Recent Developments in Bankruptcy and Restructuring
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BUSINESS RESTRUCTURING REVIEW

Welcome to the 15th Anniversary Edition of the *Business Restructuring Review*. Jones Day launched this publication 15 years ago with an enduring commitment to keeping our readers apprised of important developments in corporate bankruptcy and related fields. Much has changed during the last decade and a half. The corporate restructuring landscape is shifting rapidly. Moreover, with the continuing expansion of the global economy, corporate distress has increasingly become a cross-border problem that demands creative solutions. We are constantly learning and innovating to address and anticipate these developments. Finally, although much has changed in bankruptcy and restructuring in recent years, our dedication to providing incisive, informative, and timely analysis of ongoing developments has not. We look forward to continuing to do so.

Bruce Bennett
Practice Leader
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MARBLEGATE: SECOND CIRCUIT REVERSES BROAD INTERPRETATION OF TRUST INDENTURE ACT IN OUT-OF-COURT RESTRUCTURINGS

Brad B. Erens
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In a highly anticipated decision, a divided panel of the U.S. Court of Appeals for the Second Circuit ruled in *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp.*, 846 F.3d 1 (2d Cir. 2017), *reh'g denied*, No. 15-2124 (2d Cir. Mar. 21, 2017), that an out-of-court debt restructuring which impaired the practical ability of noteholders to be repaid did not violate section 316(b) of the Trust Indenture Act of 1939 (the "TIA"), because it did not amend an indenture's "core payment terms." The Second Circuit's decision reversed a 2014 district court ruling, which had concluded that section 316(b) provides "broad protection against nonconsensual debt restructuring" and prohibits such restructuring transactions if they adversely impact a noteholder's practical ability to be repaid. *See Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*, 75 F. Supp. 3d 592, 610 (S.D.N.Y. 2014).

THE TRUST INDENTURE ACT

The TIA was enacted to provide protections to holders of debt securities whose indentures are qualified under the statute. Section 316(b) provides that:

> the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder . . . .

15 U.S.C. § 77ppp(b). Section 316(b) protects minority bondholders by prohibiting a majority from agreeing to modify the bondholder's right to receive payment without the consent of each minority bondholder.

MARBLEGATE

In 2014, section 316(b) came under judicial scrutiny when for-profit education company Education Management Corp. ("EDMC") restructured approximately $1.3 billion in secured debt and $217 million in unsecured notes, which were issued by EDMC's subsidiaries, by means of an out-of-court exchange offer. Under the restructuring, secured creditors of EDMC's subsidiaries foreclosed on their collateral and transferred those assets to a newly formed subsidiary of EDMC. In addition, the secured creditors released the guaranty of their debt by EDMC, which caused a release of EDMC's guaranty of the unsecured notes pursuant to the terms of an indenture that was qualified under the TIA. Although the transaction did not amend the unsecured notes' payment terms (or the indenture at all), dissenting noteholders were left with nothing but claims against the EDMC subsidiaries, which at that point had no assets.

Two noteholders (collectively "Marblegate") sued to enjoin the exchange offer, alleging that it violated section 316(b) by effectively depriving them of the practical ability to collect on the notes. Relying on a 1999 decision, the district court denied Marblegate's motion for a preliminary injunction due to the adequacy of Marblegate's legal remedies but found that Marblegate would likely succeed on the merits of its claims under the TIA. *See Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*, 75 F. Supp. 3d 592 (S.D.N.Y. 2014) (relying on *Federated Strategic Income Fund v. Mechala Grp. Jamaica Ltd.*, 1999 BL 8776 (S.D.N.Y. Nov. 1, 1999)). Shortly after the court handed down this ruling in December 2014, a different judge in the same district broadly interpreted section 316(b) in two cases as likewise prohibiting parties from stripping guaranties from dissenting bondholders in out-of-court restructurings without the bondholders' unanimous consent. *See BOKF, N.A. v. Caesars Entm't Corp.*, 144 F. Supp. 3d 459 (S.D.N.Y. 2015); *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp.*, 80 F. Supp. 3d 507 (S.D.N.Y. 2015). EDMC proceeded with the exchange offer, but as a consequence of the district court's ruling, EDMC altered certain terms to protect Marblegate's rights in the event of a final ruling in Marblegate's favor, including removal of the parent guaranty cancellation. EDMC then sought a declaration from the court that cancellation of the parent guaranty as part of the exchange offer did not violate section 316(b) of the TIA.

The district court ruled in Marblegate's favor on the merits of its TIA claim. *See Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp.*, 111 F. Supp. 3d 542 (S.D.N.Y. 2015). The district court explained that at least two courts had ruled that section 316(b) "protects only the legal right to demand payment, rather than any substantive right to receive it, and thus that only formal modification of the right to sue or the payment terms impairs or affects the right to demand payment" (citing *YRC Worldwide Inc. v. Deutsche Bank Trust Co. Am.*, 2010 BL 149963 (D. Kan. July 1, 2010; *In re Nw. Corp.*, 313 B.R. 595 (Bankr. D. Del. 2004)). However, the court also noted that at least two other courts had interpreted section 316(b) more broadly as protecting a bondholder's right to receive payment, ruling that a debt restructuring depriving dissenting bondholders of assets against which to recover violates the TIA (citing *MeehanCombs*, 80 F. Supp. 3d at 515; *Mechala*, 1999 BL 8776 at *5–7).

Reaffirming its previous conclusion that the text of section 316(b) "lends itself to multiple interpretations," the district court in *Marblegate* reexamined the legislative history and purpose of the TIA but ruled, as before, that "they support[ ] a broad reading meant to inhibit involuntary debt restructurings outside the formal mechanisms of bankruptcy." After thoroughly canvassing the legislative history—including a 1936 report of the Securities and Exchange Commission (the "SEC"); the language of proposed 1937 legislation and the 1938 predecessor to the TIA; testimony; debates; commentary; congressional reports; and an SEC manual from June 1958 which analyzed section 316(b)—the district court concluded that: (i) a series of textual changes to what became section 316(b) demonstrates that the TIA's protections were broadened from a mere right to sue into a more substantive right; and (ii) the purpose of the TIA, as expressed consistently throughout its legislative history, is "to prevent precisely the nonconsensual majoritarian debt restructuring that occurred here, even if the [TIA's] authors did not anticipate precisely the mechanisms through which such a restructuring might occur." The district court accordingly ruled that cancellation of the EDMC guaranty would violate section 316(b).

THE SECOND CIRCUIT'S RULING

A divided Second Circuit panel reversed, concluding that section 316(b) of the TIA "prohibits only nonconsensual amendments to an indenture's core payment terms." Adopting this narrow reading of section 316(b), the majority wrote that "[a]bsent changes to the Indenture's core payment terms . . . Marblegate cannot invoke Section 316(b) to retain an 'absolute and unconditional' right to payment of its notes."

At the outset, the Second Circuit noted that the "core disagreement" in the case is whether the phrase " 'right . . . to receive payment' [in section 316(b)] forecloses more than formal amendments to payment terms that eliminate the right to sue for payment." The court agreed with the district court's finding that the statutory language is "ambiguous insofar as it 'lends itself to multiple interpretations' that arguably favor either side on that issue."

"On the one hand," the majority explained, "Congress's use of the term 'right' to describe what it sought to protect from non-consensual amendment suggests a concern with the legally enforceable obligation to pay that is contained in the Indenture, not with a creditor's practical ability to collect on payments." On the other hand, Marblegate's "broad reading" of the term "right" as including the ability to collect payments leads to "both improbable results and interpretive problems." Such a broad interpretation, the majority reasoned, "would transform a single provision of the TIA into a broad prohibition on any conduct that could influence the value of a note or a bondholder's practical ability to collect payment."

Having concluded that the language of section 316(b) is ambiguous, the majority relied upon the legislative history of the TIA, as well as its expressed concern about the "workability" of Marblegate's interpretation.

Initially, the majority concluded that "Congress did not intend the broad reading that Marblegate urges and the District Court embraced." According to the majority, the drafters of the TIA were "well aware of the range of possible forms of reorganization available to issuers, up to and including foreclosures like the one that occurred in this case but that the District Court concluded violated Section 316(b)." Foreclosure-based reorganizations, the majority explained, were widely used at the time of the TIA's drafting. However, the legislative history of the TIA and section 316(b) indicates that section 316(b) does not prohibit foreclosures even when they affect a bondholder's ability to receive full payment. Instead, the majority wrote,

In jurisdictions that are bound by, or adopt, the Second Circuit's decision, the effect will be to narrow substantially the grounds for attacking out-of-court restructurings based on section 316(b). Companies seeking to effectuate an out-of-court restructuring involving an exchange offer or consent solicitation of outstanding bonds that does not amend the indenture to impair core payment terms will likely take comfort in *Marblegate*. Conversely, nonconsenting bondholders will likely be more hesitant to challenge such a transaction under section 316(b).

"the relevant portions of the TIA's legislative history exclusively addressed formal amendments and indenture provisions like collective-action and no-action clauses."

Next, the majority examined what it characterized as an "additional difficulty" with Marblegate's broad interpretation of section 316(b) and addressed a "potential concern" with its holding. According to the majority, Marblegate's approach would require a determination in every case as to whether a challenged transaction constitutes an "out-of-court debt restructuring . . . designed to eliminate a non-consenting holder's ability to receive payment." This approach, the majority noted, "turns on the subjective intent of the issuer or majority bondholders, not the transactional techniques used." The majority explained that the Second Circuit has previously "expressed a particular distaste" when interpreting "boilerplate indenture provisions based on the 'relationship of particular borrowers and lenders' or the 'particularized intentions of the parties to an indenture,' both of which undermine 'uniformity in interpretation.' "

The Second Circuit majority rejected Marblegate's argument that the right to receive payment is "impaired" within the meaning of section 316(b) "when the source of assets for that payment is deliberately placed beyond the reach of non-consenting noteholders." According to the majority, such a description could apply to "every foreclosure in which the value of the collateral is insufficient to pay creditors in full." The court also rejected the argument that section 316(b) "permits 'genuinely adversarial' foreclosures but prohibits the type of foreclosure that occurred here." The majority wrote that "neither the text nor the legislative history of Section 316(b) supports a distinction between adversarial and 'friendly' foreclosures."

Limiting section 316(b) to formal indenture amendments of core payment rights, the majority explained, "will not leave dissenting bondholders at the mercy of bondholder majorities." Specifically, the majority noted, Marblegate and other similarly situated creditors have recourse in the form of "State and federal law remedies," such as the imposition of successor liability and fraudulent transfer avoidance. Moreover, "sophisticated creditors, like Marblegate, can insist on credit agreements that forbid transactions like [the one at issue]."

