JONES DAY

Recent Developments in Bankruptcy and Restructuring
Volume 17 | No. 2 | March–April 2018

JONES DAY

BUSINESS RESTRUCTURING REVIEW

U.S. SUPREME COURT NARROWS SCOPE OF SECTION 546(e)'S SAFE HARBOR FOR SECURITIES TRANSACTION PAYMENTS

On February 27, 2018, the U.S. Supreme Court issued a highly anticipated ruling resolving a long-standing circuit split over the scope of the Bankruptcy Code's "safe harbor" provision exempting certain securities transaction payments from avoidance as fraudulent transfers. In *Merit Management Group LP v. FTI Consulting Inc.*, 2018 BL 65569, No. 16-784 (U.S. Feb. 27, 2018), the unanimous Court held that section 546(e) of the Bankruptcy Code does not protect transfers made through a financial institution to a third party, regardless of whether the financial institution had a beneficial interest in the transferred property. Instead, the relevant inquiry is whether the transferor or the transferee in the transaction whose avoidance is sought is itself a financial institution.

THE SECTION 546(e) SAFE HARBOR

Section 546 of the Bankruptcy Code imposes a number of limitations on a bankruptcy trustee's avoidance powers, including the power to avoid certain preferential and/or fraudulent transfers. Section 546(e) provides that the trustee may not avoid a pre-bankruptcy transfer which is a margin payment or settlement payment "made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of)" any of those entities in connection with a securities contract, commodity contract, or forward contract, unless the transfer was made with the actual intent to hinder, delay, or defraud creditors.

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

IN THIS ISSUE

1 U.S. Supreme Court Narrows Scope of Section 546(e)'s Safe Harbor for Securities Transaction Payments

4 First Circuit Rejects *Sunbeam* Approach to Effect of Rejection of Trademark License in Bankruptcy

8 In Brief: U.S. Supreme Court Adopts Deferential Standard of Review on Chapter 11 Insider Status

9 First Circuit Limits Scope of *Jevic* in Mooting Appeal of Unstayed Bankruptcy Sale Order

12 Debate Intensifies as to Whether the Bankruptcy Code's Avoidance Provisions Apply Extraterritorially

16 Newsworthy

19 Chapter 15 Update: U.S. Venue Selection Clause Does Not Trump Distribution Scheme in Italian Restructuring Plan

23 The U.S. Federal Judiciary

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

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

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

The Seventh Circuit widened the circuit split on the issue when it agreed with the rationale of *Munford* in *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690 (7th Cir. 2016), *aff'd*, 2018 BL 65569, No. 16-784 (U.S. Feb. 27, 2018).

FTI CONSULTING

Valley View Downs, LP ("Valley View"), the owner of a Pennsylvania racetrack, acquired all of the stock of a competitor, Bedford Downs ("Bedford"), for certain harness-racing and gambling licenses in a $55 million LBO transaction. The Cayman Islands Branch of Credit Suisse ("CS Cayman") financed the purchase and wired the $55 million purchase price to a bank (the "Escrow Bank") that acted as escrow agent for the exchange and disbursed the net proceeds to Bedford's stockholders. After the LBO, Valley View filed for chapter 11 protection because its application for the gambling license was denied.

The chapter 11 litigation trustee for Valley View—FTI Consulting, Inc. (the "trustee")—sued Merit Management Group, LP ("Merit"), a shareholder in Bedford, alleging that Bedford's transfer to Valley View and thence to Merit of approximately $16.5 million (30 percent of the $55 million) was constructively fraudulent and therefore avoidable under sections 544 and 548(a)(1)(B) of the Bankruptcy Code. The bankruptcy court and the district court ruled that the transfer to Merit was protected by the section 546(e) safe harbor.

THE SEVENTH CIRCUIT'S RULING

The Seventh Circuit reversed. "Although we have said that section 546(e) is to be understood broadly," the court wrote, "that does not mean that there are no limits." Here, the court explained, although the transaction resembled an LBO, and "in that way touched on the securities market," Valley View and Merit were not "parties in the securities industry," but simply "corporations that wanted to exchange money for privately held stock." The Escrow Bank and CS Cayman, the "financial institutions" involved, were merely conduits. Accordingly, the Seventh Circuit ruled, section 546(e) does not apply.

Examining the history of section 546(e), the Seventh Circuit explained that nothing Congress did in originally enacting the

safe harbor, or in later expanding its scope to other types of actors in the securities industry, including financial institutions, indicates "that the safe harbor applie[s] to those institutions in their capacity as intermediaries." According to the court, "[T]he safe harbor has ample work to do when an entity involved in the commodities trade is a debtor or actual recipient of a transfer, rather than simply a conduit for funds."

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

The Supreme Court agreed to review the Seventh Circuit's decision on May 5, 2017.

THE SUPREME COURT'S RULING

Writing for the unanimous court, Justice Sotomayor sided with the Seventh and Eleventh Circuits, thus rejecting the rule that had long prevailed in, among other places, New York and Delaware bankruptcy courts. She stated that "the plain meaning of section 546(e) dictates that the only relevant transfer for purposes of the safe harbor is the transfer that the trustee seeks to avoid"—*i.e.*, the transfer to the ultimate transferee, as distinguished from intermediate transfers to financial institutions acting merely as conduits between the debtor and the ultimate transferee. In the absence of any allegation that either Valley View or Merit was a "financial institution" or other entity covered by section 546(e), the Court ruled that the transfer at issue fell outside the safe harbor.

According to Justice Sotomayor, lower courts that have examined whether the "financial institution" or other covered entity must have a beneficial interest in or dominion and control over the transferred property to qualify for the section 546(e) safe harbor "put the proverbial cart before the horse." Before a court can determine whether a transfer was "made by or to (or for the benefit of)" a covered entity, she wrote, "the court must first identify the relevant transfer to test in that inquiry."

Justice Sotomayor agreed with the trustee's argument that, in accordance with the language of section 546(e), the specific context in which that language is used, and "the broader statutory structure," the relevant transfer for purposes of the safe harbor "is the overarching transfer that the trustee seeks to avoid" rather than "component part[s]" of the transfer effected through financial institution intermediaries with no beneficial interest in the funds transferred.

Justice Sotomayor rejected Merit's argument that, by amending section 546(e) in 2006 to add the language "(or for the benefit of)," Congress intended to add to the scope of the safe harbor entities having only a "beneficial interest" in a transfer and to abrogate *Munford*. Noting the absence of any support cited by Merit for this position in the text of section 546(e) or its legislative history, Justice Sotomayor stated that there is a simpler explanation for the addition of the language. Congress

was merely ensuring, she wrote, that the "scope of the safe harbor matched the scope of the avoiding powers," which contain the same language (citing sections 547(b)(1) and 548(a)(1)). Therefore, she explained, nothing in the 2006 amendment "changed the focus of the §546(e) safe-harbor inquiry on the transfer that is otherwise avoidable under the substantive avoiding powers."

Finally, Justice Sotomayor rejected Merit's contention that, because Congress intended to take a comprehensive "prophylactic" approach to securities and commodities transactions, it would be incongruous to read section 546(e) such that its application would depend on the "identity of the investor and the manner in which it held its investment," rather than the nature of the transaction generally. This perceived purpose, she wrote, "is actually contradicted by the plain language of the safe harbor."

OUTLOOK

FTI Consulting is a game changer, particularly in the Second and Third Circuits, where New York and Delaware bankruptcy courts presiding over the greatest volume of cases involving transactions that may implicate the section 546(e) safe harbor have long ruled to the contrary. Going forward, deal participants, such as selling shareholders, in LBO transactions or dividend recapitalizations involving companies whose financial condition is questionable cannot, by means of financial institution intermediaries or other qualifying conduits, rely on section 546(e) to protect LBO transfers from avoidance. Instead, potential defendants will have to focus on the substantive elements of the avoidance causes of action.

Interestingly, in a footnote, the Court acknowledged that the Bankruptcy Code defines "financial institution" broadly to include not only entities traditionally viewed as financial institutions, but also the "customers" of those entities, when they act as agents or custodians in connection with a securities contract. Merit was a customer of one of the conduit banks, yet never raised the argument that it therefore also qualified as a financial institution for purposes of section 546(e). For this reason, the Court did not address the possible impact of Merit's customer status on the scope of the safe harbor.

