court, relying on *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers Inc.)*, 756 F.2d 1043 (4th Cir. 1985), that trademark license rights were not protected by section 365(n) of the Bankruptcy Code because trademarks are not included in the Bankruptcy Code's definition of "intellectual property." The panel, finding that the bankruptcy court's reliance on *Lubrizol* was flawed, instead adopted the Seventh Circuit's interpretation of the effect of rejection of an executory trademark license in *Sunbeam Prods., Inc. v. Chicago Am. Manuf., LLC*, 686 F.3d 372 (7th Cir. 2012), *cert. denied*, 133 S. Ct. 790 (2012). In *Sunbeam*, the Seventh Circuit held that when a trademark license is rejected in bankruptcy, the licensee does not lose the ability to use the licensed intellectual property.

LENDER LIABILITY

In *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 724 F.3d 129 (1st Cir. 2013), the First Circuit held 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 ("ERISA") for the multi-employer pension plan withdrawal liability incurred by one of its portfolio companies.

However, the First Circuit remanded the case to the district court to determine: (i) whether a related private equity fund was also a trade or business under ERISA; and (ii) whether 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. On remand, the district court concluded in *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 172 F. Supp. 3d 447 (D. Mass. 2016), that the answer to both of these questions is yes. The ruling was appealed to the First Circuit.

HIGHLIGHTS OF 2016

July 13—Theresa May succeeds David Cameron as Prime Minister of Britain and will preside over negotiations for Brexit during the next two years.

In *Czyzewski v. Jevic Transp., Inc. (In re Jevic Holding Corp.)*, 2016 BL 241827 (3d Cir. July 27, 2016), the Third Circuit ruled that a private equity fund and its subsidiary did not constitute a "single employer" for the purpose of assessing potential liability under the Worker Adjustment and Retraining Notification Act (the "WARN Act") and its New Jersey counterpart. The Third Circuit held, 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 for purposes of WARN Act liability.

In *In re Aéropostale, Inc.*, 2016 BL 279439 (Bankr. S.D.N.Y. Aug. 26, 2016), the court denied motions by the debtors to: (i) equitably subordinate the secured claim 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' secured claim as equity. According to the court, the lender acted reasonably in imposing new credit terms after a minimum liquidity threshold was triggered under their credit agreement. The court also found that the allegation that the lenders had a secret plan to push the debtors into bankruptcy and buy them "on the cheap" was "not credible." Finally, the court ruled that there was no basis to limit the lenders' credit bidding rights

due to the absence of any evidence of inappropriate behavior by the 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 *In re Hercules Offshore, Inc.*, 2016 BL 366002 (Bankr. D. Del. Nov. 1, 2016), the court overruled the objections of a committee of equity security holders to a chapter 11 plan that included releases of prepetition lenders, including a hedge fund which had acquired 40 percent of secured debt refinanced as part of a previous chapter 11 filing. The court rejected the committee's argument that the releases were inappropriate due to colorable claims against the lenders for misconduct in enforcing their rights under a prepetition credit agreement.

The court ruled that a claim for equitable subordination of the lenders' claims to the debtor's common stock failed as a matter of law because section 510(c) of the Bankruptcy Code does not permit creditors' claims to be equitably subordinated to equity interests. The court also held that "equitable disallowance . . . is not typically recognized by bankruptcy courts." Finally, the court ruled that the lenders had not breached the implied covenant of good faith and fair dealing by asserting "baseless" events of default. According to the court, although the lenders "were strategic in their actions, . . . lenders are free to enforce contract rights and negotiate hard against borrowers at [arm's length], particularly those that are in distress, as here." A more detailed discussion of *Hercules Offshore* can be found elsewhere in this issue of the *Business Restructuring Review*.

OUT-OF-COURT RESTRUCTURINGS—THE TRUST INDENTURE ACT

In *Waxman v. Cliffs Natural Resources Inc.*, 2016 BL 406073 (S.D.N.Y. Dec. 6, 2016), the district court dismissed a complaint alleging that a debt-for-debt exchange offered only to institutional investors and non-U.S. persons, with no related consent solicitation, violated section 316(b) of the Trust Indenture Act of 1939 (the "TIA") because the facts alleged did not implicate the type of conduct that the TIA was designed to prevent.

According to the court, section 316(b) "sprang from concerns about majorities abusing minority holders, which did not occur here." The court explained that, unlike in the cases broadly interpreting section 316(b), there was no vote or majority action of any kind and "there was no de facto bankruptcy reorganization executed outside the supervision of a bankruptcy court, as required by this set of cases." In fact, the court emphasized that "none of the indicia of an involuntary, out-of-court pseudo-bankruptcy outlined in the instructive cases" was present: (i) the plaintiffs were not "forced to relinquish claims" without bankruptcy court protections, nor were they left with "no practical ability to receive payment"; and (ii) the exchange offer did not dispose of any assets, amend any terms of the indentures, or modify or remove any guaranty (citing *BOKF, N.A. v. Caesars Entm't Corp.*, 144 F. Supp. 3d 459 (S.D.N.Y. 2015); *Marblegate Asset Mgmt., LLC v . Educ. Mgmt. Corp.*, 111 F. Supp. 3d 542 (S.D.N.Y. 2015), *rev'd*, No. 15-2141, 2017 BL 12251 (2d Cir. Jan. 17, 2017); *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp.*, 80 F. Supp. 3d 507 (S.D.N.Y. Jan. 15, 2015); *Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*, 75 F. Supp. 3d 592 (S.D.N.Y. 2014)). The court also rejected the plaintiffs' claim that the exchange offer violated the implied covenant of good faith and fair dealing because it was not made to every holder.

FROM THE TOP

The U.S. Supreme Court issued two rulings in 2016 involving issues of bankruptcy law.

In *Husky Int'l Elecs., Inc. v. Ritz*, 194 L. Ed. 2d 655, 2016 BL 154812 (2016), the Court addressed the scope of section 523(a)(2)(A) of the Bankruptcy Code, which bars the discharge of any debt of an individual debtor for money, property, services, or credit to the extent obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." In a 7-1 decision, the Court ruled that the term "actual fraud" in section 523(a)(2)(A) encompasses a fraudulent transfer even if the transfer does not involve a false representation by the debtor transferor. Jones Day successfully argued *Husky* before the Supreme Court on behalf of the prevailing party—Husky International Electronics.

In *Commonwealth v. Franklin Cal. Tax-Free Tr.*, 136 S. Ct. 1938 (2016), the Court upheld lower court rulings declaring unconstitutional a 2014 Puerto Rico law, portions of which mirrored chapter 9 of the Bankruptcy Code, that would have allowed the commonwealth's public instrumentalities to restructure a significant portion of Puerto Rico's $72 billion in bond debt. The Court ruled by a 5-2 margin (with one justice abstaining) that the Puerto Rico Public Corporation Debt Enforcement and Recovery Act was preempted by a provision of chapter 9 invalidating any "State" law purporting to implement a nonconsensual "method of composition" of a municipality's debts, even though Puerto Rico's municipalities are not eligible to file for relief under chapter 9. Following the ruling and facing the prospect of a July 1, 2016, default by Puerto Rico on a $2 billion bond payment, Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act.

On June 28, 2016, the Court granted a petition for a writ of certiorari in *Czyzewski et al. v. Jevic Holding Corp.*, No. 15-649 (June 28, 2016), in which it will review a ruling by the Third Circuit upholding the "structured dismissal" of a chapter 11 case. *See Official Committee of Unsecured Creditors v. CIT Group/Business Credit Inc. (In re Jevic Holding Corp.)*, 787 F.3d 173 (3d Cir. 2015). The Court heard arguments in *Jevic* on December 7, 2016.

On October 11, 2016, the court agreed to review the Eleventh Circuit's decision in *Johnson v. Midland Funding, LLC*, 823 F.3d 1334 (11th Cir. 2016), *cert. granted*, 137 S. Ct. 326 (2016). In *Johnson*, the Eleventh Circuit ruled that there is no irreconcilable conflict between the Bankruptcy Code and the Fair Debt Collection Practices Act (the "FDCPA"). Thus, the court concluded, a creditor may file a proof of claim in a bankruptcy case even though the debt is time-barred, but when the creditor is a "debt collector," it may be liable under the FDCPA for "misleading" or "unfair" practices. The Eleventh Circuit's ruling is at odds with decisions issued by other circuit courts of appeal.