Thus, because the Marblegate transaction neither amended any of the terms of the indenture nor prevented any dissenting bondholder from exercising its legal right to sue to collect on its bonds, the majority concluded that the exchange offer did not violate section 316(b) of the TIA.

DISSENTING OPINION

In a dissenting opinion, Judge Chester Straub examined whether section 316(b) prohibited EDMC "from engaging in an out-of-court restructuring that is collusively engineered to ensure that certain minority bondholders receive no payment on their notes, despite the fact that the terms of the indenture governing those notes remain unchanged." Judge Straub concluded that the plain meaning of section 316(b) "compels" the conclusion that such conduct is prohibited and, for this reason, would have affirmed the ruling below.

Judge Straub was persuaded by Marblegate's reading of section 316(b); that is, "the right to receive payment is 'impaired' or 'affected' when the ability to receive payment under the bond is stripped away—not only through formal amendment of a bond's payment terms, but also by other means." He rejected EDMC's argument that "[n]othing in Section 316(b) . . . entitles bondholders to actual payment on their notes," emphasizing

that the argument "nearly eliminates the import of the terms 'impair' and 'affect' and imposes qualifications in Section 316(b) that simply do not exist." According to Judge Straub, even if the term "right" in section 316(b) were defined as a "legal entitlement" or "claim," it is "unquestionable that the 'right' to receive payment can be 'diminished' or 'affected' without actual modification of the payment terms of the indenture."

If Congress "intended merely to protect against modification of an indenture's payment terms," Judge Straub wrote, "it could have so stated," yet nothing in the express language of section 316(b) limits the prohibition on impairing or affecting the right to receive payment to "mere amendment of the indenture."

Finally, in his dissent, Judge Straub noted that "Congress recently abandoned two proposals to amend § 316(b), first through a 2015 highway bill rider and then through an omnibus appropriations legislation rider." These proposals would have amended section 316(b) to provide that bondholders' rights would not be impaired under the circumstances present in *Marblegate* and *Caesars*. Recognizing that the bond market "has surely undergone significant alterations since the enactment of the TIA, including that the main players are now sophisticated corporate entities on both sides," Judge Straub wrote that the court should refrain "on its own accord" from altering the TIA, adding that " 'none of this establishes why the plaintiffs should be barred from vindicating their rights under the [TIA]' as it currently stands" (citation omitted).

OUTLOOK

In jurisdictions that are bound by, or adopt, the Second Circuit's decision, the effect will be to narrow substantially the grounds for attacking out-of-court restructurings based on section 316(b). Companies seeking to effectuate an out-of-court restructuring involving an exchange offer or consent solicitation of outstanding bonds that does not amend the indenture to impair core payment terms will likely take comfort in *Marblegate*. Conversely, nonconsenting bondholders will likely be more hesitant to challenge such a transaction under section 316(b).

Marblegate came closely on the heels of another significant ruling concerning the application of section 316(b) of the TIA to exchange offers. 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).

In 2016, Cliffs Natural Resources Inc. ("Cliffs") commenced an offer to exchange outstanding unsecured notes for new secured notes with a lower principal amount and a higher interest rate. Two noteholders who were not eligible to participate in the exchange offer commenced class action litigation alleging that the exchange offer was barred by section 316(b) because it impaired their ability to collect on their notes by effectively subordinating their unsecured notes to the proposed new secured notes. The court granted Cliffs' motion to dismiss the complaint.

According to the court, section 316(b) "sprang from concerns about majorities abusing minority holders, which did not occur here." It 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" outside bankruptcy court protections, nor were they left with "no practical ability to receive payment" by virtue of the effective subordination of the plaintiffs' notes; and (ii) the exchange offer did not dispose of any assets, amend any terms of the indentures, or modify or remove any guaranty or collateral. In short, the court wrote, the plaintiffs "were not left holding a 'worthless right to collect principal and interest.' " Jones Day represented Cliffs in the *Cliffs* litigation.

Taken together, *Marblegate* and *Cliffs* suggest that, although the pendulum previously had swung in favor of a broad reading of the protections given to noteholders under section 316(b) in connection with exchange offers, it is now swinging in the opposite direction.

On March 21, 2017, the Second Circuit denied Marblegate's petition for rehearing en banc of the court's decision in *Marblegate*.

IN BRIEF: U.S. SUPREME COURT INVALIDATES NONCONSENSUAL "STRUCTURED DISMISSAL" OF CHAPTER 11 CASE INCORPORATING SETTLEMENT DEVIATING FROM BANKRUPTCY CODE'S PRIORITY SCHEME

In a highly anticipated decision, the U.S. Supreme Court ruled on March 22, 2017, in *Czyzewski v. Jevic Holding Corp.*, No. 15-649, 2017 BL 89680 (U.S. Mar. 22, 2017), that, without the consent of affected creditors, bankruptcy courts may not approve "structured dismissals" providing for distributions which "deviate from the basic priority rules that apply under the primary mechanisms the [Bankruptcy] Code establishes for final distributions of estate value in business bankruptcies."

Due to the significant time and administrative costs associated with confirming a liquidating chapter 11 plan or converting the case to chapter 7 following the sale of substantially all of a debtor's assets under section 363(b) of the Bankruptcy Code, structured dismissals of chapter 11 cases have become a popular exit strategy. A "structured dismissal" is a dismissal conditioned upon certain elements to which the stakeholders have agreed in advance and which is subsequently approved by the bankruptcy court, as distinguished from an unconditional dismissal of the chapter 11 case ordered by the court under section 1112(b).

In *Official Committee of Unsecured Creditors v. CIT Group/ Business Credit Inc. (In re Jevic Holding Corp.)*, 787 F.3d 173 (3d Cir. 2015), the U.S. Court of Appeals for the Third Circuit ruled that, "absent a showing that a structured dismissal has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion processes, a bankruptcy court has discretion to order such a disposition." The court also held that "bankruptcy courts may approve settlements that deviate from the priority scheme of [the Bankruptcy Code]," but only if the court has "specific and credible grounds" to justify the deviation. On the basis of this reasoning, the Third Circuit approved a structured dismissal of the chapter 11 case of Jevic Transportation, Inc., a New Jersey-based trucking company, that incorporated a settlement under which unsecured creditors would receive a distribution from secured creditors' collateral, but holders of priority wage claims (i.e., truck drivers) would receive nothing. The Third Circuit agreed with the lower courts that approval of the structured dismissal and settlement was warranted due to "dire circumstances"—the debtor had no prospect of confirming a chapter 11 plan, and conversion of the case to chapter 7 would mean that only secured creditors would recover anything.

The Supreme Court reversed. Writing for the 6-2 majority, Justice Breyer stated that "we would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans." The majority found no expression of any such intent in the Bankruptcy Code, nor did it find any "significant offsetting bankruptcy-related justification" that would warrant a violation of the ordinary priority rules in the case before it. Thus, it concluded that Congress did not authorize a "rare case" exception to the ordinary priority rules.

However, Justice Breyer wrote that "[w]e express no view about the legality of structured dismissals in general."

Justices Thomas and Alito filed a dissenting opinion, in which they stated that the Court should not have agreed to hear the case. According to the dissent, two different issues were implicated in the appeal—structured dismissals and settlements that deviate from the statutory priority scheme—yet the Court granted certiorari to resolve a circuit split only with regard to the latter and was not provided with "full adversarial briefing" on the former, which is a "novel question of bankruptcy law."

An article discussing *Jevic* in more detail will be included in the next edition of the *Business Restructuring Review*.

NEWSWORTHY

Ben Larkin (London), ***Richard L. Wynne (Los Angeles)***, ***David G. Heiman (Cleveland)***, ***Bruce Bennett (Los Angeles and New York)***, ***Heather Lennox (Cleveland and New York)***, and ***Corinne Ball (New York)*** have been recommended as "Leaders in Their Field" in the area of Restructuring/Insolvency or Bankruptcy/Restructuring by *Chambers Global* 2017.

Kevyn D. Orr (Washington) was a featured speaker at the INSOL 2017 Tenth World Quadrennial Congress in Sydney, Australia, on March 20, 2017.

On April 12, 2017, ***Thomas A. Wilson (Cleveland)*** will give a presentation entitled "Detroit Chapter 9 Bankruptcy" at Harvard Business School in Cambridge, Massachusetts.

Scott J. Greenberg (New York) and ***Carl E. Black (Cleveland)*** are leading a team of Jones Day professionals representing Ohio-based auto parts manufacturer Transtar Holding Company and 46 affiliates in connection with their chapter 11 filings on November 20, 2016, in the U.S. Bankruptcy Court for the Southern District of New York.

On February 24, 2017, ***George R. Howard (New York)*** participated in a panel discussion entitled "Case Study: Molycorp" at the Wharton Restructuring and Distressed Investing Conference in New York City.

Corinne Ball (New York) and ***Mark A. Cody (Chicago)*** represented Detroit-based auto parts supplier U.S. Manufacturing Corp. ("USM") in connection with an out-of-court restructuring pursuant to which USM sold its domestic operations to Dana Inc. and its Mexican operations to American Axle & Manufacturing, Inc., such that all of USM's debts were paid in full, with a substantial return to the private equity sponsor, Wynnchurch Capital, LLC.

Scott J. Greenberg (New York), ***Mark A. Cody (Chicago)***, ***Stacey L. Corr-Irvine (New York)***, ***Joseph A. Florczak (Chicago)***, and ***Caitlin K. Cahow (Chicago)*** are representing General Wireless Operations Inc., the successor to RadioShack Corp., which filed for chapter 11 protection on March 8, 2017, in the U.S. Bankruptcy Court for the District of Delaware. General Wireless, which does business as RadioShack, was formed through the partnership of Sprint Corp. and hedge fund Standard General LP in the summer of 2015, when it acquired the assets of RadioShack Corp. out of a previous chapter 11 case.

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

Roger Dobson (Sydney) was nominated as one of the world's leading practitioners in the field of Restructuring & Insolvency for 2017 by *Who's Who Legal*.

Heather Lennox (Cleveland and New York) was selected for a *Lawyer Monthly* Women in Law Award 2017 in recognition of her outstanding legal experience and contribution within the practice area of Business Restructuring and Reorganization.

Paul M. Green (Dallas) has been named a "Texas Rising Star" for 2017 in the field of Bankruptcy: Business by *Super Lawyers*.