Looking to the future, *FTI Consulting* may cause deal participants to restructure transactions so that they qualify for the section 546(e) safe harbor.

FIRST CIRCUIT REJECTS *SUNBEAM* APPROACH TO EFFECT OF REJECTION OF TRADEMARK LICENSE IN BANKRUPTCY

Benjamin Rosenblum
Mark G. Douglas

In *Mission Product Holdings, Inc. v. Tempnology, LLC* (*In re Tempnology, LLC)*, 879 F.3d 389 (1st Cir. 2018), the U.S. Court of Appeals for the First Circuit ruled that the rejection of a trademark license in bankruptcy means that the licensee loses the ability to use the licensed intellectual property because trademarks are not among the categories of "intellectual property" afforded special protection under the Bankruptcy Code. In so ruling, the First Circuit effectively embraced the approach articulated by the Fourth Circuit in *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers Inc.)*, 756 F.2d 1043 (4th Cir. 1985), and rejected the contrary approach endorsed by the Seventh Circuit—the only other court of appeals that has directly addressed the issue—in *Sunbeam Prods., Inc. v. Chicago Am. Manuf., LLC*, 686 F.3d 372 (7th Cir. 2012), *cert. denied*, 133 S. Ct. 790 (2012). The widening rift among the circuits on this issue may be an invitation to U.S. Supreme Court review.

SPECIAL RULES GOVERNING REJECTION OF CERTAIN INTELLECTUAL PROPERTY LICENSES IN BANKRUPTCY

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

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

adding section 365(n), Congress intended to make clear that the rights of an IP licensee to use licensed property cannot be unilaterally cut off as a result of the rejection of the license.

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

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

The Seventh Circuit reasoned that lawmakers' failure to include trademark licenses among the "intellectual property" protected by section 365(n) should not be viewed as an endorsement of any particular approach regarding rejection of a trademark license agreement. Rather, the Seventh Circuit wrote, the legislative history indicates that "the omission was designed to allow more time for study, not to approve *Lubrizol*."

The Third and Eighth Circuits also had the opportunity to weigh in on the validity of the *Lubrizol* approach, but declined to reach the merits for a variety of reasons. *See Lewis Bros. Bakeries, Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, 751 F.3d 955 (8th Cir. 2014) (ruling that a license agreement was not executory and thus could not be assumed or rejected because the license was part of a larger, integrated agreement which had been substantially performed by the debtor

prior to filing for bankruptcy); *In re Exide Technologies*, 607 F.3d 957 (3d Cir. 2010) (sidestepping the issue and concluding that a trademark license agreement was not executory; in a concurring opinion, Judge Ambro noted that Congress's decision to leave treatment of trademark licenses to the courts signals nothing more than Congress's inability, when it enacted section 365(n), to devote enough time to consideration of trademarks in the bankruptcy context).

The First Circuit rejected the *Sunbeam* approach in *Tempnology*.

TEMPNOLOGY

Cold-weather clothing innovation company Tempnology LLC ("Tempnology") entered into a marketing and distribution agreement (the "Agreement") with Mission Product Holdings, Inc. ("Mission") that included, among other things, a license of certain Tempnology trademarks.

The Agreement included a provision permitting either party to terminate the Agreement without cause. Mission exercised this option in 2014, triggering a "wind-down period" of approximately two years. Shortly afterward, Tempnology issued a notice of immediate termination for cause, claiming that Mission violated the agreement. An arbitrator later ruled that

Tempnology waived any grounds for immediate termination and that the Agreement remained in effect until the expiration of the wind-down period in July 2016.

Tempnology filed for chapter 11 protection in 2015. It then moved to reject the Agreement. Mission objected, arguing that, notwithstanding rejection, by making an election under section 365(n), Mission retained its rights under the trademark license and that it could continue to exercise those rights without interference from Tempnology or any purchaser of its assets in the bankruptcy case.

Relying on *Lubrizol* and without any discussion of *Sunbeam*, the bankruptcy court ruled that, because trademarks are not included in section 101(35A)'s definition of "intellectual property," Mission's trademark license rights were not protected by section 365(n). Thus, due to the rejection of the Agreement, Mission lost the trademark license rights. *See In re Tempnology, LLC*, 2015 BL 372538 (Bankr. D.N.H. 2015).

A bankruptcy appellate panel reversed the trademark ruling on appeal. *See Mission Prod. Holdings, Inc. v. Tempnology LLC (In re Tempnology LLC)*, 559 B.R. 809 (B.A.P. 1st Cir. 2016). The panel found that the bankruptcy court's reliance on *Lubrizol* was flawed, noting that "*Lubrizol* . . . is not binding precedent in this circuit and, like the many others who have criticized its reasoning . . . , we do not believe it articulates correctly the consequences of rejection of an executory contract under § 365(g)." Instead, the panel wrote, "[w]e adopt *Sunbeam*'s interpretation of the effect of rejection of an executory contract under § 365 involving a trademark license."

THE FIRST CIRCUIT'S RULING

A divided three-judge panel of the First Circuit reversed the bankruptcy appellate panel's trademark ruling.

The First Circuit majority acknowledged that "the conclusion that an agreement finds no haven from rejection in section 365(n) does not entirely exhaust the possible arguments for finding that a right under that agreement might otherwise survive rejection." However, the majority wrote, even "leaving open the possibility that courts may find some unwritten limitations on the full effects of section 365(a) rejection, we find trademark rights to provide a poor candidate for such dispensation."

The First Circuit majority concluded that the "unstated premise" of *Sunbeam* is flawed. In particular, it explained, freeing a debtor from any continuing performance obligations under a trademark license, while preserving the licensee's right to use the trademark, simply does not comport with Congress's

principal aim in providing for rejection of a contract—namely, to "release the debtor's estate from burdensome obligations that can impede a successful reorganization" (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984)).

According to the majority, the effective licensing of a trademark requires the trademark owner (or any purchaser of its assets) to monitor and exercise control over the quality of the goods sold to the public under cover of the trademark, failing which the trademark owner would be left with a "naked license" that would jeopardize the continued validity of its trademark rights. The *Sunbeam* approach, the majority emphasized, would allow Mission to retain the use of Tempnology's trademarks "in a manner that would force the company to choose between performing executory obligations under the license or risk the permanent loss of its trademarks."

Such a restriction on Tempnology's ability to free itself from its executory obligations, even if limited to trademark licenses, the majority wrote, "would depart from the manner in which section 365(a) otherwise operates." Moreover, the court explained, the logic of the approach that trademark rights categorically survive rejection "would seem to invite further leakage," to encompass, for example, exclusive distribution rights, a right to receive advance notice before termination of performance, and other rights.

THE DISSENT

In a dissenting opinion, circuit judge Juan R. Torruella disagreed with the majority's "bright-line rule that the omission of trademarks from the protections of section 365(n) leaves a non-rejecting party without any remaining rights to use a debtor's trademark and logo." Instead, Judge Torruella would follow *Sunbeam* (and the appellate panel below) in concluding that Mission's rights to use the licensed trademark "did not vaporize" due to rejection of the Agreement.

Because section 365 is silent as to the treatment of trademark license agreements after rejection, Judge Torruella looked to the legislative history of section 365(n) to divine lawmakers' intent. He explained that Congress enacted section 365(n) as a direct response to *Lubrizol*, intending to correct the perception that section 365 was designed to be a mechanism for stripping innocent licensees of rights vital to their ongoing business operations (citing S. Rep. No. 100-505, at 4 (1985)).

Like the Seventh Circuit in *Sunbeam*, Judge Torruella noted that the legislative history explains that the omission of trademarks from the definition of IP was designed not to leave trademark licensees unprotected—i.e., to endorse the *Lubrizol* approach—but to allow more time for study. Pending completion of that study, Judge Torruella read the legislative history to encourage "equitable treatment" by the courts to resolve disputes concerning executory trademark licenses, rather than defaulting to the *Lubrizol* approach, which Congress expressly rejected in enacting section 365(n).