HIGHLIGHTS OF 2016

August 30—The EU's antitrust regulator demands that Ireland recoup roughly €13 billion ($14.5 billion) in taxes from Apple Inc., after ruling that a deal with the Irish government allowed the company to avoid almost all corporate tax across the entire EU bloc for more than a decade—a move that could intensify a feud between the EU and the U.S. over the bloc's tax probes into American companies.

ENERGY FUTURE HOLDINGS LOSES ROUND THREE IN FIGHT OVER LIABILITY FOR MAKE-WHOLE PREMIUMS

Bruce Bennett
Brad B. Erens
Scott J. Greenberg
Mark G. Douglas

On November 17, 2016, the Third Circuit Court of Appeals issued a highly anticipated ruling in the chapter 11 reorganization of Energy Future Holdings Corp. ("EFH"), invalidating one of the aspects of EFH's confirmed chapter 11 plan. In *Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 842 F.3d 247 (3d Cir. 2016), a three-judge panel of the Third Circuit reversed lower court rulings disallowing the claims of EFH's noteholders for hundreds of millions of dollars in make-whole premiums allegedly due under their indentures. In so ruling, the court created a rift between courts in the Second and Third Circuits as to whether a company that redeems debt after filing for bankruptcy is obligated to pay make-whole premiums provided for in the governing debt instruments.

EFH filed for chapter 11 protection in the District of Delaware in 2014. The company's pre-bankruptcy capital structure included first-lien and second-lien notes. The indentures for the notes included make-whole provisions designed to protect the noteholders from early redemption.

Specifically, in specifying what constitutes an "Optional Redemption," section 3.07 of each of the indentures provided that "the Issuer may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium . . . and accrued and unpaid interest."

The "Applicable Premium"—or make-whole premium—was designed to compensate the noteholders for early redemption of the first- and second-lien notes by paying them a specified percentage of the outstanding principal and stream of anticipated interest payments on the notes until their stated maturity.

Section 6.02 of the first-lien indenture contained an acceleration provision that makes "all outstanding Notes . . . due and payable immediately" if EFH files a bankruptcy petition. The acceleration provision in the second-lien indenture (also section 6.02) was slightly different: it provided that, if EFH files for bankruptcy, "all principal of and premium, if any, interest . . . [,] and any other obligations on the outstanding Notes shall be due and payable immediately[.]" Both indentures gave noteholders the right to "rescind any acceleration [of] the Notes and its consequences."

HIGHLIGHTS OF 2016

November 8—Donald Trump is elected the 45th President of the United States.

After filing for bankruptcy, EFH proposed to refinance the notes without paying the make-whole premiums. Aligning itself with a number of Southern District of New York courts (*see In re MPM Silicones, LLC*, 2014 BL 250360 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015)), the Delaware bankruptcy court ruled that, although EFH repaid the bonds prior to maturity, make-whole premiums were not payable under the bond indentures because the plain language of the indentures did not require the payment of a make-whole premium following a bankruptcy acceleration. It also held that EFH's repayment of the bonds was not an "optional redemption" because, under New York law, a borrower's repayment after acceleration is not considered "voluntary." Finally, the court ruled that EFH "did not file bankruptcy in an intentional effort to default under the Indenture so that the Applicable Premium would not be due." *See Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 527 B.R. 178 (Bankr. D. Del. 2015); *Computershare Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 539 B.R. 723 (Bankr. D. Del. 2015). The court later denied the noteholders' request for retroactive relief from the automatic stay to rescind the acceleration and demand payment of the make-whole premium. *See Del. Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 533 B.R. 106 (Bankr. D. Del. 2015). Those rulings were upheld on appeal to the district court. *See Computershare Trust Co. v. Energy Future Intermediate Holding Co. (In re*

Energy Future Holdings Corp.), 2016 BL 113612 (D. Del. Apr. 11, 2016); *Del. Trust Co. v. Energy Future Intermediate Holding Co. (In re Energy Future Holdings Corp.)*, 2016 BL 42871 (D. Del. Feb. 16, 2016).

The Third Circuit reversed the make-whole premium rulings. Writing for the panel, circuit judge Thomas L. Ambro stated:

> These rulings put the . . . noteholders in a catch-22. When [EFH] filed for bankruptcy, the maturity of its debt accelerated. This, according to the bankruptcy court, cut off the . . . noteholders' right to yield-protection. Rescission of the acceleration would have restored that right. But rescission was blocked by the automatic stay, which the court refused to lift.

The panel concluded that EFH's refinancing of the notes after filing for bankruptcy was a "redemption" within section 3.07 of the indentures and that the redemption was optional. A chapter 11 debtor which has the ability to refinance debt on better terms, Judge Ambro explained, "cannot reasonably assert that its repayment of debt is not 'voluntary' " (citation omitted). Thus, the panel ruled, the indentures require EFH to pay the make-whole premiums.

The panel rejected the argument that sections 3.07 (redemption) and 6.02 (acceleration upon bankruptcy) of the indentures were in conflict. Judge Ambro stated, "We know no reason why we should choose between Sections 3.07 and 6.02 when both plainly apply." He explained that "[b]y its own terms, Section 3.07 governs the optional redemption embedded in the refinancing and requires payment of the make-whole."

The panel found *MPM Silicones* to be "unpersuasive" and also rejected EFH's reliance on a New York Supreme Court decision—*Northwestern Mutual Life Ins. Co. v. Uniondale Realty Assocs.*, 816 N.Y.S.2d 831 (N.Y. Sup. Ct. 2006)—to support EFH's contention that it should not be required to pay a make-whole premium because section 6.02 of the indentures caused the notes' maturity to accelerate before it redeemed them. Initially, the panel noted that *Northwestern* conflicts with the ruling in *NML Capital v. Republic of Argentina*, 952 N.E.2d 482, 492 (N.Y. 2011), where New York's highest court wrote that "[w]hile it is understood that acceleration advances the maturity date of a debt, [the court was] unaware of any rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration . . . automatically cease to be enforceable after acceleration."

Moreover, the panel noted that the court in *Northwestern* held that a mortgage lender which elected to foreclose following default was not entitled to a "prepayment premium" because foreclosure had advanced the maturity date of the debt. A lender should not be permitted to accelerate and seek immediate repayment and then "pile on" by also seeking to recover a prepayment premium prior to the original stated maturity.

HIGHLIGHTS OF 2016

November 22—The Dow Jones Industrial Average reaches 19,000 for the first time ever.

Judge Ambro wrote that "while a premium contingent on 'prepayment' could not take effect after the debt's maturity, . . . a premium tied to a 'redemption' would be unaffected by acceleration of a debt's maturity." The judge summarized the "logical path" mapped out by the "*Northwestern* rule" as follows: "[P]repayments cannot occur when payment is now due by acceleration of the debt's maturity. If parties want to mandate a 'prepayment' premium following acceleration, they must clearly state it in their agreement."

But in *Energy Future*, the panel concluded that: (i) "application of the rule is off point because § 3.07 . . . does not use the word 'prepayment' "; (ii) by avoiding the term "prepayment" and using "redemption" instead, the parties intended that the make-whole premium would apply without regard to the maturity of the notes; and (iii) the policy of *Northwestern* "does not reach this case" because the noteholders did not seek both immediate repayment and payment of the make-whole premiums, but instead, EFH voluntarily redeemed the notes, in fact over the noteholders' objection.

POSTSCRIPT

On December 1, 2016, EFH filed an amended chapter 11 plan with the bankruptcy court. The new plan removed language that conditioned the effectiveness of the plan on the disallowance of the first- and second-lien noteholders' make-whole claims. The plan also removed a footnote that ensured recovery for unsecured payment-in-kind noteholders. Bankruptcy judge Christopher S. Sontchi directed that the confirmation hearing for the plan be delayed until February 14, 2017, to give the parties ample opportunity to address the proposed changes.