Scott J. Greenberg (New York), ***Michael J. Cohen (New York)***, and ***Bryan M. Kotliar (New York)*** are representing an ad hoc group of first-lien prepetition and postpetition lenders in the chapter 11 cases filed by Answers Corporation, which owns the Answers.com and Multiply websites, and its affiliates on March 3, 2017, in the U.S. Bankruptcy Court for the Southern District of New York.

On April 7, 2017, ***Sidney P. Levinson (Los Angeles)*** gave a presentation entitled "A New Look at Fraudulent Transfer Liability in High Risk Transactions" at the American Bar Association's 2017 Business Law Section Spring Meeting in New Orleans.

On March 31, 2017, ***Thomas A. Wilson (Cleveland)*** will speak at "Cities that Cope: Confronting Financial Challenges in the Urban Landscape," the 2017 symposium of the *Journal of Business and Technology Law*, hosted by the University of Maryland Francis King Carey School of Law in Baltimore.

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 February 2017 issue of *LexisNexis Research Solutions*.

An article written by ***Ben Rosenblum (New York)*** and ***Mark G. Douglas (New York)*** entitled "Another Appellate Court Rejects *Lubrizol* Approach to Effect of Rejection of Trademark License in Bankruptcy" was published in the March 2017 issue of *The Licensing Journal*.

DEEPENING THE DIVIDE: COURT RULES THAT BANKRUPTCY CODE'S AVOIDANCE PROVISIONS DO NOT APPLY EXTRATERRITORIALLY

Charles M. Oellermann
Mark G. Douglas

The ability to avoid fraudulent or preferential transfers is a fundamental part of U.S. bankruptcy law. However, when a transfer by a U.S. entity takes place outside the U.S. to a non-U.S. transferee—as is increasingly common in the global economy—courts disagree as to whether the Bankruptcy Code's avoidance provisions can apply extraterritorially to avoid the transfer and recover the transferred assets. A ruling recently handed down by the U.S. Bankruptcy Court for the Southern District of New York widens a rift among the courts on this issue. In *Spizz v. Goldfarb Seligman & Co. (In re Ampal-Am. Israel Corp.)*, 562 B.R. 601 (Bankr. S.D.N.Y. 2017), the court, disagreeing with other courts both within and outside its own district, ruled that the avoidance provisions of the Bankruptcy Code do not apply outside the U.S. because, on the basis of the language and context of the provisions, Congress did not intend for them to apply extraterritorially.

THE PRESUMPTION AGAINST EXTRATERRITORIALITY

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

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

In *Morrison* and *RJR Nabisco, Inc. v. European Cmty.*, 136 S. Ct. 2090 (2010), the Supreme Court outlined a two-step approach to determining whether the presumption against extraterritoriality forecloses a claim. First, the court examines "whether the presumption against extraterritoriality has been rebutted—that is, whether the statute gives a clear, affirmative indication that it applies extraterritorially." *Nabisco*, 136 S. Ct. at 2101; *accord Morrison*, 561 U.S. at 255. If the conclusion is that the presumption has been rebutted, the inquiry ends.

If not, the court must determine whether the case involves a domestic application of the statute by examining its "focus." If the conduct relevant to that focus occurred in the U.S., "the case involves a permissible domestic application even if other conduct occurred abroad." *Id.*; *accord Morrison*, 561 U.S. at 266–67. However, if the conduct relevant to the focus of the statute did not occur in the U.S., "the case involves an impermissible extraterritorial application regardless of any other conduct that occurred in U.S. territory." *Id.; accord Societe Generale plc v. Maxwell Commc'n Corp. plc (In re Maxwell Commc'n Corp. plc)*, 186 B.R. 807, 816 (S.D.N.Y. 1995) ("*Maxwell I*"), *aff'd on other grounds*, 93 F.3d 1036 (2d Cir. 1996) ("*Maxwell II*").

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

EXTRATERRITORIAL OPERATION OF U.S. BANKRUPTCY LAWS?

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

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

However, the provisions of the Bankruptcy Code permitting avoidance and recovery of preferential or fraudulent transfers—e.g., sections 544, 547, 548, and 550—do not expressly refer to "property of the estate" as that term is defined in section 541 or to section 541 itself. Instead, section 544 permits the trustee to avoid certain transfers of "property of the debtor" or interests of the "debtor in property"; sections 547(b) and 548(a)(1) provide for the avoidance of "an interest of the debtor in property"; and section 550 permits the trustee to recover "the property transferred" or its value from the transferee.

Furthermore, some courts, noting that section 541(a)(3) of the Bankruptcy Code provides that any "interest in property that the trustee *recovers* under section ... 550" is part of the estate, have concluded that fraudulently or preferentially transferred property is not estate property *unless and until* it is recovered by the trustee. *See, e.g.*, *FDIC v. Hirsch (In re Colonial*

Realty Co.), 980 F.2d 125 (2d Cir. 1992) (if property that has been fraudulently transferred is included in the section 541(a)(1) definition of "property of the estate," section 541(a)(3) is rendered meaningless with respect to property recovered pursuant to fraudulent transfer actions); *accord Rajala v. Gardner*, 709 F.3d 1031 (10th Cir. 2013). *But see Am. Nat'l Bank of Austin v. MortgageAmerica Corp. (In re MortgageAmerica Corp.)*, 714 F.2d 1266, 1277 (5th Cir. 1983) ("[p]roperty fraudulently conveyed and recoverable under the Texas Fraudulent Transfers Act remains, despite the purported transfer, property of the estate within the meaning of section 541(a)(1)").

Therefore, the apparent disconnect between the avoidance provisions, on the one hand, and the statutory jurisdictional grant and the definition of estate property, on the other, has created confusion in the courts as to whether the avoidance provisions were intended by Congress to apply to property outside the U.S.

RECENT DECISIONS ADDRESSING EXTRATERRITORIALITY OF AVOIDANCE PROVISIONS

Prior to *Morrison*, the courts in *Maxwell I*, *Maxwell II*, *French*, and *Barclay v. Swiss Fin. Corp. Ltd. (In re Bankr. Estate of Midland Euro Exch. Inc.)*, 347 B.R. 708 (Bankr. C.D. Cal. 2006), addressed whether the Bankruptcy Code's avoidance provisions apply extraterritorially. In *Maxwell I*, the district court ruled that Congress did not clearly express its intention, in statutory language or elsewhere, for section 547 to empower a trustee to avoid foreign preferential transfers. The U.S. Court of Appeals for the Second Circuit affirmed, but on the basis that, under principles of international comity, the U.S. court must defer to the courts and laws of the U.K., and U.S. avoidance and recovery provisions should not apply to the transfers at issue. *See Maxwell II*, 93 F.3d at 1054–55.

The U.S. Court of Appeals for the Fourth Circuit held to the contrary in *French*. Agreeing with an argument rejected in *Maxwell I*, the Fourth Circuit held that it need not decide whether the transfer of a Bahamian residence was extraterritorial because "Congress made manifest its intent that § 548 apply to all property that, absent a prepetition transfer, would have been property of the estate, wherever that property is located." By incorporating the language of section 541 to define what property a trustee may recover, the Fourth Circuit wrote, section 548 "plainly allows a trustee to avoid any transfer of property that *would* have been 'property of the estate' prior to the transfer in question—as defined by § 541—even if that property is not 'property of the estate' *now*."

The Fourth Circuit cited *Begier v. IRS*, 496 U.S. 53 (1990), in support of its conclusion that Congress intended section 548 to apply extraterritorially. The issue in *Begier* was not extraterritorial application of U.S. avoidance law, but whether property preferentially transferred was "property of the debtor" at the time of the transfer. As noted previously, section 541(a)

defines "property of the estate," and section 547(b) authorizes the trustee to avoid transfers of "an interest of the debtor in property," but the Bankruptcy Code does not define the latter.

According to the Supreme Court in *Begier*, "property of the debtor" subject to avoidance under section 547(b) "is best understood as that property that would have been part of the estate had it not been transferred" pre-bankruptcy. *Id.* at 58–59. The Court looked for guidance to section 541. In delineating the scope of "property of the estate," the Court wrote, section 541 "serves as the postpetition analog to § 547(b)'s 'property of the debtor.' " *Id*. It ruled that because property held by the debtor in trust is neither "property of the estate" under section 541 nor "property of the debtor" for purposes of section 547(b), a chapter 7 trustee could not avoid a transfer of the property as a preference.

In *Midland Euro*, the bankruptcy court considered whether section 548 could be used to avoid a transfer by a Barbados corporation to an English company of funds from an English bank through a U.S. bank to another English bank. Noting that in *French*, the Fourth Circuit "totally ignores § 541(a)(3) and uses an unclear and convoluted method to reach its conclusion," the *Midland Euro* court ruled that it could "find no basis for holding that Congress intended the trustee's avoiding powers to apply extraterritorially." 347 B.R. at 719. The court also held that allegedly fraudulent transfers do not become property of the estate until they are avoided.

At least four courts since *Morrison* have addressed the extraterritoriality of the Bankruptcy Code's avoidance and recovery provisions. In *Picard v. Bureau of Labor Ins. (In re Bernard L. Madoff Inv. Sec. LLC)*, 480 B.R. 501 (Bankr. S.D.N.Y. 2012) ("*BLI*"), the bankruptcy court applied the two-step analysis required by *Morrison* to determine whether a trustee could recover redemption payments under section 550 that were made to the New York and London accounts of a Taiwanese entity. The court ruled that, because the initial transfers of the debtor's assets had occurred in New York, the trustee was not seeking extraterritorial application of section 550. The court also concluded in dicta that "Congress demonstrated its clear intent for the extraterritorial application of Section 550 through interweaving terminology and cross-references to relevant Code provisions," including sections 541 and 548 and 28 U.S.C. § 1334(e)(1). *Id*. at 527. According to the court, "[T]he concepts of 'property of the estate' and 'property of the debtor' are the same, separated only by time." *Id*.

The district court reached the opposite conclusion in *S.I.P.C. v. Bernard L. Madoff Inv. Sec. LLC*, 513 B.R. 222 (S.D.N.Y. 2014) ("*Madoff*"). In ruling that section 550 does not apply extraterritorially, the court wrote:

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

513 B.R. at 230.

In *Weisfelner v. Blavatnik (In re Lyondell)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016), the bankruptcy court refused to dismiss a claim seeking avoidance of a fraudulent transfer under section 548 on the ground that the challenged transfer 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."