As in *Sunbeam*, Judge Torruella would look to section 365(g) for the consequences of rejection of a trademark license, which constitutes a breach of the contract, rather than abrogation of whatever rights the trademark licensee may have under applicable nonbankruptcy law.

The majority was critical of the dissent, writing that "our dissenting colleague seems to reject [*Sunbeam*'s] categorical approach in favor of what *Sunbeam* itself rejected—an 'equitable remedy' that would consider in some unspecified manner the 'terms of the Agreement, and non-bankruptcy law' " (quoting *Sunbeam*, 686 F.3d at 375–76)). According to the majority, Judge Torruella accorded too much weight to a few lines in the legislative history and overlooked the fact that when Congress otherwise intended to grant bankruptcy courts the ability to "equitably" craft exceptions to rules set forth in the Bankruptcy Code, "it did so in the statute itself" (citing sections 365(d)(5), 502(j), 552(b)(1), 557(d)(2)(D), 723(d), 1113(c), and 1114(g)).

Moreover, the majority emphasized, even if the court were in a position to legislate from the bench, it would not embrace "a case-specific, equitable approach." It found "unappealing the prospect of saddling bankruptcy proceedings with the added cost and delay of attempting to draw fact-sensitive and unreliable distinctions between greater and lesser burdens" borne by the parties. Instead, the First Circuit majority wrote, "we favor the categorical approach of leaving trademark licenses unprotected from court-approved rejection, unless and until Congress should decide otherwise."

OUTLOOK

The First Circuit's effective retrenchment to the *Lubrizol* approach in *Tempnology* is anything but welcome news for trademark licensees. In the five years since *Sunbeam* was

decided, only a handful of reported decisions have discussed the impact of the rejection of a trademark license on the licensee's ability to use the licensed trademarks, and only one court (other than the bankruptcy court and the appellate panel in *Tempnology*) has actually decided the issue. In *In re Crumbs Bake Shop, Inc.*, 522 B.R. 766 (Bankr. D.N.J. 2014), the bankruptcy court followed *Sunbeam* in ruling that trademark licensees are entitled to the protections of section 365(n) of the Bankruptcy Code, notwithstanding the omission of trademarks from section 101(35A)'s definition of "intellectual property." The court also held that a sale of assets "free and clear" under section 363(f) does not trump or extinguish the rights of a third-party licensee under section 365(n), unless the licensee consents. *See also Interstate Bakeries*, 751 F.3d at 963 (a trademark license agreement was not executory and thus could not be assumed or rejected); *Harrell v. Colonial Holdings, Inc.*, 923 F. Supp. 2d 813, 818 n.4 (E.D. Va. 2013) (noting the disagreement between *Lubrizol* and *Sunbeam*, but also that the parties had not raised the issue of the impact which the debtor's rejection of a trademark license had on the licensee's rights). *Tempnology* undermines any sense of security that *Sunbeam* and *Crumbs* offered to trademark licensees considering the ramifications of a licensor's bankruptcy filing and subsequent rejection of a trademark license.

The First Circuit's ruling highlights that there are limits to a bankruptcy court's equitable powers. Guided by U.S. Supreme Court precedent, most courts recognize that, considerations of fairness aside, a bankruptcy court's broad equitable discretion is not a mandate to depart from the plain meaning of the Bankruptcy Code. Reformation of the statute is left to Congress.

Despite its refusal to review *Sunbeam* in 2012, the U.S. Supreme Court may finally agree to weigh in on this important issue due to the widening circuit split created by *Tempnology*.

IN BRIEF: U.S. SUPREME COURT ADOPTS DEFERENTIAL STANDARD OF REVIEW ON CHAPTER 11 INSIDER STATUS

In *U.S. Capital Bank N.A. v. Village at Lakeridge, LLC*, 2018 WL 1143822, No. 15-1509 (U.S. Mar. 5, 2018), the U.S. Supreme Court held that an appellate court should apply a deferential standard of review to a bankruptcy court's decision as to whether a creditor is a "nonstatutory" insider of the debtor for the purpose of determining whether the creditor's vote in favor of a nonconsensual chapter 11 plan can be counted. The Court, however, declined in its opinion to rule on the validity of the standard applied by the lower courts to determine nonstatutory insider status and expressly declined to consider whether a noninsider automatically inherits a statutory insider's status when the noninsider acquires the insider's claim.

Section 1129(a)(10) provides that, if a creditor class is impaired under a chapter 11 plan, at least one impaired class must vote in favor of the plan, "determined without including any acceptance of the plan by an insider." This provision must also be satisfied for a chapter 11 plan to be confirmed under the nonconsensual, or "cramdown," requirements set forth in section 1129(b). Thus, a cramdown chapter 11 plan cannot be confirmed in the absence of an accepting impaired class.

Section 101(31) of the Bankruptcy Code defines "insider" to include, in the case of a corporation, an officer, director, person in control, or relative of the foregoing, as well as an affiliate or managing agent. In addition, courts have recognized that other persons or entities not specifically mentioned in the provision may qualify as "non-statutory insiders." For example, the U.S. Court of Appeals for the Ninth Circuit has determined

that a creditor is a nonstatutory insider if: "(1) the closeness of its relationship with the debtor is comparable to that of the enumerated insider classifications in [the Bankruptcy Code], and (2) the relevant transaction is negotiated at less than arm's length." *In re Village at Lakeridge, LLC*, 814 F.3d 993, 1001 (9th Cir. 2016), *aff'd*, No. 15-1509 (U.S. Mar. 5, 2018).

Single-asset real-estate debtor Lakeridge, LLC ("Lakeridge") was unable to obtain confirmation of its chapter 11 plan because the only impaired secured creditor that supported the plan—sole shareholder and secured creditor MBP Equity Partners ("MBP")—was disqualified from voting to accept it as an insider. MBP therefore sold its $2.8 million secured claim for $5,000 to an individual who then voted for the plan. On the basis that the buyer was romantically attached to an MBP board member and Lakeridge officer, Lakeridge's secured bank lender objected to confirmation. It argued that the buyer of the claim was also disqualified from voting on the plan as a nonstatutory insider.

The bankruptcy court confirmed the chapter 11 plan, finding that the claim transfer was conducted at arm's length and that the buyer was therefore not a nonstatutory insider. A divided U.S. Court of Appeals for the Ninth Circuit affirmed, ruling that the bankruptcy court's finding was entitled to deference as not being "clearly erroneous," rather than being subject to "de novo" review.

Writing for the unanimous court, Justice Kagan affirmed the approach of the Ninth Circuit. She explained that the bankruptcy court is better situated to determine the "mixed question" of law and fact of whether a creditor is a nonstatutory insider, at least when the question is the fundamentally factual one of whether a transaction was conducted at arm's length. In such a case, the deferential standard of appellate review for questions of fact should apply. The Court, however, both assumed the correctness of the Ninth Circuit's standard for identifying a nonstatutory insider (which four justices, in a concurring opinion, called into question) and recognized that in a different circumstance (involving the second prong of the standard, which was not an issue before the Court), even that standard might call for a different standard of review. Thus, the Court's decision, while somewhat clarifying, may spawn further uncertainty.

FIRST CIRCUIT LIMITS SCOPE OF *JEVIC* IN MOOTING APPEAL OF UNSTAYED BANKRUPTCY SALE ORDER

Caitlin K. Cahow

In *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), the U.S. Supreme Court held that the Bankruptcy Code does not allow bankruptcy courts to approve distributions to creditors in a "structured dismissal" of a bankruptcy case which violate the Bankruptcy Code's ordinary priority rules without the consent of creditors. The highly anticipated ruling prompted speculation as to whether courts would apply the decision more broadly to other bankruptcy-related distributions in connection with, for example, "first day" payments to vendors and employees, or payments to creditors in connection with settlements or asset sales.

Recently, *In re Old Cold LLC*, 879 F.3d 376 (1st Cir. 2018), the U.S. Court of Appeals for the First Circuit provided some indication that courts will limit *Jevic*'s reach into these other areas, when it refused to apply *Jevic* to disturb an asset sale under section 363(b) of the Bankruptcy Code. Instead, the court applied section 363(m) of the Bankruptcy Code to render statutorily moot an appellate challenge to a sale to a good faith purchaser.