On December 15, 2016, EFH asked the Third Circuit to reconsider its ruling, arguing that the decision clashes with rulings from the Southern District of New York and that the question should be certified to the New York Court of Appeals.

On December 20, 2016, EFH announced that it had reached a settlement with the noteholders in the make-whole premium dispute. Under the proposed settlement, which must be approved by the bankruptcy court, first-lien noteholders would recover 95 percent of their make-whole claim ($574 million), unless unsecured noteholders reject EFH's amended chapter 11 plan, in which case the first-lien noteholders' recovery would be increased to 97 percent. Second-lien noteholders would receive 87.5 percent of their make-whole premium ($245 million), unless unsecured noteholders reject the amended plan, in which case the second-lien noteholders' recovery would be increased to 92 percent. Another $1.7 billion in unpaid principal and $486 million in accrued unpaid interest would also be due to second-lien holders if the amended plan is effective by then.

On January 3, 2017, EFH announced that it would abandon the proposed settlement with the secured noteholders in favor of a deal with unsecured noteholders, a move which may prompt the noteholders to reject EFH's amended chapter 11 plan.

NINTH CIRCUIT FINALLY ABANDONS *ENTZ-WHITE*: DEFAULT-RATE INTEREST REQUIRED TO CURE AND REINSTATE SECURED DEBT UNDER CHAPTER 11 PLAN

Monika S. Wiener
Mark G. Douglas

In 1994, Congress amended the Bankruptcy Code to add section 1123(d), which provides that, if a chapter 11 plan proposes to "cure" a default under a contract, the cure amount must be determined in accordance with the underlying agreement and applicable nonbankruptcy law. Since then, a substantial majority of courts, including the U.S. Court of Appeals for the Eleventh Circuit, have held that such a cure amount must include any default-rate interest required under either the contract or applicable nonbankruptcy law.

Until this year, courts in the Ninth Circuit were outliers in this debate, adhering to a contrary approach articulated nearly three decades ago—well before the enactment of section 1123(d)—by the U.S. Court of Appeals for the Ninth Circuit in *Great Western Bank & Trust v. Entz-White Lumber and Supply, Inc. (Entz-White Lumber and Supply, Inc.)*, 850 F.2d 1338 (9th Cir. 1988). In *Entz-White,* the Ninth Circuit held that the payment of default-rate interest is not required to cure and reinstate a defaulted secured debt under a chapter 11 plan because cure effectively nullifies all aspects of the default and rolls back the status quo to a time prior to its occurrence.

By finally aligning the Ninth Circuit with the majority view on the meaning of section 1123(d), *New Investments* creates uniformity and a greater degree of certainty regarding what is required to cure and reinstate a defaulted debt under a chapter 11 plan.

Despite the enactment of section 1123(d) and the weight of judicial authority in other circuits rejecting the *Entz-White* approach, Ninth Circuit courts, including the court of appeals, remained faithful to the *Entz-White* rule for 28 years, albeit sometimes reluctantly.

However, the primacy of *Entz-White* in the Ninth Circuit finally ended in 2016. In *In re New Invs., Inc. (Pacifica L 51 LLC v. New Invs., Inc)*, 840 F.3d 1137 (9th Cir. 2016), a divided three-judge panel of the Ninth Circuit held that "*Entz-White*'s rule of allowing a curing debtor to avoid a contractual post-default interest rate in a loan agreement is no longer valid in light of § 1123(d)."

CURE AND REINSTATEMENT UNDER A CHAPTER 11 PLAN

Upon the occurrence of an event of payment default under a loan agreement, the lender generally has the right to accelerate the loan and exercise its legal and contractual collection remedies. However, if the borrower files for chapter 11 protection, the lender must refrain from exercising such remedies unless it obtains relief from the automatic stay to do so. As long as the stay remains in place, the borrower as a chapter 11 debtor-in-possession can propose a plan that decelerates a defaulted loan, "cures" any defaults (with certain exceptions), and reinstates the original terms of the debt—in effect, "roll[ing] back the clock to the time before the default existed." *MW Post Portfolio Fund Ltd. v. Norwest Bank Minn., N.A. (In re Onco Inv. Co.)*, 316 B.R. 163, 167 (Bankr. D. Del. 2004); *see also* 11 U.S.C. § 1123(a)(5)(G) (providing that a plan shall provide adequate means for its implementation, such as "curing or waiving of any default").

> **HIGHLIGHTS OF 2016**
>
> **November 30—**After reaching a tentative agreement in September, OPEC finally agrees to curtail oil production, marking the cartel's first cut since 2008 and reversing its two-year strategy of pumping at will to maintain market share. The decision reflects producers' desires to end the global oil supply glut, which has kept prices depressed for more than two years.

To the extent that its claim is not "impaired" under the terms of the proposed plan, the lender will be deemed to have accepted the plan and will not be entitled to vote on it. *See* 11 U.S.C. § 1126(f). Even though the lender is precluded from enforcing its contractual right of acceleration, the lender's claim will be deemed unimpaired if the plan: (i) cures any defaults (other than defaults triggered by the bankruptcy filing or certain nonmonetary defaults, as specified in section 365(b)(2) of the Bankruptcy Code); (ii) reinstates the pre-default maturity of the debt; (iii) compensates the lender for any damages sustained due to reasonable reliance on its contractual or legal ability to accelerate the debt; (iv) compensates the lender for any actual pecuniary loss arising from the debtor's failure to perform a nonmonetary obligation; and (v) does not "otherwise alter the legal, equitable, or contractual rights" of the lender. *See* 11 U.S.C. § 1124(2).

Prior to 1994, the Bankruptcy Code did not provide guidance as to the meaning of the term "cure," and courts were split as to whether payment of default-rate interest was required in order to cure a default. While most courts required payment of default-rate interest in this context, a minority of courts, including the Ninth Circuit in *Entz-White*, held that the payment of default-rate interest was not required because cure effectively nullifies all aspects of a default and reinstates the pre-default status quo. *Accord Levy v. Forest Hills Assocs. (In re Forest Hills Assocs.)*, 40 B.R. 410 (Bankr. S.D.N.Y. 1984).

In 1994, however, lawmakers added section 1123(d) to the Bankruptcy Code, which provides that, notwithstanding the entitlement of oversecured creditors to collect postpetition interest under section 506(b), the "best interests" requirement of section 1129(a)(7), and the cramdown requirements of section 1129(b), "if it is proposed in a plan to cure a default[,] the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."

Most courts have interpreted section 1123(d) as requiring the payment of default-rate interest as a condition of cure to the extent that it is required by the underlying agreement or applicable nonbankruptcy law. *See, e.g., In re Moody Nat'l SHS Houston H, LLC*, 426 B.R. 667, 672 (Bankr. S.D. Tex. 2010) ("To the extent that there was ambiguity as to how to cure a default when *Entz-White* was written, that ambiguity evaporated in 1994 when § 1123(d) was added" to the Bankruptcy Code); *In re 1 Ashbury Court Partners, LLC*, 2011 BL 396895 (Bankr. D. Kan. Oct. 5, 2011); *In re General Growth Props., Inc.*, 451 B.R. 323 (Bankr. S.D.N.Y. 2011); *In re Schatz*, 426 B.R. 24 (Bankr. D.N.H. 2009).

However, this approach is not necessarily supported by the legislative history of section 1123(d). Section 1123(d) and companion provisions in chapter 12 and chapter 13 (sections 1222(d) and 1322(e)) were enacted to abrogate the U.S. Supreme Court's decision in *Rake v. Wade*, 508 U.S. 464 (1993). In *Rake*, the Court held that, in order to cure a mortgage default under a chapter 13 plan, the mortgagee must be paid interest on the defaulted payments, including interest on interest, regardless of whether such interest was provided for in the agreement or under state law. Congress overruled the decision by enacting section 1123(d) because the ruling "had the effect of providing a windfall to secured creditors at the expense of unsecured creditors by forcing debtors to pay the bulk of their income to satisfy the secured creditors' claims," which would include interest on interest, late charges, and other fees, "even where applicable law prohibits such interest and even when it was . . . not contemplated by either party in the original transaction." H.R. Rep. No. 103-835, at 55 (1994).