Persuaded by the reasoning in *French*, the court distinguished the case before it from *Colonial Realty*. In *Colonial Realty*, the *Lyondell* court explained, the Second Circuit's recognition that sections 541(a)(1) and (a)(3) "were speaking as of different times" fell "far short of holding that property not in the estate as of the commencement of the case cannot be brought into the estate because it is in a foreign locale." The *Lyondell* court held that Congress could not have intended for property anywhere in the world to enter the bankruptcy estate once recovered pursuant to the avoidance powers while simultaneously not intending for such powers to reach anywhere in the world.

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AMPAL-AMERICAN

Ampal-American Israel Corp. ("Ampal"), a New York-based holding company with subsidiaries in Israel, filed for chapter 11

protection in the Southern District of New York in 2012. The case was converted to a chapter 7 liquidation in 2013. The chapter 7 trustee sued under sections 547(b) and 550 to avoid and recover approximately $90,000 transferred from Ampal's Tel Aviv bank account to the Tel Aviv bank account of an Israeli law firm in payment for legal services provided to Ampal in Israel. The law firm argued, among other things, that the trustee's preference claim was barred by the presumption against extraterritoriality.

Ampal-American further muddies the waters on an issue that has become increasingly prominent as the volume of cross-border bankruptcy cases continues to grow. The ruling widens a divide not only between U.S. courts, but also between courts in the Southern District of New York, where the majority of cross-border bankruptcy cases have traditionally been filed.

The bankruptcy court ruled in favor of the law firm. Bankruptcy judge Stuart M. Bernstein agreed with *Madoff* and *Maxwell I* that the avoidance provisions of the Bankruptcy Code, including section 547(b), do not apply extraterritorially. According to Judge Bernstein, "Property transferred to a third party prior to bankruptcy . . . is neither property of the estate nor property of the debtor *at the time the bankruptcy case is commenced*, the only two categories of property mentioned in Bankruptcy Code § 541(a)(1)." Moreover, he wrote that "the *Begier* Court's conclusion that 'property of the debtor' is best understood as property that would have become 'property of the estate' but for the transfer does not support the *French* and *BLI* courts' interpretation of section 548." In *Begier*, he explained, the Supreme Court read section 541(a) "as a limitation on the trustee's avoiding powers, not as an expansion of those powers."

Judge Bernstein noted that, although some provisions of the Bankruptcy Code and corresponding jurisdictional statutes, such as section 541(a) and 28 U.S.C. § 1334(e)(1), contain clear statements that they apply extraterritorially, section 547 does not—nor does section 548, he added in a footnote. Because the transfer at issue occurred outside the U.S., Judge Bernstein ruled that it could not be avoided by the trustee.

OUTLOOK

Ampal-American further muddies the waters on an issue that has become increasingly prominent as the volume of cross-border bankruptcy cases continues to grow. The ruling widens a divide not only between U.S. courts, but also between courts in the Southern District of New York, where the majority of cross-border bankruptcy cases have traditionally been filed. As things stand, the courts in *Ampal-American*, *Madoff*, *Midland Euro*, and *Maxwell I* have ruled that the Bankruptcy Code's avoidance provisions do not apply extraterritorially. The courts in *Lyondell*, *BLI*, and *French*—the only circuit court of appeals decision on this issue—have ruled to the contrary.

Without the ability to avoid transfers by U.S. debtors to non-U.S. entities under U.S. law, the only recourse available to bankruptcy trustees, chapter 11 debtors-in-possession, or other representatives of U.S. debtors (such as the representative of a U.S. debtor in a case filed in another country that has enacted the UNCITRAL Model Law on Cross-Border Insolvency) would likely be litigation abroad to seek avoidance and recovery of transferred property under foreign law. *But see Hosking v. TPG Capital Mgmt., L.P. (In re Hellas Telecomms. (Luxembourg) II SCA)*, 535 B.R. 543 (Bankr. S.D.N.Y. 2015) (in a chapter 15 case, even though U.K. law governed actual fraudulent transfer claims asserted by the liquidators of a foreign debtor, a U.S. bankruptcy court has jurisdiction to adjudicate the claims applying U.K. law). However, relatively few countries other than the U.S. have enacted such laws. This means that non-U.S. transferees are in many cases effectively insulated from avoidance liability.

Failing congressional action, the Second Circuit could resolve the uncertainty on this issue at least in the Southern District of New York by definitively ruling one way or another. However, even if the Second Circuit were to hold that the Bankruptcy Code's avoidance provisions apply extraterritorially, practical problems would remain. For example, a U.S. court may lack personal jurisdiction over a non-U.S. transferee, a fact that would significantly complicate efforts to enforce any avoidance ruling. *See Lyondell*, 543 B.R. at 147 (concluding that a litigation trustee in a chapter 11 case failed to make a prima facie case for the court's exercise of personal jurisdiction consistent with due process over a foreign transferee in avoidance litigation).

TRIBUNE 2: NO ACTUAL FRAUD IMPUTATION IN AVOIDANCE LITIGATION ABSENT CONTROL BY CORPORATE ACTORS

Aaron M. Gober-Sims
Mark G. Douglas

With its landmark ruling 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) ("*Tribune 1*"), the U.S. Court of Appeals for the Second Circuit held that claims asserted by creditors of the Tribune Co. ("Tribune") seeking to avoid payments to shareholders during a 2007 leveraged buyout ("LBO") as constructive fraudulent transfers were preempted by the "safe harbor" under section 546(e) of the Bankruptcy Code. According to the court, even though section 546(e) expressly provides that "the trustee" may not avoid certain payments under securities contracts unless such payments were made with the *actual* intent to defraud, section 546(e)'s language, its history, its purposes, and the policies embedded in the securities laws and elsewhere lead to the conclusion that the safe harbor was intended to preempt *constructive* fraud claims asserted by creditors. On September 9, 2016, the plaintiffs filed with the U.S. Supreme Court a petition for a writ of certiorari, which is currently pending, as well as a petition filed in another case involving the same issue. *See Deutsche Bank Trust Co. Ams. v. Robert R. McCormick Foundation*, No. 16-317 (U.S. Sept. 9, 2016).

Tribune 1, however, is only half the story in the litigation to recover payments made to Tribune's shareholders in connection with the LBO. Tribune's official creditors' committee (succeeded by the litigation trustee (the "Trustee") appointed under Tribune's confirmed chapter 11 plan) separately sued to avoid the payments as actual, rather than constructive, fraudulent transfers.

In *Kirschner v. FitzSimons (In re Tribune Co. Fraudulent Conveyance Litig.)*, 2017 BL 5202 (S.D.N.Y. Jan. 6, 2017) ("*Tribune 2*"), the district court overseeing the consolidated avoidance litigation held that, in the context of an action to avoid an intentionally fraudulent transfer under section 548 of the Bankruptcy Code: (i) when determining whether a debtor corporation had the intent to hinder, delay, or defraud its creditors, courts must examine the intent of the corporate actors who effectuated the transaction on behalf of the corporation; (ii) the intent of a debtor corporation's officers can be imputed to the debtor only if the officers were in a position to control the disposition of the debtor's property; and (iii) the Trustee failed to plead facts sufficient to allege that Tribune's corporate actors possessed the intent to hinder, delay, or defraud Tribune's creditors through the LBO.

THE TRIBUNE LBO

In 2007, Tribune was the target of an LBO that paid its shareholders more than $8 billion in exchange for their shares in the company (the "Shareholder Transfers"). Prior to the LBO, Tribune's board of directors (the "Board") created a special committee (the "Special Committee") to consider the LBO. The Special Committee included seven independent directors (the "Independent Directors") that served on the Board. There were two separate parts to the contemplated LBO. First, Tribune would borrow approximately $7 billion and purchase approximately 50 percent of its outstanding shares for $34 per share in a tender offer. Second, the company would purchase its remaining shares and borrow an additional $3.7 billion in a go-private merger with a newly formed Tribune entity. The Board engaged Duff & Phelps to provide a solvency opinion for both steps. Duff & Phelps issued a "viability opinion" in which it concluded that, considering potential tax savings, Tribune would be able to pay its debts as they became due after the LBO.

After considering opinions on the fairness of the proposed transaction, a majority of the Board, including six of the Independent Directors, voted in favor of the LBO on April 1, 2007. Ten days afterward, the Board retained Valuation Research Company ("Valuation Research") to render solvency opinions concerning both parts of the transaction. Valuation Research rendered the solvency opinions shortly before the completion of each part of the LBO.

Shortly after the LBO was completed in December 2007, Tribune experienced financial difficulties due to declining advertising revenues and failed to meet projections. The company filed for chapter 11 protection in December 2008 in the District of Delaware.

The court confirmed Tribune's chapter 11 plan in July 2012. The plan assigned certain of the estate's avoidance claims to a

litigation trust. Thus, the Trustee became the successor plaintiff in litigation that had been commenced in November 2010 by the unsecured creditors' committee (with leave of the court) seeking to avoid and recover the Shareholder Transfers as actual fraudulent transfers under sections 548(a)(1)(A) and 550 of the Bankruptcy Code. The shareholder defendants moved to dismiss the complaint.

Tribune 2 provides important guidance regarding the elements of an actual fraudulent transfer claim under section 548(a)(1)(A) as well as the circumstances under which the fraudulent intent of corporate actors may be imputed to the corporation. The ruling sets a high standard for imputing fraud. The legal landscape is unsettled because the *Tribune 2* fraud imputation standard differs from the approach adopted by the court in *Lyondell 3*.

THE DISTRICT COURT'S RULING

The district court granted the motion to dismiss. At the outset, the court explained that, when considering whether a debtor had the actual intent to hinder, delay, or defraud its creditors within the meaning of section 548(a)(1)(A), "courts focus on the intent of the transferor, not the intent of the transferee." However, if the transferor is a corporation, courts assessing intent in this context look to the intent of the corporate agents who effectuated the transaction on behalf of the corporation. Under certain circumstances, the court noted, the intent of such corporate actors to defraud can be imputed to the corporation.

The district court then analyzed whether Tribune's officers (the "Officers") or the Independent Directors effectuated the LBO with the intent to hinder, delay, or defraud the company's creditors and, if so, whether that intent could be imputed to Tribune.

The Officers

The district court acknowledged that the Second Circuit has not yet articulated a test for determining when an officer's intent should be imputed to a corporation in actual fraudulent transfer litigation.