MOOTNESS

"Mootness" is a doctrine that precludes a reviewing court from reaching the underlying merits of a controversy. In federal courts, an appeal can be either constitutionally, equitably, or statutorily moot. Constitutional mootness is derived from Article III of the U.S. Constitution, which limits the jurisdiction of federal courts to actual cases or controversies and, in furtherance of the goal of conserving judicial resources, precludes adjudication of cases that are hypothetical or merely advisory.

By contrast, the judge-fashioned remedy of "equitable mootness" bars adjudication of an appeal when a comprehensive change of circumstances has occurred such that it would be inequitable for a reviewing court to address the merits of the appeal. In bankruptcy cases, appellees often invoke equitable mootness as a basis for precluding appellate review of an order confirming a chapter 11 plan.

An appeal can also be rendered moot by statute. For example, sections 363(m) and 364(e) of the Bankruptcy Code

respectively provide that the reversal or modification on appeal of an order authorizing a sale of assets or financing does not affect the validity of the sale or any debt or lien resulting from the financing if the purchaser or lender acted in "good faith" and no stay of the order pending appeal was obtained.

JEVIC AND STRUCTURED DISMISSALS

As the Supreme Court noted in *Jevic*, chapter 11 cases culminate by either confirmation of a plan of reorganization or liquidation that becomes effective; conversion to a chapter 7 case; or dismissal of the case. In the case of dismissal, section 349(b) of the Bankruptcy Code is designed to reinstate as nearly as possible the pre-bankruptcy status quo unless the court orders otherwise "for cause." Prior to *Jevic*, some courts relied on this provision to approve "structured dismissals" of chapter 11 cases that provide for rights and protections typically seen in chapter 11 plan confirmation orders, including distributions to creditors. In some instances, these distributions deviated from the Bankruptcy Code's priority scheme.

The Supreme Court had an opportunity to weigh in on the legitimacy of structured dismissals and distributions deviating from the Bankruptcy Code's priority scheme in *Jevic*. In its 6-2 ruling, the Court held that bankruptcy courts may not deviate from the Bankruptcy Code's priority scheme when approving structured dismissals without the consent of creditors (without, however, offering any "view about the legality of structured dismissals in general").

The Court's majority distinguished cases in which courts have approved *interim* settlements resulting in distributions of estate assets in violation of the priority rules, such as *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007). The majority found that *Iridium* "does not state or suggest that the Code authorizes nonconsensual departures from ordinary priority rules in the context of a dismissal—which is a *final* distribution of estate value—and in the absence of any further unresolved bankruptcy issues." In this sense, the majority explained, the situation in *Iridium* was similar to certain "first day" orders, where courts have allowed for, among other things, payments ahead of secured and priority creditors to employees for prepetition wages or to critical vendors on account of their prepetition invoices.

The majority further explained that "in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve." By contrast, the majority noted, the structured dismissal in *Jevic* served no such objectives (e.g., it did not benefit disfavored creditors by preserving the debtor as a going concern and enabling the debtor to confirm a plan of reorganization and emerge from bankruptcy). Rather, the majority emphasized, the distributions at issue "more closely resemble[d] proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards" (citing, among others, certain section 363 asset sales).

The First Circuit considered whether *Jevic*'s rationale should extend to a section 363(b) asset sale in *Old Cold*.

OLD COLD

Chapter 11 debtor Tempnology, LLC (subsequently renamed Old Cold LLC) (the "Debtor") auctioned off substantially all of its assets pursuant to section 363(b) of the Bankruptcy Code. Only two bidders participated in the auction, Schleicher and Stebbins Hotels LLC ("S&S"), the stalking horse bidder, and Mission Product Holdings, Inc. ("Mission"). S&S was both a secured creditor and the majority stockholder of the Debtor. Mission was a distributor of the Debtor's clothing products and a licensee of the Debtor's intellectual property.

S&S was declared the winning bidder, with a bid consisting of certain prepetition and postpetition secured debt (i.e., a credit bid), assumption of postpetition accounts payable, and assumption of certain prepetition unsecured debt, with cash, inventory, and accounts receivable being retained by the estate.

Following two days of evidentiary hearings, the bankruptcy court approved the sale to S&S. After considering, among other things, whether the sale process provided creditors with the same substantive protections as the plan confirmation process, the court held that the transaction did not subvert chapter 11's substantive creditor protections. It also determined that the absolute priority rule was not implicated because "S&S will not retain its equity interest or receive any distribution on account of it, but is instead purchasing the Debtor's assets." In addition, the court ruled that S&S's assumption of liabilities did not constitute an attempt to circumvent the Bankruptcy Code's prohibition against intra-class discrimination under section 1129(b)(1) and that S&S was entitled to credit bid its secured claim.

Concluding that there was no evidence of misconduct or collusion in the sale process, the court held that S&S was a "good faith purchaser" within the meaning of section 363(m). In its order approving the sale, the court also waived the 14-day stay in Rules 6004(h) and 6006(d) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). This meant that the sale order became effective immediately upon entry. The Debtor and S&S consummated the sale.

Mission appealed, first to the Bankruptcy Appellate Panel for the First Circuit, which affirmed the sale order, and then to the First Circuit.

THE FIRST CIRCUIT'S RULING

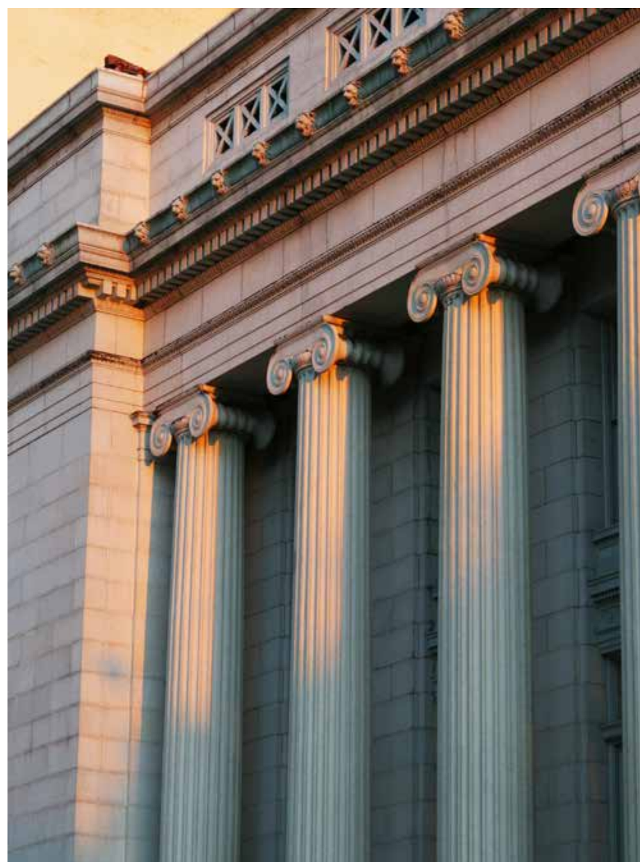
A three-judge panel of the First Circuit also affirmed. In so ruling, the court followed the majority of circuits that have generally adopted a per se rule that the appeal of a sale order is statutorily mooted if the closing of the sale is not stayed pending appeal.

Mission's principal arguments on appeal were that: (i) there was evidence of collusion, and because S&S was an insider, the bankruptcy court was required to apply "heightened scrutiny" in assessing whether S&S was a good faith purchaser, yet failed to do so; and (ii) Mission was not given adequate notice of the Debtor's request for a waiver of the 14-day stay in Bankruptcy Rules 6004(h) and 6006(d), and accordingly, Mission's failure to obtain a stay of the sale order pending appeal should be excused.

In the alternative, Mission argued that the Supreme Court's decision in *Jevic*—decided more than a year after the bankruptcy court approved the sale—controlled the outcome of Mission's appeal. According to Mission, because S&S's winning bid provided for the payment of certain unsecured claims (*i.e.*, the prepetition unsecured debt assumed by S&S) before Mission's administrative claims under its distribution and licensing agreement, the sale impermissibly violated the priority rules in contravention of *Jevic*.