In light of this legislative history, some courts have argued that section 1123(d) should not be interpreted to require payment of default-rate interest, even where the contract provides for it. Additional support for this interpretation can arguably be found in: (i) section 365(b)(2), which was also added to the Bankruptcy Code in 1994 and provides that a "penalty rate" related to the debtor's failure to perform nonmonetary obligations need not be satisfied to cure a default under an executory contract or an unexpired lease; and (ii) section 1124(2), which does not require the holder of a claim to be paid default-rate interest for the claim to be rendered unimpaired. *In re Phoenix Bus. Park Ltd. P'ship*, 257 B.R. 517, 522 (Bankr. D. Ariz. 2001) (construing the language of section 365(b)(2), which was adopted at the same time as section 1123(d), together with section 1124(2), and finding that "*Entz-White* remains good law in the Ninth Circuit" because "Congress did not legislatively overrule *Entz-White*" when it enacted section 1123(d)); *accord Brody v. Geared Equity, LLC*, 2014 BL 218335 (D. Ariz. Aug. 6, 2014); *see also General Elec. Capital Corp. v. Future Media Productions, Inc.*, 536 F.3d 969 (9th Cir. 2008) (declining to rule that *Entz-White* was overruled by section 1123(d)).

In 2015, the Eleventh Circuit conclusively rejected the *Entz-White* approach in *JPMCC 2006-LDP7 Miami Beach Lodging, LLC v. Sagamore Partners, Ltd. (In re Sagamore Partners, Ltd.)*, 620 Fed. Appx. 864, 2015 BL 280922 (11th Cir. Aug. 31, 2015). In *Sagamore*, the court ruled that "the clear mandate of § 1123 . . . allows a creditor to demand default-rate interest as a condition for reinstating [a defaulted] loan," to the extent that the loan agreement provided for the payment of interest at the default rate. The ruling created a circuit split in an area of bankruptcy jurisprudence that had long lain dormant and gone largely unnoticed.

HIGHLIGHTS OF 2016

December 2—The U.S. Labor Department reports that the jobless rate fell to 4.6 percent in November, the lowest since August 2007.

NEW INVESTMENTS TURNS THE PAGE

The Ninth Circuit finally abandoned *Entz-White* in *New Investments*, but not without dissent. In the case, the debtor's chapter 11 plan proposed to cure a default on a commercial real estate loan by selling the property to a third party and using the proceeds of the sale to pay the outstanding amount of the loan at the pre-default interest rate. The secured lender objected, claiming that, under the terms of the note, it was entitled to be paid at the higher, post-default interest rate.

On a direct appeal of the bankruptcy court's order confirming the plan over the lender's objection, a divided three-judge panel of the Ninth Circuit reversed. The panel's majority held that "§ 1123(d) renders void *Entz-White*'s rule that a debtor who proposes to cure a default may avoid a higher, post-default interest rate in a loan agreement."

According to the Ninth Circuit majority opinion, "By its terms, § 1123(d) tells us to look to the promissory note and Washington law to determine what amount New Investments must pay to cure its default. . . . [and] [h]ere, that analysis requires the payment of post-default interest." This conclusion is "consistent with the intent of § 1123(d)," the court wrote, "because it holds the parties to the benefit of their bargain."

The Ninth Circuit accordingly reversed the bankruptcy court's confirmation order and remanded the case below.

DISSENTING OPINION

Circuit judge Marsha S. Berzon dissented, stating that "neither the text of the statute nor the legislative history of § 1123(d) support[s] the majority's departure [from *Entz-White*]." According to Judge Berzon, "Nowhere did the 1994 amendments define 'cure a default' or suggest that this Circuit's then-operative definition of 'cure' was incorrect." Furthermore, she noted, Congress focused on addressing an entirely different matter—the U.S. Supreme Court's decision in *Rake v. Wade*—when it enacted section 1123(d).

"Far from repudiating *Entz-White*'s holding," Judge Berzon wrote, the legislative history of section 1123(d) "reiterated" the *Entz-White* approach, stating that "[i]t is [lawmakers'] intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred" (citing H.R. Rep. No. 103-835, at 55 (1994)). According to her, the legislative history "thus indicates, at the very least, that the new provision was not meant *sub silentio* to enact a definition of 'cure' conflicting with that adopted in *Entz-White*."

Judge Berzon observed that "[t]he majority opinion errs in concluding otherwise, and, in doing so, wrongly imposes a severe penalty on debtors in New Investments' situation."

Finally, Judge Berzon wrote that "the majority's opinion mistakenly upsets this Circuit's binding precedent . . . [because a] three judge panel of this Court is 'bound by decisions of prior panels unless an *en banc* decision, Supreme Court decision or subsequent legislation undermines those decisions' " (citation omitted).

OUTLOOK

By finally aligning the Ninth Circuit with the majority view on the meaning of section 1123(d), *New Investments* creates uniformity and a greater degree of certainty regarding what is required to cure and reinstate a defaulted debt under a chapter 11 plan. The ruling is no doubt a welcome development for lenders—and an unwelcome one for borrowers faced with the more costly prospect of paying default-rate interest as a condition to obtaining confirmation of a chapter 11 plan.

DELAWARE BANKRUPTCY COURT RULES THAT LENDERS ARE FREE TO ENFORCE CONTRACT RIGHTS AND "NEGOTIATE HARD" AGAINST DISTRESSED BORROWERS AT ARM'S LENGTH

When lenders take an aggressive approach to a financially troubled borrower that ultimately files for bankruptcy protection, stakeholders in the case, including chapter 11 debtors, trustees, committees, and even individual creditors or shareholders, frequently pursue causes of action against the lenders in an effort to augment or create recoveries. The incidence of lender-liability type claims in bankruptcy in the guise of litigation seeking, among other things, to equitably subordinate lender claims or to recharacterize such claims as equity has led some lenders to second-guess how aggressively they can enforce their rights under a loan agreement, including the extent to which they can take an active role in the affairs of a borrower.

For this reason, a ruling recently handed down by the U.S. Bankruptcy Court for the District of Delaware has been welcomed by lenders. In *In re Hercules Offshore, Inc.*, 2016 BL 366002 (Bankr. D. Del. Nov. 1, 2016), the court overruled the objections of a committee of equity security holders to a chapter 11 plan that included releases of prepetition lenders, including a hedge fund which acquired 40 percent of secured debt refinanced as part of a previous chapter 11 filing. In rejecting the committee's argument that the releases were inappropriate due to colorable claims against the lenders for misconduct in enforcing their rights under a prepetition credit agreement, the court summarized the dispute as follows:

> "Will you walk into my parlor?" said the spider
>   to the fly;
> " 'Tis the prettiest little parlor that ever you did spy.
> The way into my parlor is up a winding stair,
> And I have many pretty things to show when you
>   are there."
> "O no, no," said the little fly, "To ask me is in vain,
> For who goes up your winding stair can ne'er come
>   down again"
> [quoting *The Spider and The Fly: A Fable*,
> Mary Howitt].

> To put it into terms employed by the Equity Committee, the central dispute for determination by the Court is whether the lender (spider) here "conjured up immaterial defaults," catching the (sufficiently unwary) Debtor "completely off guard" to "impose their will on" the Debtor, undermine its "recently confirmed plan and raid the Company's coffers to force an expedited repayment" . . . (and a premature liquidation).

HERCULES OFFSHORE

Hercules Offshore, Inc., and its affiliates (collectively, "Hercules") perform offshore drilling services, both domestically in the Gulf of Mexico and internationally. In August 2015, Hercules filed a prepackaged chapter 11 case in the District of Delaware. The bankruptcy court confirmed a chapter 11 plan for Hercules in September 2015, pursuant to which $1.2 billion in debt was exchanged for 20 million shares of new common stock. Among other things, the plan provided Hercules with access to new liquidity in the form of $450 million in exit financing under a November 6, 2015, first-lien credit agreement. The first-lien lenders included Luminus Energy Partners Master Fund, Ltd. ("Luminus"), a Bermuda-based hedge fund. At the time Hercules emerged from its 2015 chapter 11 case, Luminus held approximately 1.2 percent of the debt outstanding under the first-lien credit agreement.