However, it agreed with decisions from other courts that the intent of a debtor's officers may be imputed to the debtor if the officers were in a position to control the disposition of the transferor's property and, exercising that control, effectuated the fraudulent transfer (citing *In re Roco Corp.*, 701 F.2d 978 (1st Cir. 1983); *In re Lehman Bros. Holdings Inc.*, 541 B.R. 551 (S.D.N.Y. 2015); *In re Adler, Coleman Clearing Corp.*, 263 B.R. 406 (S.D.N.Y. 2001); *In re Lyondell Chem. Co.*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014) ("*Lyondell 1*"), *abrogated in part on other grounds* in *Tribune 1*, 818 F.3d at 118; *In re Elrod Holdings Corp.*, 421 B.R. 700 (Bankr. D. Del. 2010); *In re L & D Interests, Inc.*, 350 B.R. 391 (Bankr. S.D. Tex. 2006)).

"In other words," the district court wrote, "an officer's wrongful intent may be imputed to the corporation 'by establishing that [the officer], by reason of the ability to control' members of the board, 'caused the critical mass' to form 'an actual intent to hinder, delay or defraud creditors' " (quoting *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.*), 541 B.R. 172, 177–78 (Bankr. S.D.N.Y. 2015) ("*Lyondell 2*"), *rev'd and remanded*, 554 B.R. 635 (S.D.N.Y. 2016) ("*Lyondell 3*"). According to the court, "[T]his test appropriately accounts for the distinct roles played by directors and officers under corporate law, while also factoring in the power certain officers and other actors may exercise over the corporation's decision to consummate a transaction" (citing *Lyondell 1*, 503 B.R. at 388).

In *Lyondell 3*, the district court reversed the bankruptcy court's ruling in *Lyondell 2*, holding that, under Delaware law, the knowledge and actions of a corporation's officers and directors are imputed to the corporation when the officers and directors are acting within the scope of their authority, even when the agents act fraudulently. The *Tribune 2* court acknowledged the reversal but found the reasoning in *Lyondell 2* to be "highly compelling." Moreover, the *Tribune 2* court found *Lyondell 3* to be distinguishable, noting that the allegations of control and profit motive in *Lyondell 3* were significantly more compelling than in the case before it.

"To the extent that [*Lyondell 3*] also concluded that it was unnecessary for the trustee to allege control by the CEO to impute his intent to the transferor corporation," the *Tribune 2* court wrote, "the Court disagrees." Noting that other courts applying federal law have also concluded that a finding of

control is a prerequisite for imputation, the *Tribune 2* court further observed that "even assuming, [as *Lyondell 3*] concluded, that Delaware law (as opposed to the Bankruptcy Code or federal common law) controls the imputation analysis, the relevant inquiry—and the outcome—would be the same."

The *Tribune 2* court rejected the argument that only the directors' intent is relevant in assessing the corporation's intent because "it is too restrictive and 'effectively disregards any influence on the Board that [officers] may have exercised' " (quoting *Lyondell 1*, 503 B.R. at 386). The court also rejected the argument that an officer's intent is *always* attributable to the corporation in actual fraud cases.

Instead, the court held that, for the purpose of imputing fraud in this context, if a party who does not own a majority of a corporation's shares is alleged to control the corporation, the plaintiff must show " 'such formidable voting and managerial power that [he], as a practical matter, [is] no differently situated than if [he] had majority voting control' of the corporation's shares" (quoting *In re Morton's Rest. Grp., Inc. Shareholders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013)).

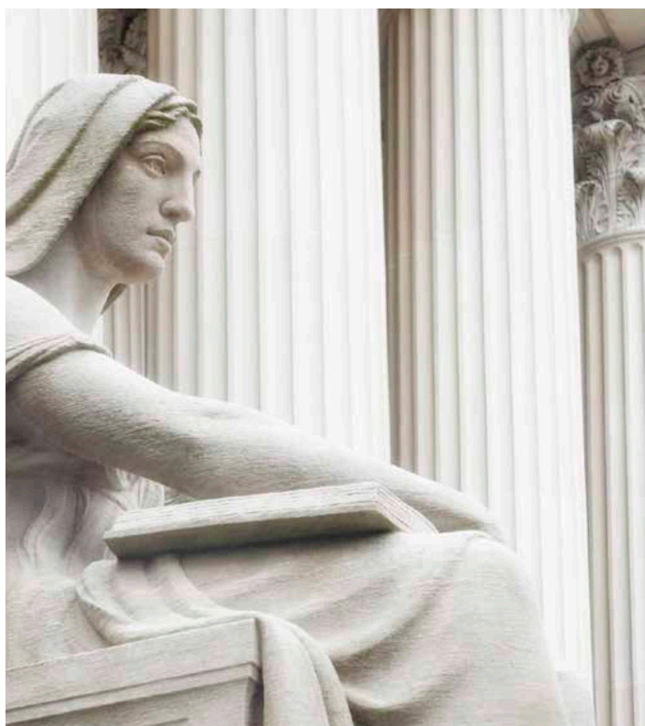
The district court concluded that the Officers had neither voting power nor managerial control of Tribune. The court found, among other things, that: (i) although Tribune's CEO was affiliated with an entity which owned 13 percent of Tribune's stock, that percentage was far below the amount typically found to constitute "formidable" voting power under Delaware law; (ii) the Trustee failed to offer evidence that the Officers had the right to appoint directors, veto Board action, or remove or reduce compensation for Board members who did not vote in favor of the LBO; and (iii) because the Special Committee reviewed projections before approving the LBO, were advised by an independent financial advisor, and obtained solvency and viability opinions from outside experts, the Trustee's arguments that the Officers deceived—and thus controlled—the Special Committee by, among other things, creating inflated projections and flawed solvency opinions and manipulating information were unavailing.

The court also rejected the Trustee's argument that the Officers had misled Valuation Research into issuing a flawed solvency opinion, thereby indirectly deceiving the Board and the Special Committee. According to the court, "[A]llowing the Trustee's expansive conception of the imputation doctrine sweeps the corporate landscape too broadly." Relying on *Tribune 1*, the court concluded that the Trustee's "multi-layered imputation theory" would undermine Congress's policy of protecting securities markets by introducing substantial uncertainty to the law governing actual fraudulent transfer claims. "[G]iven the ease with which one could allege that the misrepresentation of a material fact—originating from any source—manipulated the board's decisionmaking," the court wrote, "it is important to confine the imputation doctrine to those actors who deliberately and directly exert control inside the boardroom."

Thus, the court ruled that, because the Officers did not exercise voting or managerial control, "the Trustee's attempt to impute the Officer Defendants' intent to the corporation is unjustified."

The Independent Directors

The Trustee alleged that the Independent Directors, who were delegated authority by the Board to approve the LBO and who were "clearly" in a position to control the outcome of the Board's vote, possessed fraudulent intent. On the basis of these allegations, the district court ruled that any intent to defraud on their part could be imputed to Tribune for purposes of the Trustee's fraudulent transfer claim.



The court explained that, in determining whether a party possesses actual intent to hinder, delay, or defraud creditors, many courts apply: (1) the "purposeful harm test," whereby the plaintiff must provide either direct proof of actual intent or, because fraudulent intent is rarely susceptible to direct proof, a strong inference of fraudulent intent by relying on certain "badges of fraud"; or (2) the "securities law test," which requires either evidence that the debtor had both the motive and the opportunity to hinder, delay, or defraud its creditors or strong circumstantial evidence of conscious misbehavior or recklessness. The court concluded that the Trustee failed to allege actual fraudulent intent on the part of the Independent Directors under either standard.

The district court also observed that some courts consider the following badges of fraud when determining whether an inference can be made to support a finding of actual intent to hinder, delay, or defraud:

> (1) the lack or inadequacy of consideration; (2) the family, friendship or close associate relationship between the parties; (3) the retention of possession, benefit or use of the property in question; (4) the financial condition of the party sought to be charged both before and after the transaction in question; (5) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors; and (6) the general chronology of the events and transactions under inquiry.

In re Kaiser, 722 F.2d 1574, 1582 (2d Cir. 1983).

Among other things, the court rejected the argument that the Independent Directors acted with fraudulent intent because Tribune received less than reasonably equivalent value in connection with the LBO and because the LBO rendered Tribune insolvent. Allowing such allegations to raise a strong inference of fraudulent intent, the court wrote, would "turn every

constructive fraudulent conveyance claim into an actual fraudulent conveyance claim and thereby undermine the distinction between the two claims."

The court acknowledged that the claim that an allegedly fraudulent transfer was made to an insider or "close associate" can support an inference of fraudulent intent. However, it found that the only proceeds that the Independent Directors received from the Shareholder Transfers were from selling their shares in Tribune and that "any inference of scienter that could be drawn from the Independent Directors' receipt of a miniscule fraction of the Shareholder Transfers is weak at best."

The court also rejected the argument that the fifth badge of fraud had been satisfied. It explained that LBOs, by their nature, are transactions outside the ordinary course of business which require the incurrence of new debt. Accepting the Trustee's argument, the court wrote, "would mean that every LBO that ends in a bankruptcy within two years of its effectuation would subject transferring shareholders to an actual fraudulent conveyance claim."

Addressing the securities law test, the court acknowledged that the Independent Directors had the motive and opportunity to hinder, delay, or defraud Tribune's creditors because the Independent Directors would receive consideration in exchange for their shares only if the LBO was consummated. However, the court concluded, "the mere fact that the Independent Directors received Shareholder Transfers in connection with the LBO fails to support a strong inference of scienter, since a corporate director's desire to realize personal benefits in connection with a merger is a motive shared by every corporate director in America."

The court rejected the Trustee's argument that the Independent Directors had acted recklessly when they approved the LBO. Because the Special Committee hired its own advisor and worked with the Board's advisors, the court explained, the Special Committee did not "blindly" accept the projections of Tribune's management. Moreover, the court noted, failure to conduct more rigorous downside testing of the LBO would support a finding of negligence, not conscious misbehavior or recklessness.

With respect to the subsidiary guaranties, the court stated that a company's guaranty of new debt which subordinates old debt cannot, by itself, provide sufficient evidence of actual fraudulent intent. Similarly, the court determined that, although the Independent Directors considered negative trends in the newspaper industry and concluded that the trends weighed in favor of the LBO, the Trustee's argument amounted to "little more than a meatless assertion that the Independent Directors should have known better," which was not enough to establish fraudulent intent.

On the basis of these findings, the court ruled that the Trustee had failed to plead facts sufficient to allege that the Independent Directors possessed actual intent to hinder, delay, or defraud Tribune's creditors through the LBO.