The Debtor countered that *Jevic*, which on its face addresses only structured dismissals, does not apply to section 363(b) asset sales, which involve potentially "offsetting bankruptcy-related justification[s]" not present in structured dismissals.

The First Circuit declined to consider a *Jevic*-based challenge to the propriety of the sale, holding that "section 363(m)



applies even if the bankruptcy court's approval of the sale was not proper, as long as the bankruptcy court was acting under section 363(b)." The court further emphasized that "[s]ection 363(m) sets forth only two requirements: that there is a good faith purchaser, and that the sale is unstayed." It concluded, "Nothing in *Jevic* appears to add an exception to this statutory text."

Accordingly, the First Circuit panel affirmed the sale order, concluding that S&S was a good faith purchaser entitled to the protection of section 363(m) and ruling that Mission's "remaining challenges to the sale order are therefore rendered statutorily moot."

OUTLOOK

Old Cold indicates at least the First Circuit's disinclination to apply *Jevic* expansively in the context of asset sales protected from appellate challenge by section 363(m). It remains an open question as to whether the First Circuit and other courts will be more receptive to a *Jevic*-based challenge to distributions deviating from the Bankruptcy Code's priority scheme in other contexts.

DEBATE INTENSIFIES AS TO WHETHER THE BANKRUPTCY CODE'S AVOIDANCE PROVISIONS APPLY EXTRATERRITORIALLY

Charles M. Oellermann
Mark G. Douglas

The ability of a trustee or chapter 11 debtor-in-possession 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 apply extraterritorially to avoid the transfer and recover the transferred assets. Several bankruptcy courts have addressed this issue in recent years, with inconsistent results.

In a recent example, in *In re CIL Limited*, 2018 WL 329893 (Bankr. S.D.N.Y. Jan. 5, 2018), the U.S. Bankruptcy Court for the Southern District of New York, disagreeing with other courts both within and outside its own district, ruled that the "transfer of an equity interest in a U.K. entity to a Marshall Islands entity was a foreign transfer" and that the Bankruptcy Code's avoidance provisions do not apply extraterritorially because "[n]othing in the language of sections 544, 548 and 550 of the Bankruptcy Code suggests that Congress intended those provisions to apply to foreign transfers."

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," in either 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 it has not been rebutted, 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." *Nabisco*, 136 S. Ct. at 2101; *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 occurred in the U.S. or was extraterritorial for this purpose. 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 LAW?

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 states that the bankruptcy estate includes the debtor's property "wherever located and by whomever held." Section 541(a) provides further that such property includes various "interests" of the debtor in property. 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 imposed by 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—i.e., sections 544, 547, 548, and 550—do not expressly refer to "property of the estate" as that term is defined in section 541 or even 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 "property of the estate" under section 541(a)(1), 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)").

The different language used in 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.

CASE LAW 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), adopted differing approaches in determining 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 separate 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," the transfer of which is 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" prebankruptcy. *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 such property held in trust as a preference.

In *Midland Euro*, the bankruptcy court considered whether section 548 could be used to avoid a transfer of funds by a Barbados corporation to an English company from an English bank through a U.S. bank to another English bank. Stating 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.

Since the Supreme Court outlined its two-step approach on extraterritorial application of statutes in *Morrison*, several courts have undertaken to apply that approach to 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 in the same district 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 grant a motion 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 Fourth Circuit's 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.

In *Spizz v. Goldfarb Seligman & Co. (In re Ampal-Am. Israel Corp.)*, 562 B.R. 601 (Bankr. S.D.N.Y. 2017), the bankruptcy court agreed with *Madoff* and *Maxwell I* that the avoidance provisions of the Bankruptcy Code, including section 547(b), do not apply extraterritorially. According to the court, "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)." The court also 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*, the court explained, the Supreme Court read section 541(a) "as a limitation on the trustee's avoiding powers, not as an expansion of those powers."

The *Ampal-American* court 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 which they apply extraterritorially, section 547 does not—nor, it added in a footnote, does section 548. Because the transfer at issue occurred outside the U.S., the court ruled that it could not be avoided by the trustee.

In *In re FAH Liquidating Corp.*, 572 B.R. 117 (Bankr. D. Del. 2017), prior to filing for chapter 11 protection, the debtor entered into supply agreements with a German corporation headquartered in Munich. The agreements were expressly governed by German law and included a German forum selection clause. A litigation trustee appointed under the debtor's liquidating chapter 11 plan sued the German corporation to avoid wire transfers made pursuant to the agreements as constructively fraudulent transfers under sections 544, 548, and 550 of the Bankruptcy Code. The German corporation moved to dismiss the complaint, arguing that the wire transfers were extraterritorial and could not be avoided.

Adopting the reasoning of *Lyondell*, the *FAH Liquidating* court found that, although the wire transfers were extraterritorial, the presumption against extraterritoriality did not prevent the trustee's use of section 548 to avoid the transfers because Congress intended for the provision to apply extraterritorially.

Having concluded that the challenged transfers were extraterritorial, the court ruled that the presumption against extraterritoriality with respect to section 548 was overcome because Congress intended the provision to "reach such foreign transfers." On this point, the *FAH Liquidating* court agreed with the courts' reasoning in *Lyondell* and *French*.

The court further held that German law, rather than the Uniform Fraudulent Transfer Act, as enacted in either California or Delaware, governed the trustee's avoidance claims under section 544(b). Because the trustee would not have a remedy to avoid the transfers under section 544(b) if German law applied, the court dismissed the section 544(b) claim.

In *Official Comm. of Unsecured Creditors of Arcapita Bank B.S.C.(C) v. Bahrain Islamic Bank (In re Arcapita Bank B.S.C.(C))*, 575 B.R. 229 (Bankr. S.D.N.Y. 2017), and *Official Comm. of Unsecured Creditors of Arcapita Bank B.S.C.(C) v. Tadhamon Capital B.S.C. (In re Arcapita Bank B.S.C.(C)*, 2017 BL 368397 (Bankr. S.D.N.Y. Oct. 13, 2017), *motion for reconsideration denied*, 2018 BL 38409 (Bankr. S.D.N.Y. Feb. 5, 2018), Arcapita Bank B.S.C.(C) ("Arcapita"), a Bahrain-headquartered investment bank, entered into investment agreements with commercial banks (the "defendants") headquartered in Bahrain and Yemen. The agreements were negotiated and signed in Bahrain and provided that Bahraini law would govern any disputes, with

NEWSWORTHY

Jones Day ranked No. 1 in the 2018 *Acritas US Law Firm Brand Index*, a report ranking the top law firm brands in the United States. This is the second consecutive year that ***Jones Day*** earned the top spot.

Jones Day has been selected for the *GRR 100* 2018, a guide to the world's leading restructuring and insolvency practices that is compiled, written, and researched exclusively by independent *Global Restructuring Review* editorial staff. The *GRR 100* will be published in June 2018 and launched at the 2nd Annual GRR Awards Ceremony in London.

Heather Lennox (Cleveland and New York), ***Ben Larkin (London)***, ***Richard L. Wynne (Los Angeles)***, ***Bruce Bennett (Los Angeles 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* 2018.

An article written by ***Thomas A. Howley (Houston)***, ***Paul M. Green (Houston)***, and ***Jonathan M. Fisher (Dallas)*** entitled "Lessons Learned From The Oil Patch Blues" appeared in the March 1, 2018, edition of *Law360*.

Paul M. Green (Houston) has been named a "Texas Rising Star" for 2018 in the field of Bankruptcy: Business by *Super Lawyers*.

Corinne Ball (New York) was named one of the 2018 *Lawdragon 500* Leading Lawyers in America.

An article written by ***Charles M. Oellermann (Columbus)*** and ***Mark G. Douglas (New York)*** entitled "Bankruptcy Court Rules That It Has Constitutional Authority to Grant Nonconsensual Releases in Chapter 11 Plan" was posted on the February 6, 2018, issue of the *Harvard Law School Bankruptcy Roundtable*.

certain exceptions. Arcapita funded the investments by transferring $30 million from its U.S. bank account to U.S. bank accounts maintained by the defendants.