Due to a significant post-confirmation decrease in oil prices and revenue, a special committee of Hercules' board was created in January 2016 to pursue strategic alternatives available to the company, including a sale of assets, a sale of the company as a whole, and the issuance of additional equity or debt securities. The special committee initiated a marketing process and solicited bids for Hercules' assets or the company as a whole.

From December 2015 through April 2016, Luminus expressed concerns to the special committee that Hercules was experiencing unsustainable cash burn, would likely default on various covenants under the first-lien credit agreement in 2017, and should take steps to de-risk various projects by seeking project financing or a joint venture relationship. Luminus also proposed to purchase Hercules' assets in an out-of-court sale transaction due to the "disappointing" results of the special committee's efforts to market the assets to other buyers.

On April 15, 2016, Luminus provided a proposal to the special committee for a controlled chapter 11 bankruptcy in which Hercules' various assets could be sold off individually and holders of the company's common stock would receive $27.5 million in "cash or highly certain value." However, the committee viewed this proposal not as final, but as subject to due diligence.

Hercules allegedly defaulted on certain covenants in the first-lien credit agreement in April 2016. Nevertheless, the first-lien lenders agreed not to accelerate the debt in accordance with the terms of a series of forbearance agreements.

During the forbearance period, the special committee proposed to sell various Hercules assets, including rights in a North Sea jack-up rig that Hercules had intended to purchase outright as a new source of revenue. The first-lien lenders claimed that the transfer of such rights constituted an event of default under the first-lien credit agreement and accelerated the debt. Pursuant to the terms of the forbearance agreements, escrowed funds in the amount of $200 million that had been earmarked for the jack-up rig purchase were then released to the first-lien lenders to reduce their claims under the credit agreement.

On May 26, 2016, holders of 99 percent of the first-lien debt entered into a restructuring support agreement that was unanimously approved by Hercules' board of directors. The agreement contemplated that Hercules' operations would be wound down in a second prepackaged chapter 11 case.

Hercules filed for chapter 11 protection in the District of Delaware for the second time on June 5, 2016. Luminus then (or shortly afterward) held approximately 40 percent of the debt outstanding under the first-lien credit agreement as well as 914,992 shares (4.5 percent) of Hercules' common stock.

Hercules' prepackaged chapter 11 plan provided for the liquidation of its assets pursuant to a series of sales. The sale proceeds were to be used to pay unsecured claims in full ($35 million) and, at the low end of the estimated proceeds, $388 million of the $579 million in allowed first-lien lender claims. In addition, if the holders of Hercules' common stock voted in favor of the plan, they would receive $12.5 million in

cash on the effective date and certain additional amounts depending on the aggregate proceeds of the asset sales. The first-lien lender and unsecured creditor classes voted to accept the plan. The class containing holders of common stock voted to reject it.

After mediation requested by Hercules failed to produce a global settlement, Hercules proposed an amended plan providing for, among other things, an increased guaranteed recovery to consenting common stock holders. An official committee of Hercules' equity holders objected to the amended plan. The committee argued, among other things, that releases of the estate's claims against the first-lien lenders were impermissible.

According to the equity committee, the plan releases were invalid because the estate had colorable claims and causes of action against the first-lien lenders, including claims for equitable subordination, equitable disallowance, and breach of the implied covenant of good faith and fair dealing.

THE BANKRUPTCY COURT'S RULING

Bankruptcy judge Kevin J. Carey ruled that a claim for equitable subordination of the first-lien lenders' claims to Hercules' common stock failed as a matter of law because the U.S. Court of Appeals for the Third Circuit "has held that Bankruptcy Code section 510(c) does not permit creditors' claims to be equitably subordinated to equity interests" (citing *In re Winstar Commc'ns, Inc.*, 554 F.3d 382, 414 (3d Cir. 2009)).

Moreover, Judge Carey ruled that "equitable disallowance . . . is not typically recognized by bankruptcy courts" (citing *Sher v. JP Morgan Chase Funding Inc. (In re TMST, Inc.)*, 518 B.R. 329, 357 (Bankr. D. Md. 2014), *vacated in part on other grounds*, 2014 BL 324561 (Bankr. D. Md. Nov. 13, 2014); *In re LightSquared Inc.*, 504 B.R. 321, 339 (Bankr. S.D.N.Y. 2013)). He explained that the exceptions to the allowance of a claim are specifically delineated in section 502(b) of the Bankruptcy Code, "and a creditors' conduct—whether or not it was in good faith—is not within this list of exceptions." In addition, Judge Carey noted that "the record here does not support such a claim."

The equity committee claimed that the first-lien lenders had breached the implied covenant of good faith and fair dealing by asserting "baseless" events of default under the first-lien credit agreement, by declining to extend the deadline for compliance with certain covenants in the credit agreement, and by forcing Hercules to enter into the forbearance agreements.

Judge Carey rejected these arguments. He explained that Hercules did not dispute that it had breached covenants under the first-lien credit agreement. The judge wrote that although the equity committee characterized such defaults as "immaterial, . . . there is no 'materiality' requirement in the [credit agreement] . . . [, which states] that *any failure* to satisfy the [relevant requirements] is grounds for acceleration of the loan" (emphasis added).

Similarly, the judge emphasized, withholding consent to an extension of time for Hercules to comply with covenants "was arguably unfortunate, but not inappropriate."

The equity committee also argued that, by claiming Hercules was in default, the first-lien lenders had forced Hercules to enter into the forbearance agreements, thereby preventing the company from accessing escrowed funds which would have allowed it to purchase the North Sea jack-up rig—an important additional source of revenue that might have kept the company out of bankruptcy.

HIGHLIGHTS OF 2016

December 12—Citing the steady growth of the American economy, the U.S. Federal Reserve increases its benchmark interest rate for only the second time since the 2008 financial crisis.

Judge Carey rejected this argument as well. According to him, although the first-lien lenders "were strategic in their actions, lenders are free to enforce contract rights and negotiate hard against borrowers at [arm's length], particularly those that are in distress, as here."

Judge Carey noted that Hercules characterized the first-lien lenders, "sardonically, as 'aggressive,' 'vocal,' 'persistent,' and at times 'annoying.' " However, he wrote that "there is no evidence that they acted unlawfully and no evidence that [Hercules was] damaged by any alleged lender misconduct." Evidence was lacking, he explained, that the first-lien lenders had interfered with Hercules' business or had somehow been implicitly bound to grant extensions of time to satisfy covenants. Nor was any evidence introduced to establish that the lenders had caused or contributed to Hercules' inability to timely satisfy covenants. Instead, the record showed that the first-lien lenders "acted within the boundaries of their contractual rights."

Finally, Judge Carey noted that the first-lien lenders had agreed to provide substantial consideration in exchange for the plan releases, including guaranteed payments to unsecured creditors and equity holders from the proceeds of their collateral. He therefore approved the releases, observing that they "bring needed certainty to [Hercules'] exit from chapter 11."

ADMINISTRATIVE CLAIM MAY BE SET OFF AGAINST PREFERENCE LIABILITY

Charles S. Wittmann-Todd
Mark G. Douglas

In *Official Comm. of Unsecured Creditors of Quantum Foods, LLC v. Tyson Foods, Inc. (In re Quantum Foods, LLC)*, 554 B.R. 729 (Bankr. D. Del. 2016), a Delaware bankruptcy court held in a matter of apparent first impression that a creditor's allowed administrative expense claim may be set off against the creditor's potential liability for a preferential transfer. The ruling is an important development for prepetition vendors that continue to provide goods or services to a bankruptcy trustee or chapter 11 debtor-in-possession.

SETOFF AND AVOIDANCE OF PREFERENTIAL TRANSFERS

Section 553(a) of the Bankruptcy Code provides, subject to certain exceptions, that the Bankruptcy Code "does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case." Section 553 does not create setoff rights—it merely preserves any such rights that exist under contract or applicable nonbankruptcy law. Debts are considered "mutual" when they are due to and from the same persons or entities in the same capacity.