OUTLOOK

Tribune 2 provides important guidance regarding the elements of an actual fraudulent transfer claim under section 548(a)(1)(A) as well as the circumstances under which the fraudulent intent of corporate actors may be imputed to the corporation. The ruling sets a high standard for imputing fraud.

The legal landscape is unsettled because the *Tribune 2* fraud imputation standard differs from the approach adopted by the court in *Lyondell 3*. Both rulings considered whether the fraudulent intent of officers and directors can be imputed to a Delaware corporation for purposes of fraudulent transfer litigation, yet the courts disagreed as to whether control must be adequately alleged as a prerequisite to imputation and as to which law—Delaware or federal—should apply. Confusion on these issues is likely to remain unless and until the Second Circuit ultimately resolves them.

Jones Day represents certain of the defendants in the *Tribune* fraudulent transfer litigation.

FIRST CIRCUIT RULING HIGHLIGHTS DIFFERENCE BETWEEN PROMESA STAY AND AUTOMATIC STAY IN BANKRUPTCY

Ben Rosenblum
Mark G. Douglas

An important aspect of the Puerto Rico Oversight, Management, and Economic Stability Act, 48 U.S.C. §§ 2101–2241 ("PROMESA")—the temporary stay of creditor collection efforts that came into effect upon its enactment—was the subject of a ruling handed down by the U.S. Court of Appeals for the First Circuit. In *Peaje Investments LLC v. García-Padilla*, 845 F.3d 505 (1st Cir. 2017), the First Circuit affirmed in part and vacated in part a lower court order denying two motions for relief from the PROMESA stay. The court held, among other things, that: (i) the lack of "adequate protection" of a secured creditor's interest is "cause" for relief from the stay, even though PROMESA does not expressly include language to that effect; and (ii) the party seeking relief from the PROMESA stay bears the burden of demonstrating "cause" for relief because the Bankruptcy Code's burden-shifting provision in connection with a motion for relief from the automatic stay does not apply under PROMESA, other than in a debt adjustment proceeding.

THE AUTOMATIC STAY

Section 362(a) of the Bankruptcy Code provides that the filing of a bankruptcy petition operates as a stay of substantially all creditor collection efforts against a debtor or its assets. Subsection (d)(1) of section 362 provides that, on the request of a party-in-interest and after notice and a hearing, the court shall grant relief from the automatic stay "for cause, including the lack of adequate protection of an interest in property of such party in interest."

Except for the "lack of adequate protection" language quoted above, the term "cause" is not defined in the Bankruptcy Code. Courts have devised various tests to determine whether this flexible standard has been met in any given case. *See, e.g.*, *Sonnax Indus., Inc. v. Tri Component Products Corp. (In re Sonnax Indus., Inc.)*, 907 F.2d 1280 (2d Cir. 1990) (applying a 12-factor test to consider in connection with a request for stay relief to continue pending litigation); *Izzarelli v. Rexene Prods. Co. (In re Rexene Prods. Co.)*, 141 B.R. 574, 576 (Bankr. D. Del. 1992) (applying a three-factor test).

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

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

Prior to the enactment of section 362 in 1978, some cases found that parties seeking relief from the stay bore the burden of demonstrating that they would be harmed by its continuation, *see, e.g.*, *In re Planned Sys., Inc.*, 78 B.R. 852, 858 (Bankr. S.D. Ohio 1987); *In re Anchorage Boat Sales, Inc.*, 4 B.R. 635, 641 n.6 (Bankr. E.D.N.Y. 1980), while other cases placed the burden on the trustee. *See, e.g.*, *In re Third Ave. Transit Corp.*, 198 F.2d 703, 705 (2d Cir. 1952). Where the alleged harm was a decrease in the value of the creditor's collateral, the required showing included evidence that "the value of the collateral [was] not substantially in excess of the amount of the debt." *In re Wynn Homes, Inc.*, 14 B.R. 520, 523 (Bankr. D. Mass. 1981).

PROMESA

On June 30, 2016, President Barack Obama gave his imprimatur to PROMESA. The bipartisan legislation was approved in a flurry of legislative dealmaking that preceded a deadline for Puerto Rico to make $2 billion in bond payments. Despite the passage of PROMESA, Puerto Rico defaulted on its general obligation debt for the first time on July 1, 2016.

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 Puerto Rico law, portions of which mirrored chapter 9 of the Bankruptcy Code, that would have

allowed the commonwealth's public instrumentalities to be restructured. *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 Puerto Rico and certain of its instrumentalities. 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.

PROMESA § 2194 provided that its enactment would serve as a stay of substantially all creditor collection efforts against Puerto Rico, its instrumentalities, and their property until February 15, 2017. As permitted by PROMESA, the commonwealth sought and obtained from the Oversight Board an extension of the stay for an additional 75 days. The Puerto Rico government has since requested that the Oversight Board seek from the United States Congress a further extension of the stay to December 31, 2017. Acts violating the stay are void under section 2194(h).

Section 2194(e) provides that, upon the request of a party and "after notice and a hearing," the court—the U.S. District Court for the District of Puerto Rico—may grant relief from the stay "for cause shown." The term "cause," however, is not defined.

Under section 2194(f), the stay terminates automatically 45 days after a request for stay relief is made unless the court orders otherwise. Section 2194(g) provides that, upon the request of a party-in-interest, the court, with or without a hearing, "shall grant such relief from the stay provided under subsection (b) as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing" on a stay relief request.

PROMESA includes a separate stay triggered by the commencement of a debt adjustment proceeding by a qualified Puerto Rico instrumentality. Specifically, section 2161 provides that many provisions of the Bankruptcy Code, including section 362, shall apply in a PROMESA debt adjustment proceeding. PROMESA does not expressly provide that section 362 applies with respect to the stay imposed by PROMESA § 2194(b).

In *Peaje Investments*, the First Circuit considered the appeal of an order denying two requests for relief from the stay triggered by PROMESA's enactment, one filed on behalf of a creditor of the Puerto Rico Highway and Transportation Authority ("PRHTA") and one filed on behalf of creditors of Puerto Rico's Employees Retirement System (the "ERS").

PEAJE INVESTMENTS

Peaje Investments LLC ("Peaje") is the beneficial owner of certain bonds issued by the PRHTA. The bonds are secured by a lien on toll revenues. In July 2016, Peaje filed a motion seeking relief from the stay under PROMESA § 2194(e) so that it could challenge the Puerto Rico government's diversion of the toll revenues to other uses, which Peaje alleged diminished the value of its collateral.

In September 2016, certain holders of bonds (collectively, the "Altair Movants") issued by the ERS also filed a motion to lift the PROMESA stay unless adequate protection were afforded

the Altair Movants in the form of placing employer contributions subject to the Altair Movants' lien in an account established for their benefit. *See Altair Global Credit Opportunities Fund (A), LLC v. García-Padilla*, No. 16-2433 (D.P.R.).

After procedurally consolidating the actions, the district court denied both motions without holding a hearing. Looking to section 362(d) of the Bankruptcy Code and the constitutional underpinnings of the adequate protection requirement, the court held that the "lack of adequate protection" necessarily constitutes "cause" to lift the stay under PROMESA § 2194(e), just as it does under section 362(d). However, the court concluded that both Peaje and the Altair Movants were adequately protected. According to the court, the toll revenues are "constantly replenished," and therefore, "to hold a security interest in a stable, recurring source of income that will eventually provide funds for the repayment of the PRHTA bonds" constituted adequate protection. Similarly, the court held that "pursuant to the terms of the applicable bond resolution," the Altair Movants "hold a security interest and lien in certain pledged property, including all future employer contributions." The court explained, "This lien continues indefinitely until the ERS's outstanding debt obligations have been satisfied in full," stating that since "they will only be delayed in recovering the funds needed to repay their ERS bonds," the Altair Movants were adequately protected. Peaje and the Altair Movants appealed.

THE FIRST CIRCUIT'S RULING

A three-judge panel of the First Circuit affirmed the district court's ruling as to Peaje but vacated the holding as to the Altair Movants.

The court rejected the commonwealth's "threshold" argument that, by omitting the clause "lack of adequate protection" from PROMESA § 2194(e), but including that language in section 362(d)'s definition of "cause," Congress intended for the definition of "cause" under section 2194(e) not to include actions impairing collateral in a manner which leaves the secured creditor's interest inadequately protected. The First Circuit explained that the concept of "adequate protection" is derived from the Fifth Amendment protection of property

interests. According to the court, "The PROMESA stay implicates these same constitutional concerns." The First Circuit did not fault the district court's conclusion that the existence of an equity cushion—a "common form" of adequate protection—meant that Peaje's interest in its collateral was adequately protected and that relief from the stay was not warranted.

Because the district court did not hold a hearing on the stay relief motions, the First Circuit vacated the portion of the court's ruling denying the Altair Movants' request for relief from the stay. The court explained, as an initial matter, that the language "after notice and a hearing" in PROMESA § 2194(e)(2) and various provisions of the Bankruptcy Code does not require a hearing to be convened, such as in cases where the material facts are not disputed.

In inquiring whether a hearing should have been required on the stay relief motions, the First Circuit examined the burden of proof for such a motion. Under section 362(g) of the Bankruptcy Code, the court explained, Congress changed pre-Bankruptcy Code practice by expressly placing the burden of demonstrating the debtor's lack of equity in property on the party seeking stay relief, but allocating the burden "on all other issues," including adequate protection, to the party opposing stay relief. In contrast, PROMESA § 2194(e)(2) places the burden of demonstrating "cause" on the movant.

"In light of Congress's decision not to transplant the Bankruptcy Code's express alteration of the pre-Code burden regime into PROMESA," the First Circuit wrote, "we hold that PROMESA, like the pre-Code regime, places the burden on creditors to establish cause, including lack of adequate protection." Due to the temporary nature of the PROMESA stay, as well as lawmakers' intent to minimize "creditor lawsuits," the court explained, "it makes sense to require creditors to shoulder the burden of demonstrating that the impairment of the collateral will likely harm their protected interest in repayment."

Because Peaje did not allege that future toll revenues would fail to provide a sufficient equity cushion, thereby leaving its interest without adequate protection, the First Circuit ruled that the district court was not required to hold a hearing to consider a claim which was facially insufficient.