After Arcapita filed for chapter 11 protection in the U.S. Bankruptcy Court for the Southern District of New York, the official creditors' committee sued the defendants, seeking, among other things, to avoid and recover the $30 million in payments as preferential transfers under sections 547 and 550. The defendants moved to dismiss, contending that the avoidance claims were precluded by the "presumption against extraterritoriality."

The bankruptcy court denied the defendants' motion to dismiss because the committee's claims were either based on domestic conduct—the U.S. bank transfers were at the "heart" of the transactions—or based on statutes that apply extraterritorially. Because the court concluded that the transfers were domestic rather than foreign, the court noted that it "need not resolve whether the avoidance provisions [here, sections 547 and 550] of the Bankruptcy Code apply extraterritorially."

CIL

CIL Limited, formerly known as CEVA Logistics Limited ("CEVA Logistics"), was a Cayman Islands holding company that owned 100 percent of the stock of the CEVA Group PLC ("CEVA Group"). CEVA Group is a Netherlands-based company that through its subsidiaries conducts logistics and freight management services in 160 countries. As of March 2013, CEVA Logistics was owned by investment funds controlled by New York-based Apollo Global Management, LLC (collectively, "Apollo").

Beginning on April 1, 2013, CEVA Group, CEVA Logistics, and certain related entities entered into a restructuring agreement pursuant to which, among other things, new CEVA Group stock was issued to a newly formed Marshall Islands affiliate of Apollo—CEVA Holdings LLC ("CEVA Holdings")—and CEVA Logistics' ownership interest in CEVA Group was reduced to 0.01 percent.

On April 2, 2013, CEVA Logistics changed its name to CIL Limited ("CIL" or the "debtor") and commenced provisional liquidation proceedings in the Cayman Islands. Shortly afterward, Cayman Islands-based creditors filed an involuntary chapter 7 petition against the debtor in the U.S. Bankruptcy Court for the Southern District of New York. The bankruptcy court entered an order for relief in the chapter 7 case on May 14, 2013. On May 31, 2013, the Cayman Islands court converted the provisional liquidation proceedings to official liquidation proceedings.

Contending that CIL received no benefit in connection with the 2013 restructuring agreement, the chapter 7 trustee commenced an adversary proceeding in the U.S. bankruptcy court seeking, among other things, a determination that the stock transfer made as part of the restructuring was actually and constructively fraudulent under U.S. federal law (sections 544(b) and 548 of the Bankruptcy Code), U.S. state law (the New York Debtor & Creditor Law), and foreign law (the U.K. Insolvency Act of 1986 and the Cayman Islands Companies Law). The trustee sought to avoid the transfer and to recover the new CEVA Group stock or its value under sections 550 and 551 of the Bankruptcy Code. The defendants moved to dismiss, arguing that: (i) the stock transfer was foreign, and sections 544, 548, and 550 cannot be applied extraterritorially; and (ii) principles of international comity dictate that the fraudulent transfer claims be dismissed because the interests of the Cayman Islands in adjudicating the dispute outweigh those of the U.S.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court dismissed the fraudulent transfer claims. Initially, the court found that the transfer at issue was foreign because it involved the transfer of an equity interest in a U.K. entity (CEVA Group) from a Cayman Islands entity (the debtor) to a Marshall Islands entity (CEVA Holdings). The court rejected the chapter 7 trustee's argument that the "center of gravity" of the challenged transaction was in the U.S., noting that the trustee overstated the significance of the contacts of the defendants (which included Apollo, the officers and director of the debtors and their affiliates, and the companies' professionals and agents) with the U.S.

Next, the court explained that "Congress has not expressed an affirmative intent for sections 548 and 550 to be applied extraterritorially, and nothing in the text of those sections indicates such an intent." Like the courts in *Madoff* and *Ampal-American*, the *CIL* bankruptcy court concluded that Congress's failure to do so, "particularly in light of the fact that sections 541(a)(1) and 1334(e) expressly apply extraterritorially, operates to limit sections 548 and 550 to their terms."

In addition, the *CIL* court agreed with *Maxwell I* and *Madoff* that, in assessing the scope of the Bankruptcy Code's

avoidance provisions, section 541(a)(1) is irrelevant because property that is the subject of avoidance litigation does not become "property of the estate" unless and until it is recovered. Like the court in *Lyondell*, the *CIL* court acknowledged that the application of section 541(a)(3) (designating interests in recovered property as estate property) "might be viewed as to give rise to a 'timing' problem." Even so, the *CIL* court ruled, Congress has not "clearly expressed" that sections 548 and 550 apply extraterritorially.

The court also held that section 544(b), which permits a trustee to bring avoidance actions available to creditors under "applicable law" (here, New York State, U.K., and Cayman Islands law), cannot be used to avoid foreign transfers. The court rejected the chapter 7 trustee's argument that, by means of section 544(b), he was attempting not "an 'extraterritorial' exportation of U.S. law[,]" but to bring foreign law into a U.S. bankruptcy case. The court wrote that it was "not persuaded that the inclusion of the phrase 'voidable under applicable law' gives section 544(b) *de facto* extraterritorial application."

Finally, the court held that, by application of the principles of international comity, Cayman Islands law applied to the avoidance claims. However, the bankruptcy court also ruled that due to, among other things, practical concerns regarding the chapter 7 trustee's ability to bring avoidance claims in the Cayman Islands (whose law does not recognize constructively fraudulent transfers), the court would adjudicate the trustee's intentional fraud claim under Cayman Islands law, but "divorced of any aspect of the Bankruptcy Code."

OUTLOOK

CIL further muddies the waters on an issue that has become increasingly prominent as the volume of cross-border bankruptcy cases, and the prominence of cross-border transactions, continues to grow. The split on this issue exists not merely between courts in different jurisdictions, but also among 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 *CIL*, *Ampal-American*, *Madoff*, *Midland Euro*, and *Maxwell I* have ruled that the Bankruptcy Code's avoidance provisions do not apply extraterritorially. The courts in *FAH Liquidating*, *Lyondell*, *BLI*, and *French*—the last being the only circuit court of appeals decision on this issue—have ruled to the contrary. The bankruptcy court in *Arcapita Bank* skirted the issue.

Without the ability to avoid extraterritorial transfers by U.S. debtors to non-U.S. entities under U.S. law, the only recourse available to many bankruptcy trustees, chapter 11 debtors-in-possession, or other representatives of U.S. debtors (such as chapter 11 plan trustees or 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. However, at least two courts, including the bankruptcy court in *CIL*, have ruled that a U.S. bankruptcy court can adjudicate foreign law avoidance claims. *Accord 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 had jurisdiction to adjudicate the claims applying U.K. law).

Nevertheless, relatively few countries besides the U.S. have enacted avoidance 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).

CHAPTER 15 UPDATE: U.S. VENUE SELECTION CLAUSE DOES NOT TRUMP DISTRIBUTION SCHEME IN ITALIAN RESTRUCTURING PLAN

Dan T. Moss
Mark G. Douglas

In determining whether a U.S. bankruptcy court should provide the representative of a foreign debtor with various forms of assistance in a case under chapter 15 of the Bankruptcy Code, the court must consider, consistent with the principles of international comity, among other things: (i) whether such assistance will reasonably assure that U.S. creditors are protected against the prejudice and inconvenience associated with processing their claims; and (ii) whether the interests of creditors and other stakeholders are sufficiently protected in the debtor's foreign bankruptcy proceeding.

The U.S. Bankruptcy Court for the District of Delaware recently considered these requirements in *In re Energy Coal S.p.A.*, 2018 WL 276139 (Bankr. D. Del. Jan. 2, 2018). The court ruled that choice of law and venue selection provisions in a contract between a U.S. creditor and an Italian debtor did not trump the debt restructuring plan approved by an Italian bankruptcy court. In short, the court determined that, although the parties reached a compromise allowing the creditors to liquidate their claims in a U.S. court, it is "appropriate to expect U.S. creditors to file and litigate their claims" in non-U.S. bankruptcy cases, just as U.S. bankruptcy courts expect non-U.S. creditors to do in U.S. bankruptcy cases.