Even though section 553 expressly refers to *prepetition* mutual debts and claims, many courts, including the Fifth and Tenth Circuits, have held that mutual *postpetition* obligations may also be offset. *See Zion First Nat'l Bank, NA v. Christiansen Bros., Inc. (In re Davidson Lumber Sales, Inc.)*, 66 F.3d 1560 (10th Cir. 1995); *Palm Beach Cty. Bd. of Pub. Instruction v. Alfar Dairy, Inc. (In re Alfar Dairy, Inc.)*, 458 F.2d 1258 (5th Cir. 1972). *Accord Zerodec Mega Corp. v. Terstep of Tex., Inc. (In re Zerodec Mega Corp.)*, 59 B.R. 272 (E.D. Pa. 1986); *In re Pub Dennis of Cumberland, Inc.*, 142 B.R. 38 (Bankr. D.R.I. 1992); *Mohawk Indus. v. United States (In re Mohawk Indus., Inc.)*, 82 B.R. 174 (Bankr. D. Mass. 1987); *Elsinore Shore Assoc. v. First Fidelity Bank, NA (In re Elsinore Shore Assoc.)*, 67 B.R. 926 (Bankr. D.N.J. 1986).

However, setoff is available in bankruptcy only "when the opposing obligations arise on the same side of the . . . bankruptcy petition date." *Pa. State Employees' Ret. Sys. v. Thomas (In re Thomas)*, 529 B.R. 628, 637 n.2 (Bankr. W.D. Pa. 2015); *see also generally Lee v. Schweiker*, 739 F.2d 870 (3d Cir. 1984). Thus, prepetition obligations may not be set off against postpetition debts and vice versa. *See In re Enright*, 2015 BL 261143 (Bankr. D.N.J. Aug. 13, 2015); *In re Passafiume*, 242 B.R. 630 (Bankr. W.D. Ky. 1999); *In re Ruiz*, 146 B.R. 877 (Bankr. S.D. Fla. 1992).

Section 547(b) of the Bankruptcy Code provides for avoidance of transfers made by an insolvent debtor within 90 days of a bankruptcy petition filing (or up to one year, if the transferee is an insider) to or for the benefit of a creditor on account of an antecedent debt where the creditor, by reason of the transfer, receives more than it would have received if, assuming the transfer had not been made, the debtor were liquidated in chapter 7.

Section 547(c)(4) contains a "subsequent new value" defense in preference litigation. It provides that, with certain exceptions, the trustee may not avoid a transfer "to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor." For purposes of section 547, "new value" includes, among other things, "money or money's worth in goods, services, or new credit." Thus, even where a creditor has received a preferential transfer, the transferee may offset against the preference claim any subsequent unsecured credit that was extended to the debtor. Goods or services provided to the debtor postpetition cannot qualify as "subsequent new value" because the petition date marks the end of the preference analysis period. *See Friedman's Liquidating Tr. v. Roth Staffing Co., LP (In re Friedman's, Inc.)*, 738 F.3d 547 (3d Cir. 2013)).

Section 502(d) of the Bankruptcy Code penalizes any creditor that is the recipient of a preferential transfer but refuses to return transferred assets to the estate. It provides that "the court shall disallow any claim of any entity . . . that is a transferee of a transfer avoidable under section . . . 547 . . . of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable."

NOTABLE PLAN CONFIRMATIONS AND EXITS FROM BANKRUPTCY IN 2016

COMPANY	FILING DATE (BANKR. COURT)	CONF. DATE EFFECTIVE DATE	ASSETS	INDUSTRY	RESULT
Energy Future Holdings Corp.	04/29/2014 (D. Del.)	08/26/2016 CD	$41 billion	Utility	Reorganization
Alpha Natural Resources, Inc.	08/03/2015 (E.D. Va.)	07/12/2016 CD 07/26/2016 ED	$10.7 billion	Mining	Reorganization
Doral Financial Corporation	03/11/2015 (S.D.N.Y.)	08/10/2016 CD 10/28/2016 ED	$8.5 billion	Banking	Liquidation
Arch Coal, Inc.	01/11/2016 (E.D. Mo.)	09/13/2016 CD 10/05/2016 ED	$8.4 billion	Mining	Reorganization
Energy XXI Ltd.	04/14/2016 (S.D. Tex.)	12/13/2016 CD 12/30/2016 ED	$4.7 billion	Oil & Gas	Reorganization
Offshore Group Investment Ltd (n.k.a. Vantage Drilling Int'l)	12/03/2015 (D. Del.)	01/15/2016 CD 02/10/2016 ED	$3.5 billion	Oil & Gas	Reorganization
Halcón Resources Corporation	07/27/2016 (D. Del.)	09/08/2016 CD 09/09/2016 ED	$3.5 billion	Oil & Gas	Reorganization
SandRidge Energy, Inc.	05/16/2016 (S.D. Tex.)	09/09/2016 CD 10/04/2016 ED	$3 billion	Oil & Gas	Reorganization
Molycorp, Inc.	06/25/2015 (D. Del.)	04/08/2016 CD 08/31/2016 ED	$2.6 billion	Mining	Reorganization
RCS Capital Corp.	01/31/2016 (D. Del.)	05/19/2016 CD 05/23/2016 ED	$2.5 billion	Brokerage	Reorganization
Sabine Oil & Gas Corp.	07/15/2015 (S.D.N.Y.)	07/27/2016 CD 08/11/2016 ED	$2.4 billion	Oil & Gas	Reorganization
Swift Energy Company	12/31/2015 (D. Del.)	03/31/2016 CD 04/22/2016 ED	$2.2 billion	Oil & Gas	Reorganization
Trump Enter. Resorts, Inc.	02/17/2009 (D.N.J.)	03/12/2015 CD 02/26/2016 ED	$2.2 billion	Gaming/Lodging	Sale
C&J Energy Services Ltd.	07/20/2016 (S.D. Tex.)	12/16/2016 CD 01/06/2017 ED	$2.2 billion	Oil & Gas	Reorganization
Seventy Seven Energy Inc.	06/07/2016 (D. Del.)	07/13/2016 CD 08/01/2016 ED	$1.9 billion	Oil & Gas Services	Reorganization
Atlas Resource Partners, L.P.	07/27/2016 (S.D.N.Y.)	08/26/2016 CD 09/01/2016 ED	$1.7 billion	Oil & Gas	Reorganization
Magnum Hunter Resources Corporation	12/15/2015 (D. Del.)	04/18/2016 CD 05/06/2016 ED	$1.7 billion	Oil & Gas	Reorganization
Energy & Exploration Partners Inc.	12/07/2015 (N.D. Tex.)	04/26/2016 CD 05/13/2016 ED	$1.4 billion	Oil & Gas	Reorganization
Key Energy Services, Inc.	10/24/2016 (D. Del.)	12/06/2016 CD 12/15/2016 ED	$1.3 billion	Oil & Gas	Reorganization
Quiksilver, Inc.	09/09/2015 (D. Del.)	01/29/2016 CD 02/11/2016 ED	$1.3 billion	Retail	Reorganization
Dex Media, Inc.	05/16/2016 (D. Del.)	07/15/2016 CD 07/29/2016 ED	$1.3 billion	Advertising	Reorganization
Quicksilver Resources Inc.	03/07/2015 (D. Del.)	08/16/2016 CD 08/31/2016 ED	$1.2 billion	Oil & Gas	Liquidation
GT Advanced Technologies Inc.	10/06/2014 (D.N.H.)	03/07/2016 CD 03/17/2016 ED	$1.2 billion	Solar/Electronics	Reorganization
James River Coal Company	04/07/2014 (E.D. Va.)	03/21/2016 CD 03/22/2016 ED	$1.2 billion	Mining	Liquidation
Basic Energy Services, Inc.	10/25/2016 (D. Del.)	12/09/2016 CD 12/23/2016 ED	$1.2 billion	Oil & Gas	Reorganization
Hercules Offshore, Inc.	06/05/2016 (D. Del.)	11/15/2016 CD 12/02/2016 ED	$1.1 billion	Oil & Gas	Sale
Aspect Software Parent Inc.	03/09/2016 (D. Del.)	05/25/2016 CD 05/26/2016 ED	$952 million	Call Center Tech.	Reorganization
Verso Corp.	01/26/2016 (D. Del.)	06/23/2016 CD 07/18/2016 ED	$878 million	Paper Manuf.	Reorganization
Miller Energy Resources, Inc.	10/01/2015 (D. Alaska)	01/28/2016 CD 03/29/2016 ED	$767 million	Oil & Gas	Reorganization
Veneco, Inc.	03/18/2016 (D. Del.)	07/13/2016 CD 07/25/2016 ED	$751 million	Oil & Gas	Reorganization
SFX Entertainment, Inc.	02/01/2016 (D. Del.)	11/15/2016 CD 12/02/2016 ED	$710 million	Entertainment	Reorganization
Black Elk Energy Offshore Operations, LLC	09/10/2015 (S.D. Tex.)	07/13/2016 CD 07/25/2016 ED	$566 million	Oil & Gas	Liquidation
Relativity Media LLC	07/30/2015 (S.D.N.Y.)	02/02/2016 CD 04/14/2016 ED	$560 million	Entertainment	Reorganization