However, the First Circuit concluded that the Altair Movants' motion warranted a hearing because the Altair Movants included in their filings statements by the ERS that "uncertainty about future employer contributions could affect 'the repayment of [the ERS's] bond payable.' "

OUTLOOK

PROMESA, which was patterned on chapter 9 of the Bankruptcy Code, incorporates many Bankruptcy Code provisions that apply in chapter 9 to govern debt adjustment proceedings of Puerto Rico instrumentalities. However, as illustrated by *Peaje Investments*, the PROMESA § 2194 stay and the Bankruptcy Code's automatic stay are not identical. Thus, the First Circuit concluded that Congress intended that the burden of proof governing a motion for relief from the temporary PROMESA stay should be different from the evidentiary burden governing a request for stay relief in a debt adjustment proceeding under PROMESA. In a footnote, the First Circuit acknowledged that "[i]f debt-adjustment proceedings are commenced under Title III of PROMESA, the statute contemplates that the bankruptcy stay provision will become fully applicable. *See* 48 U.S.C. § 2161(a) (incorporating by reference 11 U.S.C. § 362)."

Nonetheless, due to the constitutional concerns underpinning the concept of "cause" for relief from the stay under both PROMESA and the Bankruptcy Code, the court determined that the "lack of adequate protection" of a secured creditor's interest in its collateral should qualify as "cause" for relief from the PROMESA stay, even though Congress did not expressly say so in the statute.

Jones Day represents certain of the Altair Movants in the *Peaje Investments* case.

CHAPTER 15 INAPPLICABLE UNLESS "FOREIGN REPRESENTATIVE" SEEKS ENFORCEMENT OF FOREIGN INSOLVENCY COURT'S ORDER

Timothy Hoffmann
Mark G. Douglas

Chapter 15 of the Bankruptcy Code offers an effective mechanism for U.S. courts to provide assistance to non-U.S. courts presiding over the insolvency proceedings of foreign debtors with assets located in the U.S. An important feature of chapter 15 is "comity," the deference that U.S. courts give to the decisions of foreign courts under appropriate circumstances. A ruling recently handed down by the U.S. Court of Appeals for the Second Circuit illustrates that, although comity is an integral part of chapter 15, this chapter is far from the only context in which it applies. In *Trikona Advisers Ltd. v. Chugh*, 846 F.3d 22 (2d Cir. 2017), the court affirmed a district court ruling giving collateral estoppel effect to the findings of a foreign insolvency court, even though no chapter 15 petition had been filed in the U.S. on behalf of the foreign debtor seeking recognition of its Cayman Islands winding-up proceeding. According to the Second Circuit, because the party seeking such relief was not a "foreign representative" under chapter 15, the provisions of chapter 15 simply did not apply, but the district court nonetheless did not err in granting comity to the foreign insolvency court's factual findings.

INTERNATIONAL COMITY

U.S. courts apply general principles of international comity in determining whether to recognize and enforce foreign judgments or to defer to the pronouncements or laws of foreign nations. *See Timberlane Lumber Co. v. Bank of Am., N.T. & S.A.*, 549 F.2d 597 (9th Cir. 1976) (articulating a multifactor balancing test to determine whether to abstain from asserting jurisdiction on comity grounds); *see also, e.g.*, *In re Vitamin C Antitrust Litig. (Animal Sci. Prods., Inc. v. Hebei Welcome Pharm. Co.)*, 837 F.3d 175 (2d Cir. 2016) (deferring to the Chinese government's statement filed in U.S. district court and reversing an order denying a motion to dismiss an antitrust complaint on the ground of international comity).

Comity is "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws." *Hilton v. Guyot*, 159 U.S. 113, 164 (1895); *accord Shen v. Leo A. Daly Co.*, 222 F.3d 472, 476 (8th Cir. 2000) (previously litigated claims should not be retried if the reviewing court finds that the foreign court provided a full and fair trial of the issues in a court of competent jurisdiction, the foreign forum ensured the impartial administration of justice, the foreign forum ensured that the trial was conducted without prejudice or fraud, the foreign court had proper jurisdiction over the parties, and the foreign judgment does not violate public policy) (citing *Hilton*, 159 U.S. at 163).

THE ROLE OF COMITY IN CROSS-BORDER BANKRUPTCY CASES

Comity has long been an important consideration in cross-border bankruptcy cases. In the U.S., such cases are governed by chapter 15 of the Bankruptcy Code (discussed in more detail below), which is patterned on the UNCITRAL Model Law on Cross-Border Insolvency, a framework of legal principles that has been adopted in 41 nations or territories.

Prior to the enactment of chapter 15 in 2005, section 304 of the Bankruptcy Code governed proceedings commenced by the accredited representatives of foreign debtors in the U.S. that were "ancillary" to bankruptcy or insolvency cases filed abroad. *See* 11 U.S.C. § 304 (repealed 2005). Ancillary proceedings were typically commenced under section 304 for the limited purpose of protecting a foreign debtor's U.S. assets from creditor collection efforts by means of injunctive relief granted by a U.S. bankruptcy court and, in some cases, for the purpose of repatriating such assets or their proceeds abroad for administration in the debtor's foreign bankruptcy case. In deciding whether to grant injunctive, turnover, or other appropriate relief under former section 304, a U.S. bankruptcy court was required to consider "what will best assure an economical and expeditious administration" of the foreign debtor's estate, consistent with a number of factors, including comity. *Id.*

PROCEDURES AND RELIEF UNDER CHAPTER 15

Comity continues to play an important role in cross-border bankruptcy cases. Under chapter 15, the "foreign representative" of a non-U.S. debtor may file a petition in a U.S.

Trikona's significance is twofold. First, the ruling indicates that, although international comity is an integral feature of chapter 15, the doctrine applies in many other contexts besides chapter 15 and, for that matter, many other contexts besides cross-border bankruptcy proceedings. . . . Second, the decision is important because it provides guidance regarding the role of—and limitations on—comity in chapter 15 cases.

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

"Foreign proceeding" is defined in section 101(23) of the Bankruptcy Code as "a collective judicial or administrative proceeding in a foreign country . . . under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation."

Section 1509(b)(3) provides that, if a U.S. bankruptcy court recognizes a foreign proceeding under chapter 15, "a court in the United States shall grant comity or cooperation to the foreign representative." If the bankruptcy court denies a petition for recognition, the court may, under section 1509(d), "issue any appropriate order necessary to prevent the foreign representative from obtaining comity or cooperation from courts in the United States."

Section 1509(f) provides that the failure of a foreign representative "to commence a case or to obtain recognition under [chapter 15] does not affect any right the foreign representative may have to sue in a court of the United States to collect or recover a claim which is the property of the debtor." Finally, section 1524 provides that, upon recognition of a foreign proceeding under chapter 15, the foreign representative "may intervene in any proceedings in a State or Federal court in the United States in which the debtor is a party."

While chapter 15 gives a foreign representative considerable access to other U.S. courts after a U.S. bankruptcy court recognizes a foreign proceeding, neither chapter 15 nor any other provision of the Bankruptcy Code discusses the circumstances under which foreign parties other than a "foreign representative" in a "foreign proceeding" can seek to enforce the rulings of foreign courts in U.S. courts under principles of international comity. This was the focus of the Second Circuit's ruling in *Trikona*.

TRIKONA

Trikona Advisors, Ltd. ("TAL") was a Cayman Islands-based investment advisory company owned by companies controlled by Aashish Kalra (collectively, "Kalra") and Rakshitt Chugh (collectively, "Chugh"). In December 2011, Kalra sued Chugh in a U.S. district court in Connecticut, alleging, among other things, that Chugh had breached fiduciary duties by causing TAL to engage in certain transactions which resulted in its collapse. TAL was substituted as plaintiff after Chugh was removed from its board of directors.

Two months afterward, Chugh caused TAL to file a winding-up petition in the Grand Court of the Cayman Islands. Kalra opposed the petition on the basis of substantially the same allegations contained in the complaint filed in the Connecticut litigation. After a trial, the Cayman Islands court granted the winding-up petition. In doing so, the court rejected each of Kalra's objections—interposed as affirmative defenses—concluding that there was "no merit whatsoever in the allegations made against . . . Chugh." This ruling was affirmed on appeal by the Court of Appeal of the Cayman Islands and the Judicial Committee of the Privy Council in London.

After the ruling of the Cayman Islands court, Chugh moved for summary judgment in the Connecticut litigation on the ground of collateral estoppel. Chugh argued that, in ruling on the winding-up petition, the Cayman Islands court made findings of fact in its favor on all allegations regarding TAL's collapse

and that TAL, as Kalra's successor in interest, was collaterally stopped from relitigating those issues. The U.S. district court ruled in favor of Chugh.

THE SECOND CIRCUIT'S RULING

On appeal to the Second Circuit, TAL argued, among other things, that: (i) the district court was precluded by chapter 15 from applying collateral estoppel to the findings of fact from the Cayman Islands winding-up proceeding; and (ii) the district court erred in granting comity to the judgment of the Cayman Islands court because doing so was contrary to U.S. national policy.

According to TAL, because no application for recognition of the Cayman Islands winding-up proceeding under chapter 15 was ever filed, the judgment of the Cayman Islands court could not be recognized in the Connecticut district court. The Second Circuit rejected this argument, ruling that "the requirements of Chapter 15 do not apply here." It explained that, in the case before it, no party to the district court litigation was a "foreign representative" in a "foreign proceeding," as those terms are defined in the Bankruptcy Code. In addition, the Second Circuit emphasized, no party was seeking the assistance of a foreign country, the case did not involve a proceeding under the Bankruptcy Code pending concurrently with a foreign bankruptcy proceeding, and foreign creditors were not seeking to commence an action under the Bankruptcy Code. According to the Second Circuit, "Chapter 15 does not apply when a court in the United States simply gives preclusive effect to factual findings from an otherwise unrelated foreign liquidation proceeding."

In reaching this conclusion, the Second Circuit distinguished an unpublished ruling issued by a Connecticut state court in separate litigation involving some of the same parties. The state court held that the plaintiff could enforce an order of the Cayman Islands court awarding attorneys' fees in connection with TAL's winding-up proceeding only in a chapter 15 case. According to the Second Circuit, even if the ruling was correct as a matter of law, the plaintiffs in the related case had requested "the direct assistance of a court within the United States in enforcing an order issued in connection with a foreign liquidation proceeding[,] . . . a scenario that arguably falls within the scope of Chapter 15." Here, by contrast, the court wrote, Chugh argued that "the findings of fact made in the wind-up proceeding should be given preclusive effect," rather than seeking the assistance of the Connecticut district court in enforcing any judgment of the Cayman Islands court.

The Second Circuit also rejected TAL's argument that the district court should not have granted comity to the judgment of the Cayman Islands court as a matter of U.S. "national policy." Noting that other U.S. courts have granted comity to Cayman Islands court judgments, the Second Circuit wrote that TAL "provides no argument, in law or policy, for its contention that comity would be inappropriate here."