PROCEDURES AND RELIEF UNDER CHAPTER 15

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

"Foreign proceeding" is defined in section 101(23) of the Bankruptcy Code as "a collective judicial or administrative proceeding in a foreign country . . . 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."

Because more than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries, chapter 15 contemplates recognition in the U.S. of both a foreign "main" proceeding—a case pending in the country that contains the debtor's "center of main interests" (COMI)—and foreign "nonmain" proceedings, which may have been commenced in countries where the debtor merely has an "establishment."

Upon recognition of a foreign "main" proceeding, section 1520(a) provides that certain provisions of the Bankruptcy Code automatically come into force, including section 361, which entitles any entity asserting an interest in the debtor's U.S. assets to "adequate protection" of that interest; section 362, which imposes an automatic stay preventing creditor collection efforts with respect to the debtor or its U.S. assets; section 363, which restricts the debtor's ability to use, sell, or lease its U.S. property outside the ordinary course of its business; section 549, which gives a trustee the power to avoid unauthorized postpetition asset transfers; and section 552, which provides that, with certain exceptions (e.g., pledged proceeds and rents), prepetition security interests do not encumber U.S. property acquired by the bankruptcy estate or by the debtor postpetition.

If the bankruptcy court recognizes a foreign proceeding as either a main or nonmain proceeding, section 1521(a) authorizes the court to grant a broad range of provisional and other relief designed to preserve the foreign debtor's assets or otherwise provide assistance to the court or other entity presiding over the debtor's foreign main proceeding. Under section 1521(a)(1), such relief can include "staying the commencement or continuation of an individual action or proceeding concerning the debtor's assets, rights, obligations or liabilities to the extent they have not been stayed under section 1520(a)."

Under section 1521(a)(7), the court may also "grant[] any additional relief that may be available to a trustee, except for relief available under sections 522, 544, 545, 547, 548, 550, and 724(a)." These excepted sections authorize a bankruptcy trustee to, among other things, avoid and recover transfers that are fraudulent under the Bankruptcy Code and/or, under certain circumstances, "applicable" law (generally state law).

Section 1522 provides that the bankruptcy court may grant relief under section 1521 "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected."

Section 1506 of the Bankruptcy Code sets forth a public policy exception to the relief otherwise authorized in chapter 15, providing that "[n]othing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

Under section 1507 of the Bankruptcy Code, in determining whether a U.S. bankruptcy court should provide "additional assistance" to a foreign representative in a chapter 15 case, the court must consider whether such assistance, "consistent with the principles of comity," will reasonably assure, among other things: (i) the just treatment of all creditors and interest holders; (ii) protection of U.S. creditors "against prejudice and inconvenience in the processing of claims in such foreign proceeding"; and (iii) "distribution of proceeds of the debtor's property substantially in accordance with the order prescribed" in the Bankruptcy Code.

Cooperation between U.S. and foreign courts—or a form of comity—is an indispensable element of the chapter 15 paradigm. "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).

In *Energy Coal*, the bankruptcy court weighed considerations of comity and prejudice to creditors in determining whether to recognize a foreign court's order approving a foreign debtor's debt restructuring plan as well as the plan itself and whether to enjoin creditors from proceeding against the debtor's U.S. assets.

ENERGY COAL

Genoa, Italy-based Energy Coal S.p.A. ("Energy Coal") markets solid fuels, coal, and petroleum coke products for use in steel manufacturing. Certain affiliated independent contractors (the "Contractors") sourced Energy Coal's petroleum coke supply in the U.S. pursuant to 2005 and 2007 agreements (the "Coke Agreements"). One of the Coke Agreements included a Florida choice of law provision and stated that "any suit involving this agreement may only be filed in the state or federal court having jurisdiction within the State of Florida."

In April 2015, an Italian bankruptcy court granted Energy Coal's petition to commence an arrangement with creditors proceeding, or *concordato preventivo*, under the Italian Insolvency Law and appointed a foreign representative for the company.

Energy Coal's foreign representative filed a petition in the U.S. Bankruptcy Court for the District of Delaware on October 2, 2015, seeking recognition of Energy Coal's *concordato preventivo* under chapter 15. The U.S. bankruptcy court entered an order on November 12, 2015, recognizing the Italian proceeding as a foreign main proceeding. Subsequently, the foreign representative sent official notice of termination of the Coke Agreements effective March 31, 2016.

After Energy Coal's creditors overwhelmingly approved the company's debt restructuring plan, the Italian bankruptcy court entered a "homologation order" approving the plan in October 2016. The plan provided that administrative expenses would be paid in full while unsecured creditors would receive a distribution of up to 7 percent of their allowed claims, depending upon classification of their claims. The homologation order provided that, except as specified in the plan, Energy Coal's remaining debts would be discharged.

In January 2017, Energy Coal's foreign representative filed a motion in the U.S. bankruptcy court seeking recognition of the Italian bankruptcy court's homologation order as well as an injunction preventing creditors within the U.S. from proceeding against Energy Coal or its U.S. assets.

The Contractors objected to the requested injunction in the U.S., making two primary arguments: (i) they were entitled to payment in full of amounts they were owed under the Coke Agreements pursuant to Energy Coal's debt restructuring plan as administrative claims (i.e., not as unsecured claims receiving up to a 7 percent distribution) because their claims were based upon services provided after the commencement of the *concordato preventivo*; and (ii) "all their disputes with Energy Coal—including both the liquidation of their claims and any dispute over priority and distribution—should be determined by a Florida court" in accordance with the choice of law and venue provisions in the Coke Agreements.

The foreign representative responded that, although the Contractors' claims under the Coke Agreements were treated as unsecured claims under Energy Coal's debt restructuring plan, the company had established a reserve sufficient to pay the claims in full if the Italian court later ruled that the Contractors' claims were entitled to administrative priority. Moreover, the foreign representative explained, the Contractors had the right to file their claims against Energy Coal in the Italian proceeding. Finally, the foreign representative agreed that the Contractors' claims could be liquidated in a court of competent jurisdiction in the U.S., provided that any judgment must be satisfied in accordance with the debt restructuring plan approved by the Italian bankruptcy court.

THE BANKRUPTCY COURT'S RULING

The U.S. bankruptcy court granted the foreign representative's motion for recognition of the homologation order and the restructuring plan and for injunctive relief.

The court explained that section 1521(a)(7) empowers a bankruptcy court to grant to a foreign representative any "additional relief available to a trustee," with certain exceptions. According to the court, this provision gives a bankruptcy court, guided by principles of comity and the mandate to protect the interests of creditors and other stakeholders, the power to issue injunctive relief to enforce the terms of a restructuring plan approved in a foreign proceeding.

The court rejected the Contractors' argument that, due to the choice of law and venue provisions in the Coke Agreements, they were entitled to litigate *and to collect* their claims in the U.S. without regard to the Italian proceeding:

> [The Contractors] cite no case law for the proposition that a choice of law provision in a contract should override the comity afforded foreign main proceedings vis-à-vis distributions on claims. Indeed, taken to its logical conclusion, [their] argument means the distribution scheme of a confirmed plan in a foreign main or non-main proceeding could be litigated in all the fora in which U.S. creditors have contracts containing forum selection clauses. This is not the law, nor is it appropriate or sensible. As recognized by other courts, "U.S. bankruptcy courts have not hesitated to require foreign creditors to file their claims and to litigate in our courts if they wish a distribution from a U.S. Debtor's estate. It is equally appropriate to expect U.S. creditors to file and litigate their claims in a foreign main bankruptcy case" [footnote omitted]. While the Court appreciates that there is additional

> cost to seeking distribution of a claim in Italy, the Foreign Representative's agreement to permit liquidation of the claim in the United States strikes an appropriate balance in this case.

Accordingly, the court ruled that, while the Contractors could liquidate their claims in Florida courts, they must submit to the Italian bankruptcy court for distributions on their liquidated claims in accordance with the approved restructuring plan. This would include allowing the Italian bankruptcy court to determine whether the Contractors' claims were administrative or unsecured.