Quantum Foods provides guidance on four important points: (i) there is no such thing as a postpetition new value preference defense because the preference analysis ends as of the petition date; (ii) mutual postpetition obligations may be set off if the setoff otherwise complies with section 553 and the law governing setoffs; (iii) a preference claim arises postpetition even though the preference itself necessarily occurred prepetition; and (iv) administrative expense claims cannot be disallowed under section 502(d).

QUANTUM FOODS

Tyson Foods, Inc. ("Tyson") regularly delivered meat products to Quantum Foods, LLC ("Quantum"). During the first two months after Quantum filed for chapter 11 protection in February 2014, Tyson supplied roughly $2.6 million in meat products to Quantum for which it was not paid. The bankruptcy court later granted Tyson an administrative expense claim in that amount under section 503(b)(1)(A) of the Bankruptcy Code.

Quantum's official unsecured creditors' committee (the "committee"), which had been authorized by the court to prosecute the estate's avoidance claims, sued Tyson, alleging that Tyson had been the recipient of fraudulent and preferential transfers and seeking avoidance of the transfers under sections 547 and 548 of the Bankruptcy Code. The committee also sought recovery of the transfers under section 550 and provisional disallowance of Tyson's administrative expense claim under section 502(d).

Tyson argued that it was entitled to set off any potential preference recovery against its allowed administrative claim. The committee countered that Tyson's setoff defense was in reality a " 'disguised' or 'renamed' postpetition new value defense." According to the committee, such a defense is invalid because it would reduce the total amount of value restored to Quantum's estate and would therefore violate section 502(d) by allowing Tyson's claim in part, even though it had not returned allegedly fraudulent or preferential transfers. The committee moved for judgment on the pleadings.

THE BANKRUPTCY COURT'S RULING

Bankruptcy judge Kevin J. Carey acknowledged that "[t]here is no provision in the Bankruptcy Code that deals expressly with post-petition setoff," noting that "[w]hether an allowed post-petition administrative expense claim can be used to set off preference liability" is a question of first impression in the Delaware bankruptcy court.

Relying on the Third Circuit's decision in *Friedman's*, Judge Carey ruled that the setoff at issue was "not a new value defense but rather an ordinary setoff claim" and should therefore be permitted. He explained that a new value defense can arise only in the context of a preference analysis, which, according to *Friedman's*, looks only to the preference period, which begins prepetition and ends on the petition date:

> I am not persuaded by the Committee's argument that Tyson's claim is a disguised new value defense because it has the effect of reducing the amount of preferential transfers returned to the estate. Tyson's setoff claim does not affect the bottom line of the preference calculation; rather, setting off Tyson's Administrative Claim affects only the amount paid to the estate. Tyson's Administrative Claim affects the preference claim externally, not internally. This distinction is not merely semantic but rather evinces the nature of Tyson's claim.

According to Judge Carey, because the (postpetition) administrative claim was independent of the committee's preference action (which was necessarily based upon prepetition activity), Tyson properly characterized its claim as a setoff.

Judge Carey ruled that the setoff of Tyson's administrative claim against its potential preference liability was permissible. He acknowledged that "[t]he judicial consensus is that 'setoff is only available in bankruptcy when the opposing obligations arise on the same side of the . . . bankruptcy petition date' " (citations omitted). Even so, Judge Carey concluded that a preference "claim" (defined by the Bankruptcy Code as a "right to payment") of the estate necessarily arises only postpetition. For guidance on this point, he looked to *In re Tek-Aids Indus., Inc.*, 145 B.R. 253, 256 (Bankr. N.D. Ill. 1992), in which the court wrote:

> The estate's causes of action for the preferences did not exist before the filing of the Chapter 11 petition. If the Debtor had never filed bankruptcy, none of the preference actions could ever have been brought by anybody . . . . The fact that the trustee's ability to recover a given transfer as a preference depends on prepetition actions is irrelevant. A preference action can only be initiated in the context of a bankruptcy case after the filing of a bankruptcy case.

Finally, Judge Carey rejected the committee's argument that Tyson's administrative expense claim should be disallowed under section 502(d). This argument, he wrote, "overlooks case law recognizing that 'administrative expense claims are accorded special treatment under the Bankruptcy Code and are not subject to section 502(d)' " (quoting *In re Lids Corp.*, 260 B.R. 680, 683 (Bankr. D. Del. 2001)). According to Judge Carey, if vendors perceived that preference liability would be used to block payment of their administrative expense claims, they would be extremely reluctant to extend postpetition credit.

OUTLOOK

Quantum Foods provides comfort to vendors that continue doing business with debtors in bankruptcy. In addition, the decision provides guidance on four important points: (i) there is no such thing as a postpetition new value preference defense because the preference analysis ends as of the petition date; (ii) mutual postpetition obligations may be set off if the setoff otherwise complies with section 553 and the law governing setoffs; (iii) a preference claim arises postpetition even though the preference itself necessarily occurred prepetition; and (iv) administrative expense claims cannot be disallowed under section 502(d). These guiding principles provide an added layer of certainty to vendors, which may rely on administrative expense treatment of their claims for the value of goods or services provided postpetition and, by virtue of section 503(b)(9), the value of goods received by a debtor in the ordinary course of business within 20 days before filing for bankruptcy.

ANOTHER APPELLATE COURT REJECTS *LUBRIZOL* APPROACH TO EFFECT OF REJECTION OF TRADEMARK LICENSE IN BANKRUPTCY

Ben Rosenblum
Mark G. Douglas

Only a handful of courts have had an opportunity to address the ramifications of rejection of a trademark license since the U.S. Court of Appeals for the Seventh Circuit handed down its landmark decision in *Sunbeam Prods., Inc. v. Chicago Am. Manuf., LLC*, 686 F.3d 372 (7th Cir. 2012), *cert. denied*, 133 S. Ct. 790 (2012). A bankruptcy appellate panel for the First Circuit recently did so in *Mission Prod. Holdings, Inc. v. Tempnology LLC (In re Tempnology LLC)*, 559 B.R. 809 (B.A.P. 1st Cir. 2016). The panel followed *Sunbeam* and reversed the ruling of a bankruptcy court that trademark license rights are not protected by section 365(n) of the Bankruptcy Code because trademarks are not included in the Bankruptcy Code's definition of "intellectual property."

SPECIAL RULES GOVERNING REJECTION OF CERTAIN INTELLECTUAL PROPERTY LICENSES IN BANKRUPTCY

Absent special statutory protection, the rejection by a chapter 11 debtor-in-possession ("DIP") or a bankruptcy trustee of an intellectual property ("IP") license, particularly a license of IP that is critical to a licensee's business operations, can have a severe impact on the licensee's business and leave the licensee scrambling to procure other IP to keep its business afloat. This concern was heightened by the Fourth Circuit's 1985 ruling in *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers Inc.)*, 756 F.2d 1043 (4th Cir. 1985). In *Lubrizol*, the court held that, if a debtor rejects an executory IP license, the licensee loses the right to use any licensed copyrights, trademarks, and patents. It also concluded that the licensee's only remedy is to file a claim for money damages, since the licensee cannot seek specific performance of the license agreement.