Having concluded that the district court properly ruled that the findings of the Cayman Islands court satisfied the requirements for collateral estoppel, the Second Circuit affirmed the ruling below.

OUTLOOK

Trikona's significance is twofold. First, the ruling indicates that, although international comity is an integral feature of chapter 15, the doctrine applies in many other contexts besides chapter 15 and, for that matter, many other contexts besides cross-border bankruptcy proceedings. Comity is invoked frequently by U.S. and foreign courts as a vehicle for enforcing judgments in the absence of treaties, conventions, or statutes that expressly provide for such recognition. Chapter 15 was an issue in *Trikona* only because the litigant involved sought a U.S. court's recognition of, and deference to, the findings of a non-U.S. insolvency court. Because the litigant was not a "foreign representative" seeking recognition of a "foreign proceeding" and enforcement of a foreign insolvency court's order, chapter 15 simply did not apply.

Second, the decision is important because it provides guidance regarding the role of—and limitations on—comity in chapter 15 cases. A foreign representative may file a chapter 15 case on behalf of a foreign debtor in the U.S. as a means of gaining access to U.S. courts for the purpose of attempting to enforce a judgment of a foreign court presiding over the debtor's insolvency proceedings. However, the foreign representative need not do so in all cases. It may sue in a U.S. court to collect or recover a claim that is the property of the debtor without filing a chapter 15 petition.

IN BRIEF: DELAWARE BANKRUPTCY COURT RULES THAT BOND INDENTURE FEE DEFENSE PROVISION SATISFIES *ASARCO* STANDARD

In an opinion and order issued on March 8, 2017, the Delaware bankruptcy court presiding over the chapter 11 cases of defunct telecommunications company Nortel Networks Inc. and its affiliates (collectively, "Nortel") held in *In re Nortel Networks Inc.*, No. 09-10138 (KG) (Bankr. D. Del. Mar. 8, 2017), that a provision in a bond indenture obligating Nortel to pay legal fees charged by the indenture trustee's attorneys for defending their requested fees did not violate the U.S. Supreme Court's ruling in *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158 (2015).

The court concluded that the terms of the indenture served as an exception to the "American Rule," which requires each litigant to pay its own attorneys' fees—win or lose—*unless a statute or contract provides otherwise*. In *ASARCO*, the Supreme Court ruled that "lawyers could not recover fees for defending their fees in [a] bankruptcy case" and that section 330 of the Bankruptcy Code, which provides that a court may award reasonable compensation for actual, necessary services rendered by professionals employed in a bankruptcy case, is not an exception to the rule because it does not mention "fees," a "prevailing party," and a "civil action."

The *Nortel* court concluded that the case before it satisfied the *ASARCO* standard and was distinguishable from *In re Boomerang Tube, Inc.*, 548 B.R. 69 (Bankr. D. Del. 2016). In *Boomerang*, the official unsecured creditors' committee sought to retain attorneys under section 328 of the Bankruptcy Code, which authorizes a bankruptcy trustee or an official committee to retain professionals "on any reasonable terms and conditions." The retention agreement provided that the bankruptcy estate would bear the cost of fees charged by the attorneys for defending their fees. Citing *ASARCO*, the court refused to approve the fee defense provision. It ruled that section 328 "is not a 'specific and explicit' statute that authorizes the prevailing party to recover fees in an adversarial action."

The *Boomerang* court found that "the retention agreement was a contract, but that it was not a bilateral agreement, and that its terms were subject to the court's approval and modification." It

accordingly held that "the retention agreement was not 'a contract between two parties providing that each will be responsible for the other's legal fees if it loses a dispute between them,' " but instead, "a contract between the creditors' committee and its attorneys providing that the estate, a third party, would pay the defense costs even if the estate was not the objecting party."

In *Nortel*, the court explained that, unlike in *Boomerang*, the indenture "provides for payment of the Indenture Trustees' and its attorneys' fees incurred in the fee dispute" because it "requires the Debtors . . . to indemnify the Indenture Trustee for 'costs and expenses of defending itself' " and "entitles the Indenture Trustee to exercise a charging lien against distributions to secure payment." Accordingly, the court ruled that the indenture "is clearly outside the circumstances of *ASARCO* and *Boomerang* [and the] . . . Indenture Trustee and its lawyers are therefore awarded their fees for the fee dispute."

The *Nortel* court also partially sustained the objection of two investment funds holding 90 percent of the bonds to a portion of the professional fees asserted by the indenture trustee's attorneys. The court disallowed as "unnecessary" approximately $914,000 of $8.1 million in fees requested by two law firms representing the indenture trustee.

INTERNATIONAL LEGISLATIVE UPDATE

NEW EU REGULATION ON CROSS-BORDER PRESERVATION OF ACCOUNTS POTENTIALLY USEFUL TOOL TO SECURE ASSETS IN EU MEMBER STATES

January 18, 2017, was the effective date of EU Regulation No 655/2014 of May 15, 2014 (the "Regulation"). The main purpose of the Regulation was the establishment of a European Account Preservation Order procedure: a uniform, harmonized procedure that makes it easier for creditors to obtain protective measures within the European Union (the "EU").

The Regulation enables a creditor to obtain a "preservation order" (a "PO") designed to ensure that the creditor can enforce its claims against a debtor or its assets in a cross-border EU context. The Regulation applies only to pecuniary claims asserted in civil and commercial matters in cross-border cases. A cross-border case is defined as a case in which any bank account to be preserved by a PO is maintained by the debtor in an EU member state other than the member state containing the court in which the application for the PO is filed or the member state in which the creditor is domiciled.

A creditor may obtain a PO before suing the debtor in the court of an EU member state upon demonstrating emergent need that its ultimate recovery may be jeopardized, and a likelihood of success on the merits in the litigation, or after obtaining a judgment against the debtor. A debtor may oppose the entry or implementation of a PO or seek its modification or revocation once entered. A debtor also has the right to post security in lieu of entry of a PO and may appeal the PO. Damages for any injury sustained by the debtor due to the entry of a PO may be imposed on the creditor under appropriate circumstances.

The Regulation does not apply in the United Kingdom or Denmark, which did not adopt it.

AMENDMENTS TO GERMAN INSOLVENCY LAW PROVIDE CLARITY ON STATUS OF NETTING AGREEMENTS

In December 2016, the German legislature amended the German Insolvency Code (the "Insolvency Code") to clarify the status of netting arrangements in financial transactions. Doubts about that status were raised by a June 9, 2016, ruling by the German Federal Court of Justice (Docket No. IX ZR 314/14) invalidating netting provisions used throughout the financial industry (patterned, for example, on the German Master Agreement for Financial Derivatives Transactions and the International Swaps and Derivatives Association Master Agreement) if they deviate from the requirements set forth in section 104 of the Insolvency Code, which are mandatory pursuant to section 119 of the Insolvency Code. Specifically, the court invalidated the contractual calculation method for claims of nonperformance in the case of insolvency by either party. The decision left open whether a contractually agreed-upon early termination right violates section 104.

The amendments were published in the *Federal Gazette* on December 28, 2016. Among other things, the amendments:

- Clarify and clearly differentiate between the statutory resolution rules for financial contracts and the scope of permissible contractual departures from the statutory rules;
- Leave largely intact the existing statutory model for resolving and settling financial contracts in case of insolvency; and
- Update the list of covered financial transactions to reflect the current status of financial services supervision.

The core of the reform is revised paragraph 4 of section 104. This provides that counterparties may contractually agree on netting provisions which deviate from the statutory provisions governing termination and settlement of regulated contracts as long as the deviations are compatible with the essential principles of section 104, thereby in principle upholding existing standard industry netting arrangements. On the day the June 9 court ruling was rendered, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or the "BaFin") issued a general decree to the effect that closeout netting arrangements of the type which were dealt with in the court ruling would be consummated as agreed upon among the parties concerned. This administrative decree was effective only until December 31, 2016. The statutory amendments to section 104 of the Insolvency Code apply from December 29, 2016, onwards. Thus, due to the rapid response by the BaFin and the German legislature, the impact of the Federal Court of Justice's decision is limited.

REFORMS TO GERMAN INSOLVENCY CODE AVOIDANCE ACTION PROVISIONS

In February 2017, the German legislature enacted reforms designed to improve procedures governing the avoidance of pre-insolvency transfers and to encourage work-outs between debtors and creditors. Under the Insolvency Code, an insolvency trustee (or the supervisor in a debtor-in-possession proceeding) has the power to avoid and recover: (i) preferential transfers made during the three months prior to the petition date; (ii) transfers made with the intent to defraud creditors during the 10 years prior to the petition date, if the transferee had knowledge of the debtor's intent or is deemed to have constructive knowledge of fraudulent intent because it was aware of the debtor's anticipated cash-flow insolvency and the fact that the transfer would harm creditors; (iii) transfers made for no consideration during the four years prior to the petition date; (iv) shareholder loan repayments made during the year prior to the petition date; and (v) certain transfers made subsequent to the petition date but before the formal commencement of insolvency proceedings.

The reform amends, among other things, the fraudulent transfer provisions in the Insolvency Code by reducing to four years the longest-possible avoidance look-back period of 10 years (applicable to "claw-back" of transfers made by a debtor with the intent to harm creditors), provided that such four-year period applies in those instances where the transfer resulted in a fulfillment of the transferee's claim or the securing of such claim. It also changes the rules governing the circumstances under which a transferee will be deemed to have knowledge of the debtor-transferor's insolvency, especially in cases where the transferee has agreed to modified payment terms on a loan or extension of credit or with respect to the delivery of goods and services made before an agreement as to the modified payment terms was reached. In addition, the reform amends the Insolvency Code to require that, if a contemporaneous exchange for new value is challenged as a fraudulent transfer, the transferee must have had knowledge at the time of the transfer of the debtor's "dishonesty" as well as the debtor's insolvency and its intention to cause harm to creditors.

According to the legislative history, the amendment is intended to obligate the administrator to prove—as was required prior to 2003—that the debtor and the transferee actively colluded to remove assets from the reach of creditors or that the transferee had knowledge of the debtor's intent to do so.

Finally, section 143 of the Insolvency Code was amended to provide that interest accrues on a monetary avoidance judgment only after the transferee defaults on paying the judgment. Previously, interest began to accrue on the filing date of the avoidance litigation and became payable if the insolvency administrator prevailed in the litigation.

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