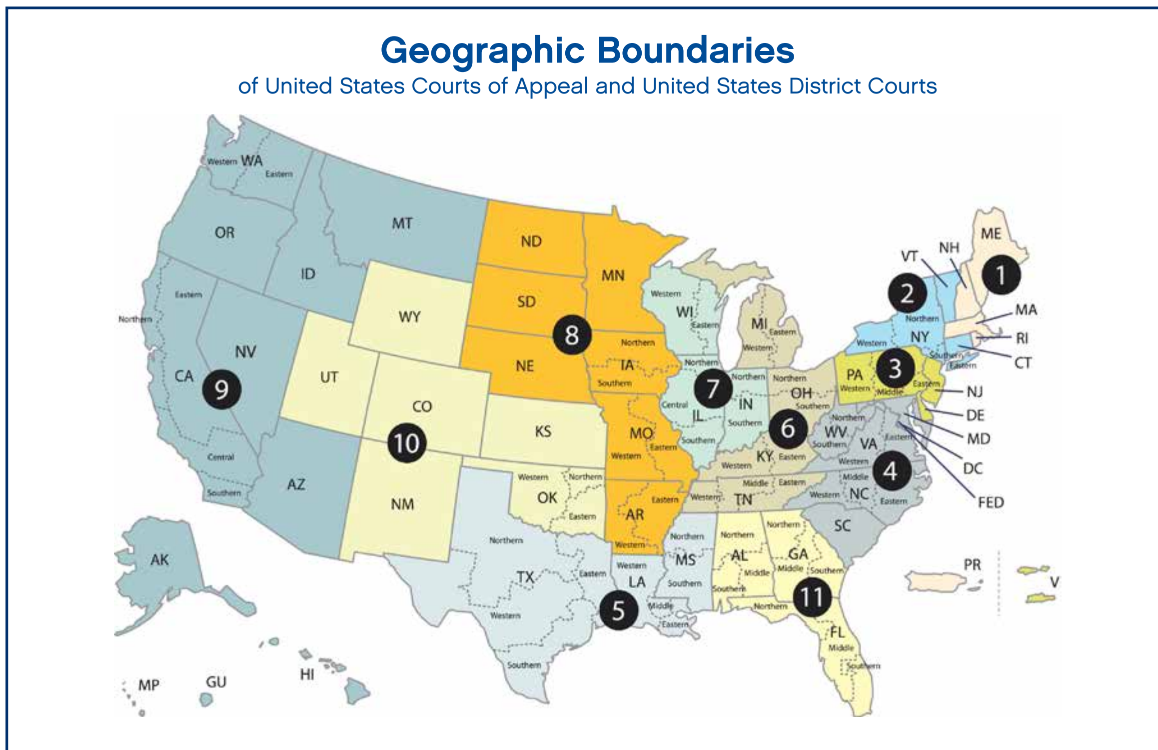
OUTLOOK

Energy Coal reinforces the importance of comity in cross-border bankruptcy cases under chapter 15 and other versions of the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law") that have now been enacted by more than 40 nations and territories. To advance comity, chapter 15 and the Model Law provide a mechanism for courts in jurisdictions other than the venue of the debtor's main proceeding to cooperate with the presiding court. Those laws also permit non-main proceeding courts to provide various forms of assistance designed to, among other things, prevent the debtor's assets in other countries from being seized by local creditors.

Chapter 15 is also premised on the idea that creditor claims against a foreign debtor should be resolved in the debtor's foreign main proceeding. This does not mean that a U.S. court must defer in all cases to the court presiding over the main proceeding. Important safeguards are built into chapter 15 in cases where public policy (section 1506), protection of U.S. creditors against prejudice (section 1507(b)), or the best interests of creditors or other stakeholders (section 1522) dictate that deference is unwarranted.

However, *Energy Coal* and other similar rulings indicate that U.S. entities conducting business with a non-U.S. entity must be cognizant that at least certain aspects of claims against the foreign entity may be adjudicated in restructuring proceedings outside the U.S. Further, U.S. creditors with claims against a non-U.S. debtor must monitor and, if necessary, participate in the debtor's foreign main proceeding to safeguard their rights. Because chapter 15 and relevant court rulings embrace the concept that final claims resolution against foreign debtors should be centralized in a single forum, a foreign main proceeding will likely be the only venue for a U.S. creditor to collect on its claim.

THE U.S. FEDERAL JUDICIARY



U.S. federal courts have frequently been referred to as the “guardians of the Constitution.” Under Article III of the Constitution, federal judges are appointed for life by the U.S. president with the approval of the Senate. They can be removed from office only through impeachment and conviction by Congress. The first bill considered by the U.S. Senate—the Judiciary Act of 1789—divided the U.S. into what eventually became 12 judicial “circuits.” In addition, the court system is divided geographically into 94 “districts” throughout the U.S. Within each district is a single court of appeals, regional district courts, bankruptcy appellate panels (in some districts), and bankruptcy courts.

As stipulated by Article III of the Constitution, the chief justice and the eight associate justices of the Supreme Court hear and decide cases involving important questions regarding the interpretation and fair application of the Constitution and federal law. A U.S. court of appeals sits in each of the 12 regional circuits. These circuit courts hear appeals of decisions of the district courts located within their respective circuits and appeals of decisions of federal regulatory agencies. Located in the District of Columbia, the Court of Appeals for the Federal Circuit has nationwide jurisdiction and hears specialized cases such as patent and international trade cases. The 94 district courts, located within the 12 regional circuits, hear nearly all cases involving federal civil and criminal laws. Decisions of the district courts are most commonly appealed to the district’s court of appeals.

Bankruptcy courts are units of the federal district courts. Unlike that of other federal judges, the power of bankruptcy judges is derived principally from Article I of the Constitution, although bankruptcy judges serve as judicial officers of the district courts established under Article III. Bankruptcy judges are appointed for a term of 14 years (subject to extension or reappointment) by the federal circuit courts after considering the recommendations of the Judicial Conference of the United States. Appeals from bankruptcy court rulings are most commonly lodged either with the district court of which the bankruptcy court is a unit or with bankruptcy appellate panels, which presently exist in five circuits. Under certain circumstances, appeals from bankruptcy rulings may be made directly to the court of appeals.

Two special courts—the U.S. Court of International Trade and the U.S. Court of Federal Claims—have nationwide jurisdiction over special types of cases. Other special federal courts include the U.S. Court of Appeals for Veterans Claims and the U.S. Court of Appeals for the Armed Forces.

BUSINESS RESTRUCTURING REVIEW

The *Business Restructuring Review* is a publication of the Business Restructuring & Reorganization Practice of Jones Day.

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

If you would like to receive a complimentary subscription to the *Business Restructuring Review*, send your request via email to Mark G. Douglas at mgdouglas@jonesday.com.

The *Business Restructuring Review* provides general information that should not be viewed or utilized as legal advice to be applied to fact-specific situations.

JONES DAY HAS OFFICES IN:

ALKHOBAR
AMSTERDAM
ATLANTA
BEIJING
BOSTON
BRISBANE
BRUSSELS
CHICAGO
CLEVELAND
COLUMBUS
DALLAS
DETROIT
DUBAI
DÜSSELDORF
FRANKFURT
HONG KONG
HOUSTON
IRVINE
LONDON
LOS ANGELES
MADRID
MEXICO CITY
MIAMI
MILAN
MINNEAPOLIS
MOSCOW
MUNICH
NEW YORK
PARIS
PERTH
PITTSBURGH
RIYADH
SAN DIEGO
SAN FRANCISCO
SÃO PAULO
SHANGHAI
SILICON VALLEY
SINGAPORE
SYDNEY
TAIPEI
TOKYO
WASHINGTON

Jones Day's publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information purposes only and may not be quoted or referred to in any other publication or proceeding without the prior written consent of the Firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our "Contact Us" form, which can be found on our website at www.jonesday.com/contactus. The mailing/distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship. The views set forth herein are the personal views of the authors and do not necessarily reflect those of the Firm.

© Jones Day 2018. All rights reserved.