In order to better protect such licensees, Congress amended the Bankruptcy Code in 1988 to add section 365(n). Under section 365(n), licensees of some (but not all) IP licenses have two options when a DIP or trustee rejects the license. The licensee may either: (i) treat the agreement as terminated and assert a claim for damages; or (ii) retain the right to use the licensed IP for the duration of the license (with certain limitations). By adding section 365(n), Congress intended to make clear that the rights of an IP licensee to use licensed property cannot be unilaterally cut off as a result of the rejection of the license.

However, notwithstanding the addition of section 365(n) to the Bankruptcy Code, the legacy of *Lubrizol* endures—since by its terms, section 365(n) does not apply to trademark licenses and other kinds of "intellectual property" outside the Bankruptcy Code's definition of the term. In particular, trademarks, trade names, and service marks are not included in the definition of "intellectual property" under section 101(35A) of the Bankruptcy Code. Due to this omission, courts continue to struggle when determining the proper treatment of trademark licenses in bankruptcy.

Several courts, including three circuit courts of appeal, have had an opportunity since *Lubrizol* and the enactment of section 365(n) to weigh in on how rejection in bankruptcy of a trademark license impacts the rights of the nondebtor licensee.

In *In re Exide Technologies*, 607 F.3d 957 (3d Cir. 2010), the Third Circuit could have considered the issue but sidestepped it instead, concluding that a trademark license agreement was not executory because the nondebtor licensee had materially completed its performance under the agreement prior to the debtor's bankruptcy filing. Thus, the court held that the agreement could not be assumed or rejected at all. As a consequence, the Third Circuit never addressed whether rejection of the agreement (had it been found to be executory) would have terminated the licensee's right to use the debtor's trademarks.

However, in a separate concurring opinion, circuit judge Thomas L. Ambro took issue with the bankruptcy court's conclusion that rejection of a trademark license agreement necessarily terminates the licensee's right to use the debtor's trademark. Congress's decision to leave treatment of trademark licenses to the courts, Judge Ambro argued, signals nothing more than Congress's inability, at the time it enacted section 365(n), to devote enough time to consideration of trademarks in the bankruptcy context; no negative inference should be drawn by the failure to include trademarks in the Bankruptcy Code's definition of "intellectual property." The judge wrote that "it is simply more freight than negative inference will bear to read rejection of a trademark license to effect the same result as termination of that license."

In *Sunbeam*, the Seventh Circuit expressly rejected *Lubrizol*. In *Sunbeam*, the court held as a matter of first impression that when a trademark license is rejected in bankruptcy, the licensee does not lose the ability to use the licensed IP.

Focusing on the impact of section 365(g) of the Bankruptcy Code (specifying the consequences of rejection), the Seventh Circuit explained that, outside bankruptcy, a licensor's breach does not terminate a licensee's right to use IP. According to the court, "What § 365(g) does by classifying rejection as breach is establish that in bankruptcy, as outside of it, the other party's rights remain in place." The debtor's unfulfilled obligations under the contract are converted to damages, which, if the contract has not been assumed, are treated as a prepetition obligation. "[N]othing about this process," the court remarked, "implies that any rights of the other contracting party have been vaporized." Instead, rejection "merely frees the estate from the obligation to perform and has absolutely no effect upon the contract's continued existence" (internal quotation marks and citation omitted).

The Seventh Circuit, reasoning that lawmakers' failure to include trademark licenses among the "intellectual property" protected by section 365(n) should not be viewed as an endorsement of any particular approach regarding rejection of a trademark license agreement, observed that "an omission is just an omission." Moreover, the Seventh Circuit wrote, "According to the Senate committee report on the bill that included §365(n), the omission was designed to allow more time for study, not to approve *Lubrizol*."

In a decision similar to the Third Circuit's holding in *Exide Technologies*, the Eighth Circuit skirted the issue of the effect of rejection of a trademark license agreement in *Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, 751 F.3d 955 (8th Cir. 2014). In *Interstate Bakeries*, the court held that a license agreement was not executory and thus could not be assumed or rejected because the license was part of a larger, integrated agreement which had been substantially performed by the debtor prior to filing for bankruptcy. In a footnote, the Eighth Circuit remarked that "[b]ecause the agreement is not executory, we need not address whether rejection of a trademark-licensing agreement terminates the licensee's rights to use the trademark."

A New Jersey bankruptcy court ruled in *In re Crumbs Bake Shop, Inc.*, 522 B.R. 766 (Bankr. D.N.J. 2014), that trademark licensees are entitled to the protections of section 365(n) of the Bankruptcy Code, notwithstanding the omission of trademarks from section 101(35A)'s definition of "intellectual property." The court also held that a sale of assets "free and clear" under section 363(f) does not trump or extinguish the rights of a third-party licensee under section 365(n), unless the licensee consents.

TEMPNOLOGY

Tempnology LLC ("Tempnology") was a New Hampshire-based material innovation company that developed chemical-free cooling fabrics for use in consumer products under the brand name "Coolcore." In 2012, Tempnology entered into a co-marketing and distribution agreement (the "Agreement") with Mission Product Holdings, Inc. ("Mission"), a marketer and distributor of innovative sports technologies. In the Agreement, Tempnology granted Mission a nonexclusive license to certain of Tempnology's copyrights, patents, and trade secrets; an exclusive right to distribute certain cooling material products that Tempnology manufactured; and an associated trademark license.

After filing for chapter 11 protection in the District of New Hampshire in 2015, Tempnology immediately sought to reject the Agreement. Mission objected, arguing, among other things, that notwithstanding rejection of the Agreement, by making an election under section 365(n), Mission retained its exclusive product distribution rights as well as its rights under the IP license and the trademark license and that it could continue to exercise those rights without interference from Tempnology or any purchaser of its assets in the bankruptcy case.

Relying on *Lubrizol* and without discussing *Sunbeam*, the bankruptcy court ruled that: (i) the nonexclusive copyright, patent, and trade secret license in the Agreement was a license of IP (as defined in section 101(35A)) and Mission's rights to continue to use the licensed IP were protected under section 365(n); (ii) the Agreement's exclusive distribution rights were not IP and were therefore not protected under section 365(n); (iii) because trademarks are not included in section 101(35A)'s definition of "IP," the Agreement's trademark license rights were not protected by section 365(n); and (iv) due to the rejection of the Agreement, Mission lost both the exclusive distribution rights and the trademark license rights. *See In re Tempnology, LLC*, 2015 BL 372538 (Bankr. D.N.H. 2015).

On appeal, the bankruptcy appellate panel affirmed the bankruptcy court's holding that the exclusive distribution rights in the Agreement were not IP and were therefore not protected by section 365(n). It also affirmed the decision that section 365(n) did not protect Mission's rights as a trademark licensee. In so holding, the panel declined to follow the approach advocated in Judge Ambro's concurring opinion in *Exide Technologies* and applied by the court in *Crumbs Bake Shop*.

The panel found that the bankruptcy court's reliance on *Lubrizol* was flawed, noting that "*Lubrizol* . . . is not binding precedent in this circuit and, like the many others who have criticized its reasoning . . . , we do not believe it articulates correctly the consequences of rejection of an executory contract under § 365(g)." Instead, the panel wrote, "We adopt *Sunbeam*'s interpretation of the effect of rejection of an executory contract under § 365 involving a trademark license."

Applying the *Sunbeam* approach, the panel concluded that, although the trademark and logo were not among the categories of IP specifically protected by section 365(n), "[Tempnology's] rejection of the Agreement did not vaporize Mission's trademark rights under the Agreement." According to the panel, "Whatever post-rejection rights Mission retained in the [Tempnology] trademark and logo are governed by the terms of the Agreement and applicable non-bankruptcy law."

Tempnology has been appealed to the First Circuit, which will now have an opportunity to weigh in on the issue.

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